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Secretariat of the Basel Committee
on Banking Supervision
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Dear Sir / Madam

Re: *Response to the second consultation on revisions to the Basel securitisation framework*

The Banking Association of South Africa and its members appreciate this opportunity to comment on the Basel Committee on Banking Supervision (The Committee) second consultative document to revise the Basel securitisation framework.

We appreciate the further work which has been undertaken on the proposed capital framework for securitisation and welcome the changes to the hierarchy of approaches, the revised floor and clarification on the use of inferred ratings. The new proposal is an improvement on the old version in terms of the simplicity of the scheme, but still looks to penalise high-quality securitisations and we therefore believe that some sections of the revised document need further consideration.

We believe it is important contextualise the securitisation market in South Africa before addressing the questions raised in the consultation document, attached as **Annexure A**.

Total outstanding listed debt in the South African debt capital markets (including securitisation) as at 31 December 2013 was ZAR 1.7 trillion, of which South African Government debt accounted for ZAR 1.1 trillion. The remaining outstanding corporate and securitisation debt amounts to ZAR 692 billion and is broken down in **Table 1** below.

Issuer Type	1Q13	2Q13	3Q13	4Q13
ABCP	29.04	30.72	30.06	27.79
Banks / Financials	207.10	206.22	212.99	217.92
CLN	40.57	38.13	39.11	38.70
Corporates	95.16	99.82	97.69	103.14
Municipal	14.07	16.31	16.31	16.28
Other/ Structured	15.13	14.61	15.64	15.27
Securitisations	50.62	51.34	48.01	47.94
SOEs	205.91	213.69	217.63	225.66
Sovereign	979.04	1 010.34	1 057.72	1 105.54
Grand Total	1 636.63	1 681.18	1 735.16	1 798.23

❖ Source: Johannesburg Stock Exchange & Rand Merchant Bank Global Markets

Securitisation transactions represent a relatively small component of the overall South African debt market with Residential Mortgage Backed Securities (“RMBS”) making up the overall majority of issuance.

Securitisation transactions do provide originators with an alternative means of financing that contributes to the diversification of their funding sources, which is becoming increasingly important given the challenges with the implementation of the Net Stable Funding Ratio (NSFR) in South Africa. RMBS, in particular, is one of the few possible sources of liquid assets in South Africa that can be included in the assessment of the Basel III Liquidity Coverage Ratio (LCR).

Although there is a need to ensure the appropriate capitalisation of banks in respect of their exposures to securitisations, we believe that the latest proposed revision to the securitisation framework remains overly conservative and will lead to a reduction in the use of securitisation as an alternative means of financing. This we believe would further diminish the South African banking industry’s ability to comply with NSFR and LCR whilst hampering growth in segments such as residential mortgages.

It is also important to note that to date no investor has incurred any loss in respect of their participation in the South African securitisation market. It is our opinion that this is due to appropriate legislation governing the origination of debt as well as legislation governing entrance to the securitisation market and not only legislation governing the capitalisation banks’ exposures to securitisations.

We would like to draw The Committee’s attention to the following issues in addition to the specific questions contained in **Annexure A**.

1. Use of National Scale Ratings versus Global Scale Ratings

While we are both supportive and appreciative that the calibration for the underlying models has been revised to be consistent with the Basel IRB credit risk framework and revised LCR framework, that allows level 2a and 2b assets to use National Scale Ratings, we believe that there is a misalignment between IRBA and ERBA, specifically for securitisation in Emerging Market economies where external ratings on a global scale are effectively capped to the rating of the sovereign in which the securitisation is incorporated.

For example, under IRBA it is possible for the most senior position in South African RMBS to attract the 15% risk weight floor (i.e. the equivalent of an AAA rating under the ERBA). Under our existing portfolio structures, given our sovereign rating celling, our best RMBS portfolio is unlikely to achieve an AAA rating on a global scale basis resulting in a significant discrepancy in the capital requirements between the IRBA and ERBA as it currently stands.

