ING

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To:
Basel Committee on Banking Supervision
c/o Bank for International Settlements
CH-4002Basel, Switzerland

Date
21 March 2014

Subject
Response of ING Bank on the consultative document “Revisions to the Basel Securitisation Framework", issued December 2013 (“BCBS269”).

Dear Committee,

We appreciate the opportunity to provide feedback on the Basel Committee’s consultative document BCBS269.
In response to the consultative document we would like to highlight the clear benefits and advantages of asset securitisation as a primary tool in supporting the real economy. Please refer to attached ING response to BCBS 236 which provides specific reference to the various reasons we believe a well-functioning securitisation market can enhance the capacity of banks to fulfil their role in intermediating between the liquidity needs of savers and the long term funding requirements of borrowers.
We believe that the proposed new capital rules should be grounded in how the applicable risk weights reflect actual performance of securitisation transactions. Whilst liquidity of European asset backed securities did suffer in recent years, resulting in some sharp reductions in secondary market prices, the fundamental loss record and related default history has actually indicated the efficacy of the securitisation techniques. To this end we further note recent pro-securitisation commentary from various European institutions (note AFME response for specific detail) and highlight as an example the ECB’s Yves Mersch:

*“It is critical that the regulatory treatment of asset-backed securities is based on real data and not the legacy of the US sub-prime disaster. We have had a very different experience with ABS here in Europe: Between mid-2007 and the first quarter of 2013 the default rate on ABS in the EU was only around 1.4%, whereas it was 17.4% in the United States*".

## *GENERAL RESPONSE TO THE CONSULTATIVE PAPER*

We welcome a number of improvements in the paper namely a simplification of the hierarchy of approaches, the introduction of the concept of flexibility in application of the IRBA (although please note our comment below on the practical implementation of same), the partial recognition of excess spread for senior tranches and a positive move in the risk weights and floors albeit in our opinion these still overestimate the inherent risks associated with these transactions.

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***OVERALL OBSERVATIONS/REMARKS***

In relation to the specific proposals we would like to provide the following observations/remarks:

- **The proposed risk weights under each of the methodologies are still not commensurate with the risks involved or with known historical performance.**
  The results of the calibration appear to be overly-conservative and will have a serious impact on a properly functioning securitisation market, an activity which can have significant positive benefits on the recovery of the real economy. It is difficult to formulate a practical response on the sufficiency of the calibration since the IRBA calibration details the Committee used have not been shared.

- **The document suggests a flexible approach in estimating $K_{IRB}$, we wish to understand how this flexibility world work in practice.**
  We very much welcome the introduction of the concept of flexibility in relation to the application of the IRBA model but it is unclear how this will be implemented and if this is intended to aid easier application then the current SFA approach. In the absence of such a widening of scope of application it will mean that application will be limited to a bank's own originated asset pool rather than supporting securitisation's for the banks client base (i.e. supporting the real economy- see introduction) or any investment application.
  The requirement of a $K_{IRB}$ model for each asset class and jurisdiction and the specific onerous data requirements this entails is not practically possible for any client or investment transactions and thus a broader more flexible top-down approach has to be envisaged and described. In the absence of this a lot of the improvements in hierarchy as proposed by the new consultative paper become less valuable. Additionally, although the introduction of a flexible approach in relation to the IRBA is a positive development, without further recommendations or clarity from the Committee, different jurisdictions, regulators, and banks will interpret this in different ways which will adversely impact consistency of the application.

- **Large discrepancy in capital charges depending on approach.**
  Despite commentary that the Standardised Approach is intended to be relatively aligned to the IRBA, in our initial impact analysis (we will be responding to the QIS request) we note large discrepancies between results under the two approaches. This causes a consistency issue should there not be practical access to use the IRBA (see response above),. Furthermore the ability to consider excess spread under the Standardised Approach is not explicit, furthermore we consider that using the delinquency metric is not an appropriate tool in assessing capital requirements when often specific mitigations exist in transactions around this metric (i.e. delinquent assets are not eligible for funding).

- **Definition of tranche maturity remains overly conservative.**
  We believe that defining tranche maturity based on contractual cash flows or using legal maturity is too conservative and does not take into account specifics of the product. Legal maturity is typically a mechanistic tool (to a.o. trigger events such as enforcement of security and winding up of the structure) and does not reflect the economic life of the transaction. Given the pass through and revolving nature of securitisation transactions, the vast majority of transactions are not or cannot feature contractual cash flows (barring at ultimate maturity). We specifically note that the way the maturity of the bond is calculated the cap will apply for practically the entire life of the bond as the senior tranche will (in almost all circumstances) repay before all assets repay. Given the significant infrastructure surrounding structuring a transaction, transactions with a 1 year maturity are not

feasible in most instances and not reflective of long term goals of funding the real economy. Respecting the Committees concerns about increased reliance on internal models and assumptions, systematic controls can be implemented in this regard (similar to internal and external oversight on the IAA or IRBA) and we also note the Committee's stated aim is to "reduce mechanistic reliance on external ratings".

- **A further lowering of the RW floor is appropriate.**
  We welcome a reduction of the proposed RW floor from 20% to 15% but note that this is still significantly higher than the existing 7% floor and still does not fully recognise credit enhancement and hence the significant mitigation covering unexpected losses for senior tranches. As we do not have the specifics of how the model has been calibrated, we feel it is difficult to assess the basis of the 15%. We believe a further reduction is appropriate and would be more reflective of actual historic performance (see previous response and graphs) asides from a couple of documented outliers. Furthermore we note other competing financial instruments have lower floors (i.e. covered bonds) and would argue that for high quality securitisations similar floors should be applied. In addition, as outlined in our previous response, there have been significant positive regulatory and accounting reforms which have helped address the legacy issues surrounding the industry. These include but are not limited to risk retention reform, large exposure limits, shadow banking, loan level disclosure, IFRS 9 & 10, leverage ratio, NSFR, etc.

