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Dear Sir or Madam

BASEL COMMITTEE ON BANKING SUPERVISION (THE 'COMMITTEE'): CONSULTATIVE DOCUMENT 269 "REVISIONS TO THE SECURITISATION FRAMEWORK" PUBLISHED DECEMBER 2013 (THE "CD")

Nationwide Building Society ('Nationwide') welcomes the opportunity to respond to the Committee's Revisions to the Securitisation Framework consultative document (the 'CD') in its capacity as both issuer and investor in securitisations.

Nationwide is the UK's third largest mortgage lender and one of the three largest savings providers, with circa. £190 billion in assets. Nationwide is a market leader in providing banking services but we are not a bank – we are a mutual building society – the largest in the UK. We are owned by and run for the benefit of our 15 million members – which include our retail savings and mortgage customers. As such we are unique in UK retail financial services, providing a mass-market credible alternative to the plc banks and focusing on long-term, transparent customer relationships. Whilst our core business is residential mortgage lending funded by retail deposits, we are a full service personal finance provider, offering current accounts, personal loans, credit cards, investments and insurance.

The principles on which we are run are fundamentally different to those of our plc peers – we exist to deliver value to our member customers and we are accountable to them. We are able to optimise profit – rather than maximise profit – to deliver member value over the longer term through improved pricing and market-leading customer service. This results in a lower risk appetite and profile than our peers that has meant we have remained safe and secure throughout the financial crisis with capital and liquidity ratios amongst the highest in our peer group.

A strong building society sector in the UK, led by mass market mutuals such as Nationwide, provides a competitive alternative to the big plc banks for consumers. In the nine month period ending 31 December 2013, Nationwide advanced £21.6bn of mortgages - a market share of 15% - and our net mortgage lending was up by 58% to £8.4bn. We continue to account for over 20% of all new first time buyer mortgages. We target between 20-25% of our funding from wholesale markets, meaning that efficient access to secured funding is critical to our lending activities in the real economy. Any excessively penal capital requirements that reduce investment in securitisation will cause us to have to seek potentially more expensive funding through other methods (the cost of which is ultimately reflected in the cost to the consumer) or potentially reduce our ability to lend. Nationwide also invests in high quality securitisations to meet internal and regulatory liquidity requirements. As an investor, the relative expense of securitisation could cause an increase in investments in potentially riskier assets that attract lower capital requirements.

As an issuer, Nationwide has been sponsoring a UK RMBS Master Trust since 2008. Our only motivation in operating this securitisation programme is funding. The programme solely distributes AAA rated securities, and the pool underlying the programme is a random selection of eligible prime UK 1st charge mortgages. All of the economic risk and reward of the programme remains substantially with Nationwide, and we have neither sought nor been granted any regulatory capital relief from the underlying assets which remain on our regulatory balance sheet. As such, any capital held by bank investors in tranches of this programme is incremental to, and not in place of, capital held by us as originator of the underlying mortgages.

We much appreciate the revisions made to the proposed framework since the first consultation paper issued in 2012. We particularly welcome the efforts made to simplify the range of approaches, the efforts to reduce cliff effects and the reductions to the capital floors which make the framework more risk sensitive.

Whilst some progress has been made, our overall concern is that the capital requirements remain excessive and that further adjustments need to be made to the framework to make it more risk sensitive. We are concerned that if brought into effect, the framework will discourage investment in real-economy consumer funding securitisations like those originated by Nationwide and its peers. This in turn can only have a negative impact on bank funding and hence economic growth.

We have followed and contributed to the combined industry response to the CD that will be submitted by the Association of Financial Markets Europe and we support the common position described in that submission. Given the potential damage that excessive capital requirements could do to our business and the value our members derive from it, we think it important to submit a solo response on our members' behalf.

Key Comments

Our over-arching comments are as follows:

1. The IRB approach is not practicable for all investors in ABS;
2. Capital charges and risk floors remain excessive;
3. The level of incremental capital is inappropriate for funding-only securitisations;
4. The maximum cap for senior tranches should be applicable to investors in securitisations;
5. Information requirements for the External Rating Based approach (ERBA) do not reflect current practice;
6. The calculation of maturity should recognise scheduled note repayments in master trust structures and take account of the WAL of the notes more generally;
7. The Standardised Approach should be better aligned with risks; and
8. The adjustment for delinquency should be removed as it double-counts the risk.