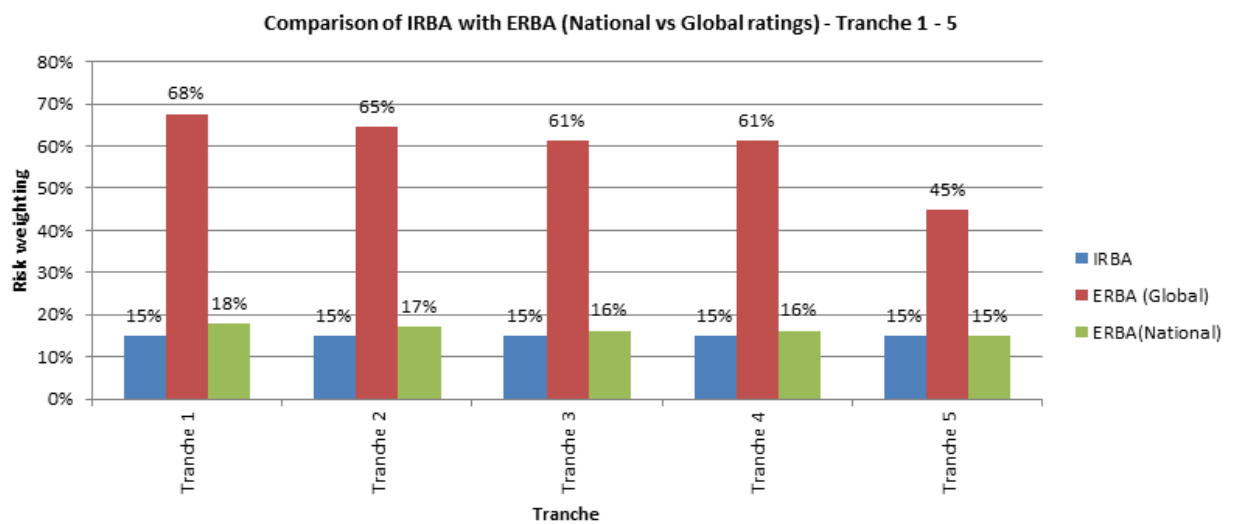
National Scale Ratings were primarily developed for use in emerging markets with non-investment grade or low-investment sovereign scale ratings and little or no default creditworthiness. The National scale permits greater credit differentiation than is possible on the Global scale. The relationship between the National and Global local currency ratings assigned within a single jurisdiction is not rigid. By definition, a notch on the Global scale usually compares to several notches on the National scale and the relationship between the two scales does change over time as more entities are rated or the sovereign rating changes.

To this extent, we have provided the Fitch January 2014 mapping table for illustrative purposes in **Table 2** below.

South Africa National Rating	Local Currency Rating
AAA (zaf)	BBB+ and above
AA (zaf)	BBB+
AA / AA- (zaf)	BBB
A+ / A (zaf)	BBB-
A- / BBB+ / BBB (zaf)	BB+
BBB- / BB+ (zaf)	BB
BB / BB- (zaf)	BB-
B+ (zaf)	B+
B (zaf)	B
B- (zaf)	B-
CCC (zaf)	CCC
C (zaf)	C
D (zaf)	D

Using a South African RMBS structure, where the senior tranche attains a rating of A-, we have compared the IRBA with ERBA using the South African National Scale and Global Scale ratings.