Noting the above problems with the calibration to real risk, the definition of maturity and difficulties of implementing $K_{IRB}$ models for anything other than banks own originated assets, we expect that for most transactions total RWA consumption of the securitisation investment will be prohibitively high and will thus necessitate either originators increasing the spread (thereby increasing cost of raising finance in the real economy) or banks as investing participants will continue to avoid the securitisation market as the economic return cannot cover the regulatory costs. This needs to be considered in the context of a.o ECB and others recent commentary supporting the product as a real economy lending tool.

***ING'S PROPOSAL***

In this section we would like to present our views to improve the proposed framework.

A. The concept of flexibility contained within IRBA has to be clarified with specific consideration given to actual data availability in real economy transactions, both where banks act as sponsor/lender and investor. Specifically assessing data on a "top-down" approach should be considered (i.e. where loan by loan data may not be explicitly available but significant historical data is available to assess portfolio inputs such as PD and LGD) where assessments of appropriate capital using similar models in the banks are considered rather than specific application of an approved $K_{IRB}$ model.

B. We believe (and these would need to be elaborated upon in detail in any regulatory framework) there could be four options for calculating IRBA based RW for securitisations which we consider in some more detail below (from bottom up to top down) with proposed recommendations on each;

1. **The investor adopts existing internal AIRB models to calculate $K_{IRB}$**
   If investors have direct exposures to comparable portfolios (same country, same products, etc) and these investors have PD, EAD and LGD models in place which are approved by the Competent Authorities, allowing these investors to calculate regulatory capital requirements based on the AIRB approach, then, these same models could (the ability to allow such transferability of models should be confirmed) be utilised to calculate $K_{IRB}$ for investments in securitisation positions.

   Although we are of the view that such a situation is extremely rare. It would be unusual for an investor to participate in a securitisation wherein the underlying assets are highly correlated with existing exposures of the investor. From a diversification point of view, bank investors invariably seek securitisation investments which would lead to a more diversified portfolio, instead of loading on more concentrated assets.

2. **The originator of the securitisation will provide approved AIRB model output (PD and LGD values) to the investor**
   If the investor has AIRB approved PD, EAD and LGD models, the output-values for all individual underlying exposures could be transferred and periodically updated to the investors, so the investors can calculate an appropriate $K_{IRB}$. It might well be the case (also from diversification desires) that the investors does not have similar exposures on their balance sheets and as a consequence the Competent Authority over-looking the PD, EAD and LGD models of the originator is a different regulatory authority than the Competent Authority of the investors. In such a case these regulatory authorities should accept that $K_{IRB}$ assessment is transferable across jurisdictions (in order to make it workable both practically and within the time constraints of a transaction). In reality though it is difficult to see how this would work for many real economy transactions as the majority of originators (i.e non-bank financial institutions) do not (and will not) have approved AIRB models.

3. **The investor adopts the rules for purchased receivables to** calculate $K_{IRB}$
   The investor can utilise external and internal reference data to estimate PD and LGD values according to the rules for purchased receivables. LGD values may be inferred from the expected long-run loss rate in combination with PD estimates. The originator should provide these inputs. ING views this option as a solid approach which could make the $K_{IRB}$ a successful alternative. Nevertheless, some purchased receivables requirements (e.g. related to policy requirements) cannot be met by an investor in securitisation positions, hence we kindly request additional clarification of BIS.

4. **Deduce a Risk Weight from the observed losses in the underlying pool**
   Based on portfolio losses (history), a portfolio PD and LGD is constructed, which can be used as input in the AIRB formulas. The underlying assets are summarised as one transaction with a single portfolio PD and portfolio LGD.

C. The IAA should be allowed/amended to for on-balance sheet bank funding rather than specifically when transactions are funded through an ABCP conduit. We are unclear as to why and what value funding through an ABCP conduit adds to the credit and capital assessment of a transaction. Furthermore, the apparent new requirement under the IAA that a bank is required to have an approved IRB model for the majority of the underlying pool should be removed as one of the key practical benefits of the current IAA treatment is the ability to assign capital for non-rated non IRB specific pools within defined parameters.

D. The Risk Weight cap has to be reduced from 15% thereby closer reflecting the true historical performance of well protected securitisation asset classes. Although we do not have details on the specific calibration we believe the overall numbers produced do not represent the risk assumed and therefore a more realistic overall calibration has to be applied across the hierarchy.

E. The Maturity definition has to be adjusted to reflect the economic reality and the specifics of the transactions. One potential solution is that the maturity definition should follow the LCR methodology in order for the market to track one regulatory metric of WAL.

F. The ability to consider other risk mitigants such as excess spread, guarantees and instances where the delinquency parameter (w) is mitigated (i.e through non funding) under the standardised approach.

G. We also participated in the AFME/SIFMA response and strongly support the concepts and methodologies proposed therein.

H. Any implementation of a new regulatory framework should consider a phasing in process for prior exposures taken under a different regime.

We believe that introduction of these improvements would achieve the stated aims and principles of the committee as outlined in the consultative document.

We remain available should you wish to discuss. Yours Sincerely,