IRB approach

In its capacity as an investor in ABS, Nationwide would be required to select one of the approaches in the hierarchy to apply to its securitisation investments. Whilst the IRB approach heads the hierarchy in the CD, there are a number of practical considerations which may mean that we would not elect to use this, e.g. in order to use it for an investment in Dutch RMBS, we would need an IRB model capable of calculating K_{IRB} for the underlying Dutch mortgages, which as a UK mortgage lender we do not have. Even if such a model were readily available, the problem remains that the data to use with it is not always available e.g. for legacy transactions. We recommend that the final framework makes it clear that firms are able to use any of the three approaches interchangeably as agreed with their supervisor.

Capital charges

The capital charges produced under the framework remain excessive and are inequitable in that they do not take into account the true performance of securitisation investments. The

calibration underlying the risk weights put forward for all securitisations worldwide still appears to be calculated according to the loss experience of a minority of securitisation investments originated in one country i.e. US sub-prime. This approach is unfairly damaging to high-quality European securitisations – as Fitch pointed out, while US sub-prime RMBS produced 57.4% of global structured finance losses, senior European securitisation investments have demonstrated zero losses through the crisis – see Appendix 1.

For an investment that has exhibited 0% losses, the overall risk floor of 15% proposed is out of proportion to the real nature of the risk. Similarly, under the ERBA, a 5 year high-quality AA investment that would previously attract an 8% risk-weight would now carry a 50% risk-weight. Risk-weights of 25% (for 1 year) and 50% (5 year) ignore the risk protection afforded by credit enhancement to such senior investments and are disproportionate to the real risk taken by investors.

The scale of the disproportion is visible in the experience of our Silverstone securitisation programme. The securitisation does not involve significant risk transfer (SRT) and total cumulative losses since 2008 amount to ~ 4bps which contrasts with total credit enhancement of ~18%, with further excess spread of 0.77% - see Appendix 2. For investors to apply a risk weight of 25% to a AAA Silverstone investment is out of all proportion to the risk of loss, especially as the losses of 0.04% are easily cured from the 0.77% of excess spread without eroding the additional 18% credit enhancement.

Furthermore, such capital requirements penalise securitisation investments relative to other forms of financing. For example for Nationwide as an investor, under the proposed ERBA, a five year high-quality AA investment would carry a 50% risk weight under the proposals, whereas applying the current Basel II IRB approach, the equivalent AA covered bond secured by equivalent assets would require a risk weighting of 9.3%. What seems all the more inappropriate is that the secured, bankruptcy-ring-fenced AA rated securitisation investment would even require more capital than the equivalent, unsecured corporate bond, which for Nationwide would carry a 37.3% risk weighting for a AA five year investment.

Consequently, we ask the Committee to revisit the framework to align it better with the true nature of the risks addressed. To do this, we encourage the Committee to consider ways to differentiate between securitisations either in the risk weights or floors for example by 1) distinguishing between funding-only and SRT securitisations, 2) differentiating between high quality securitisation and other securitisations and 3) differentiating by asset class according to the empirical data available regarding performance.

Incremental capital penalises no risk transfer

The capital charges are especially penal for funding securitisations like Nationwide's Silverstone programme which are not SRT securitisations because the originator continues to hold the same level of capital against the loans as it would hold if the loans were not securitised. Any capital held by investors is in addition to capital already held in the financial system against the same risk. Leaving aside the debate on capital neutrality for SRT securitisations, for securitisations which do not have SRT there is a clear and compelling argument that no incremental capital is needed – to state otherwise this would imply that the capital rules regarding the underlying loans were inadequate. We request the Committee to consider the options for bringing the treatment for such securitisations as close to capital neutrality as possible for all approaches.

Risk weight cap to apply universally

Under the current framework, the unrated most senior securitisation exposure held by an originator receives a maximum risk weight equal to the average risk weight applicable to the underlying exposures, subject to supervisory review. The CD states that a firm "should not have to apply to a senior tranche a higher risk weight than if it held the underlying exposures directly, given the credit enhancement it receives from subordinated tranches and proposes

that this cap should apply whether or not the securitisation exposure is rated, provided that the bank is able to determine risk weights assigned to the underlying credit exposures."[1]

We strongly agree with the first part of this statement and recommend that this approach apply equally to investors as well as originators or sponsors. We maintain that regardless of whether the investment is held by an originator or an investor the credit risk remains the same. We understand that the Committee's view is that the cap should only be applicable to banks which can calculate K_{IRB} on the underlying pool. This leaves the problem that firms which use the standardised approach ('SA') or which do not have access to the relevant data and/or are not in a position to model the exposures and calculate K_{IRB} would be unable to use the cap. To ensure that the cap is available to be used universally by investors and sponsors as well as originators, we propose that investor banks should either be able to use the SA to calculate the cap and/or be able to use the same risk weight that the originator publishes as part of its Pillar 3 disclosure. Where this is not published, the committee can consider whether an originator should be encouraged to disclose this or its own internal K_{IRB} on the underlying pool so that investors can use it to calculate the applicable risk weight cap.