Graph 1: Tranche 1-5



Graph 2: Tranche 6-9

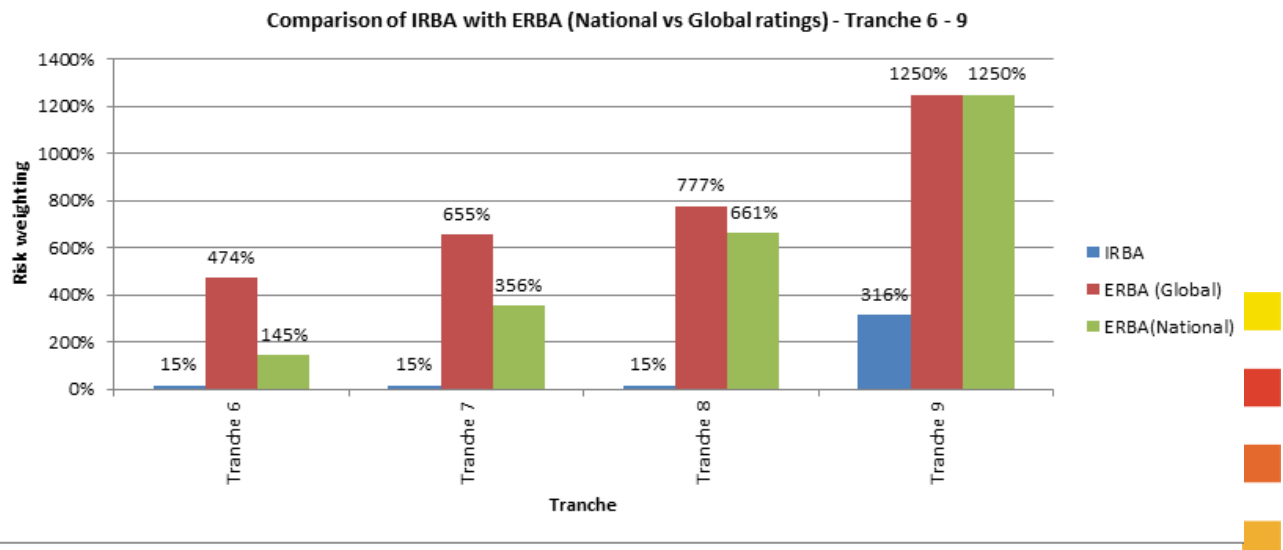


Table used to demonstrate graph above:

	National Scale (zaf)	Global Scale	IRBA	ERBA International	ERBA National
Tranche 1	AAA	A-	15%	68%	18%
Tranche 2	AAA	A-	15%	65%	17%
Tranche 3	AAA	A-	15%	61%	16%
Tranche 4	AAA	A-	15%	61%	16%
Tranche 5	AAA	A-	15%	45%	15%
Tranche 6	A-	BB+	15%	474%	145%
Tranche 7	BBB-	BB	15%	655%	356%
Tranche 8	BB	BB-	15%	777%	661%
Tranche 9	NR	NR	316%	1250%	1250%

As is evident for all the tranches, when using the global ratings, the risk weights are always higher when compared to national scale ratings. We also believe that an argument can be made, under the determination of maturity, that maturity is already been factored in by ratings agencies and as such, should look to be removed.

Recommendation

It is with this detail that we request The Committee to allow local regulators to apply national scale ratings for determining in-country capital requirements for securitisation tranches.

2. 15% Risk weight floor for highly-rated senior tranche securitisation exposures

We welcome the lowering of the ERBA risk weight floor to 15-25% respectively, however we believe ERBA remains overly conservative for certain segments of the securitisation market. For example, under the ERBA a capital charge of 2% (i.e. a risk weight of 25%) is required for AAA rated 5 year senior securitisation debt, compared with the loss (incurred and projected) of 0.2% for RMBS in Europe, Middle East & Africa ("EMEA") or 0.003% for RMBS in Asia-Pacific ("APAC")¹. As these losses include AAA to non-investment grade tranches, it is more than likely that the losses for senior AAA rated RMBS in EMEA and APAC are closer to zero. Although we acknowledge that losses were more pronounced with RMBS in the US market (i.e. 13.1% for subprime deals and 15.9% for Alt-A deals), we maintain it is inappropriate to calibrate a framework based on loss experience from a single jurisdiction or a market segment that is not pursued worldwide.

Further to this, considering an investment in long dated AAA bonds modelled with a very conservative LGD would yield a risk weight of approximately 10%. Consequently it may be difficult to structure to an AAA attachment point, yet generate sufficient yield to support the capital employed in holding the AAA position.

¹ Extracted from the report published by Fitch Ratings regarding global structured finance losses for issuance during the period 2000 – 2011

Recommendation

We believe that the risk-weight floor for *senior* tranches between 1-5 years should be set somewhere between 7% and 12% as a maximum, with linear interpolation being used to account for the tranche maturity. Furthermore we propose that the risk-weight floor for *non-senior thin tranches* between 1 – 5 years be set between 7% and 40%

3. Definition of re-securitisation exposure

A re-securitisation exposure is defined in the new standards text as “a securitisation exposure in which the risk associated with an underlying pool of exposures is tranching and at least one of the underlying exposures is a securitisation position”.

The committee has provided further clarity by stating that exposures resulting from re-tranching will not fall within the definition of a re-securitisation if they act like a direct tranching of a pool with no securitised assets.

We agree that in such circumstances, re-tranching does not increase correlation risk (such as was the case for CDO squared transaction) which was the rationale for assigning higher risk weights.

Recommendation

In terms of the clarification provided, it is our view that liquidity facilities and programme wide credit enhancement facilities, provided to simple securitisation structures such as ABCP conduits that contain securitisation exposures in their portfolios, should not be treated as re-securitisation exposures.

Greater clarity on this would be appreciated.

4. Use of IRBA for Non-IRB exposures

We welcome the proposed use of the IRBA approach in circumstances where the underlying pool is mixed between those assets risk weighted on an IRB basis and those risk weighted on a standardised basis. However, comparing the proposed risk weight of 1250% for non-IRB exposures to the maximum risk weights applied under the Standardised Approach, the proposal appears overly conservative.

Recommendation

Using a risk weight of 150% would be in line with the risk weight the asset would receive if it were not securitised. As such, we believe that this would provide the appropriate balance between risk sensitivity and prudence, in cases where the pool is predominantly IRB.

5. Maturity in static pool transactions

The definition of maturity remains very conservative. In the current proposal, either legal maturity or the weighted average contractual cash flows of the tranche can be used; however, it is very unusual for a securitisation tranche to have contractually fixed payments (i.e. fixed amounts on fixed dates) with no dependence on the underlying cash flows. Therefore, the second alternative could hardly be used, and legal final maturity which is vaguely connected to the effective maturity would be used as default. On the other hand, in static pool transactions, the cash flows of the underlying portfolio are often contractually fixed (e.g. amortising loans).



Recommendation

For such transactions, we propose to use the contractual maturity profile of the pool and transfer this one-to-one to the tranches of the securitisation (i.e. without any credit to prepayments or other effects). This approach would allow using a definition that will be close to the actual maturity of a static pool securitisation, while still being conservative and free of model risk in the form of assumptions regarding prepayments or other factors.

6. Maturity in replenishing transactions

Similar to static pool transactions, the definition of maturity for replenishing transactions seems very conservative. In the current proposal, the longest possible maturity of any asset during the replenishment phase has to be added to the remaining replenishment period.

Recommendation

Given the uncertainties in the calculation of maturity in replenishing transactions, we propose to take into account contractual safeguards where they exist. If, for example, the weighted-average maturity (WAM) of the replenished pool (without any credit to prepayments or other effects) is contractually limited to a certain value, then this term is used instead of the longest maturity of any single asset. This definition would follow the concept that only contractually documented values can be used, but the resulting value would be much closer to the actual realised maturity of a replenishing securitisation. Since the limit on the WAM is only a maximum value, this definition still would be conservative.

7. Conclusion

In closing, we recommend that the calibration of the various approaches be revisited and that sufficient time be set aside to understand the impact of the proposed revisions to the Basel Securitisation Framework before they are finalised by the BCBS.

Please note that we are more than happy to supply additional information on any of our responses should the BCBS require it.

Yours faithfully



Gary Haylett
General Manager – Strategic Projects



ANNEXURE A

**Basel Committee on Banking Supervision second consultative document:
Revision to the Basel Securitisation Framework**

- 1. The Committee seeks input as to whether the proposed treatment of derivatives, other than credit derivatives, achieves an appropriate balance between risk sensitivity and simplicity and welcomes respondent's views on how to improve upon the proposed treatment.**

We believe the treatment of derivatives, other than credit derivatives, outlined in the consultation document does achieve the appropriate balance between risk sensitivity and simplicity, provided the exposure amount to which risk weight is applied is calculated in accordance with counterparty credit risk framework.

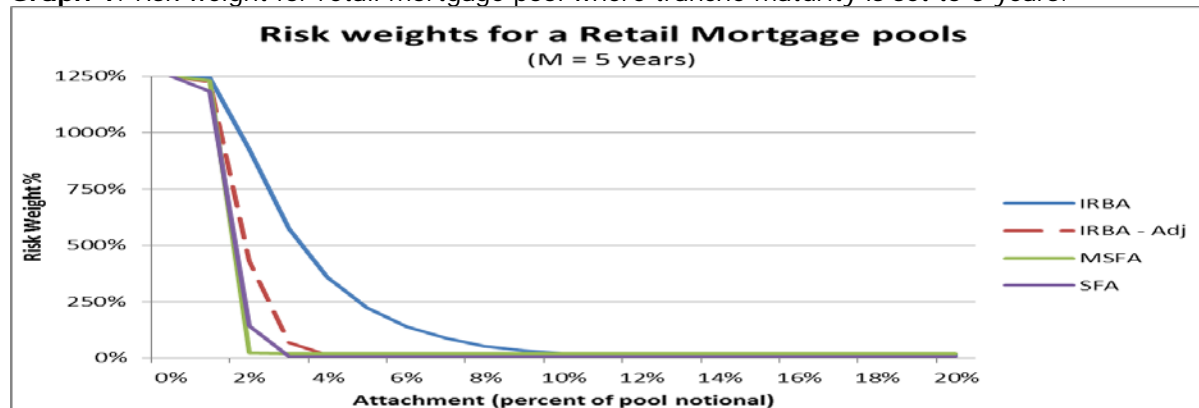
- 2. While the formulation of the IRBA is much simpler than the MSFA, the Committee recognises that there may be opportunities to make further simplifications by, for example, eliminating one or more of the four variables proposed to calculate "p," while achieving a degree of risk sensitivity similar to that of the MSFA. The Committee is interested in respondent's views on ways to simplify the parameterisation of "p".**