In addition, we recommend that the definition of what is a "senior" investment for the purposes of the cap should be broadened to make the cap available where the risk merits it. The CD currently defines a senior tranche as generally being the most senior position within a securitisation transaction. However, in high-quality securitisations, other high ranking bonds can benefit from extensive credit enhancement can far exceed the maximum potential loss lying within a 99% confidence interval and which would thus merit their being treated as senior investments. We therefore further recommend that for the purposes of the cap, senior be defined as either a) any investment rated AA and above or b) any investment where the credit enhancement exceeds the maximum potential VaR on the underlying pool.

Information requirements for External Ratings-Based Approach

The CD currently stipulates that in order to apply the ERBA "loss and cash-flow analysis as well as sensitivity of ratings to changes in the underlying ratings assumptions should be publicly available." As such information is not available from credit rating agencies we suggest that this requirement is deleted.

Maturity

We note that the CD provides that for the IRB and ERB approaches, tranche maturity can be calculated as the "weighted-average maturity of the contractual cash flows of the tranche"[2]. High quality UK RMBS securitisations like Nationwide's typically offer notes which have scheduled redemption features since many investors prefer defined repayment schedules. Such scheduled repayments are supported by an extensive cash accumulation provisions. While it appears to be straightforward, we would welcome clarification that scheduled repayments of principal such as scheduled amortisation instalments and bullet redemption payments are included in the scope of "contractual cash flows of the tranche" and thus used to determine maturity. In addition, we support the view that investors should be able to calculate tranche maturity as the weighted average life of the notes under a specified prepayment rate, e.g. the current prepayment rate on the portfolio published in the most recent investor report or a realistic assumed rate.

Standardised Approach (SA) should reflect true performance

We recommend that the Committee investigate ways to improve the risk sensitivity of the SA along the lines mentioned above, e.g. by differentiating on the basis of asset class and quality. For example, it seems unreasonable to impose the same capital requirements for sub-prime as for prime mortgage securitisations, given their relative performance through the crisis.

[1] CD, p 19.

[2] CD, p 15.

Delinquent loans double-counted

Users of the SA are required to calculate the capital requirement for the pool using a calculation which increases what would have been the capital charge for the entire pool under the SA by applying a factor “W” which is the number of delinquent exposures multiplied by 0.5. Yet the unadjusted capital charge for the entire pool is already designed to address the credit risk of the entire pool, including the risk of loans becoming delinquent. Furthermore, the rate of delinquencies is not necessarily reflective of the level of actual losses that will be experienced. Accordingly, we recommend removing this factor.

Responses to Questions

We have reviewed the specific questions raised in the CD and are aware of the industry reponse being prepared by AFME. We support the answers put forward by the industry and do not propose to add to those in this letter.

Yours faithfully

Andy Townsend

Treasurer

Appendix 1

Default rates from Mid-2007 to end 2012

	Original Issuance (EUR billion)	Default Rate (%)
Europe		
Total PCS eligible asset classes	**959.9**	**0.10**
Credit Cards	33.2	0.00
RMBS	755.7	0.08
Other consumer ABS	68.0	0.13
SMEs	103.0	0.23
Only senior tranches to be PCS labelled, the default rate for which is zero, like Covered Bonds		
Total Non-PCS eligible asset classes	**734.2**	**5.07**
Leveraged loan CLOs	71.3	0.10
Other ABS	71.0	0.16
Corporate Securitisations	67.7	0.33
Synthetic Corporate CDOs	254.3	2.47
CMBS	163.2	8.67
Other CDOs	77.8	6.33
CDOs of ABS	28.9	39.64
Total European securitisation issuances	**1,694.1**	**2.25**
Covered Bonds	**1,085.0**	**0.00**
Total European issuances	**2,779.0**	**1.37**
Select US asset classes		
Credit cards	295.4	0.04
Autos	215.1	0.04
Student loans	266.8	0.28
RMBS	3,254.9	18.79

Source: Standard & Poor's

Source: Prime Collateralised Securities

Appendix 2

<u>Silverstone Master Trust Performance:</u>

Mortgage Trust Assets:	£25bn
AAA notes outstanding:	£16.7bn

Credit Enhancement:

Z notes	14.34%
Reserve Fund	3.73%
Total	18.07%

Excess spread: 0.77%

Total Losses since 2008: 0.04% (£8.9m)

Source: Silverstone investor report dated 12/2/14