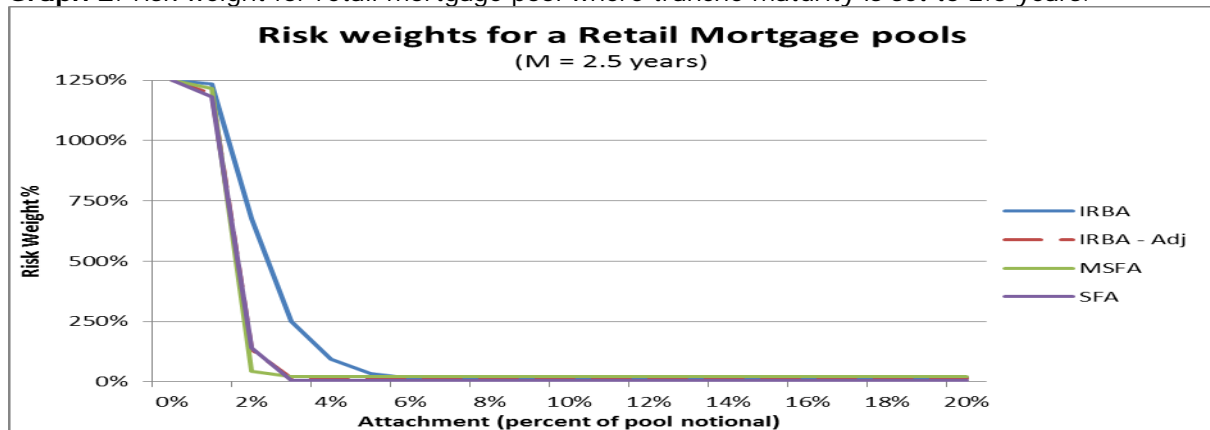
We acknowledge that the IRBA is much simpler than the MSFA and that it may be possible to further simplify the IRBA. However, we are concerned by the current formulation of the supervisory parameter "p" and the impact this could have on good quality RMBS structures. Of particular concern is the "E" parameter for retail portfolios set at 0.24 and 0.27 versus 0.07 for wholesale portfolios. This effectively results in the RWA for securitisations over retail portfolios being 3 times that of securitisations over wholesale portfolios, assuming both portfolios were of similar size and risk. This is particularly the case with attachment points between 2% and 10%.

To illustrate this effect a comparison of the IRBA, MSFA and SFA was performed based on a *Retail Mortgage* portfolio with an effective number of exposures of close on 4000; an exposure weighted PD of 4.5% - 5%; and an exposure weighted LGD of 11% - 12%. In addition to the aforementioned comparison, we have also calculated the IRBA having adjusted the supervisory parameter "p".

The adjustment comprises of a reduction in the "E" parameter for senior tranches on retail portfolios from 0.24 to 0.07 as well as the removal of the 0.3 floor within the calculation of "p".

Graph 1: risk weight for retail mortgage pool where tranche maturity is set to 5 years.



Graph 2: risk weight for retail mortgage pool where tranche maturity is set to 2.5 years.**Graph 3:** risk weight for retail mortgage pool where tranche maturity is set to 1 year.

If we were to ignore the capping rule, the resulting RWA from The Committee's proposed IRBA exceeds the current SFA by significant multiples. We believe this to be unduly conservative given the loss experience on RMBS in Europe, Middle East and Africa. We, therefore, recommend that The Committee revisit the formulation of the supervisory parameter "p" and that a QIS be undertaken before finalizing any revisions to the securitisation framework

3. If respondents favoured a pro-rata calculation of the maximum capital requirement, the Committee would welcome arguments that justify that a pro rata cap would result in appropriately conservative capital requirements.

We are not sure how a pro-rata calculation adjustment will work because:

- how would you pro-rata a senior tranche with mezzanine debt that is the bulk of the risk, but the smallest portion of the nominal base, **or**
- If you hold more than 1 tranche that includes senior and mezzanine debt, how will you determine an accurate level on the risk you are taking?

The cap currently applies, regardless of what the size of your investment is and this is a function of calculating the amount of capital in respect of notes held and then comparing this to the capital of the entire underlying asset pool.

We would only recommend a pro-rata calculation for a single tranche as it is unlikely to work appropriately in instances where holdings across multiple tranches, due to the difference in seniority making it difficult to proportion accordingly.

