Opinion of True Sale International GmbH[1] on the BCBS Consultative Document "Revisions to the Basel Securitisation Framework" (December 2013)

Issued for Comment

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We welcome the opportunity to comment on the second consultative paper in terms of "Revisions to the securitisation framework and expressively appreciate that the Basel Committee has lowered the excessive capital requirements compared to the first consultative document and will still keep hold of the External Ratings-Based Approach as well as the Internal Assesment Approach.

However, the current suggestion, made during the second consultation, for a revision of the securitisation framework still includes no differentiated view of the securitisation market. No account is taken of the fact that the market reveals striking quality differences that were manifest throughout the financial crisis and beyond. By far the largest portion of the European securitisation market – and this also applies most of all to securitisations from Germany – has provided evidence of its excellent quality through a similarly high quality performance. The German market, in particular, is known to be characterised by auto ABS, SME securitisations and the securitisation of trade and leasing receivables.

The best and most informative evidence of the excellent performance of European securitisations during the crisis is, as far as we are aware, a regularly updated research study by S&P, the most recent version of which was published on 6 December 2013[1]; a copy is enclosed. We are also enclosing a continually updated analysis by Moody's on the collateral performance of the most important asset classes. Lastly, to illustrate the performance effect of balance-sheet securitisations as opposed to originate transactions taking German SME securitisations as an example, we refer to the enclosed article from 2010[2].

Overall, every average treatment of the whole market or – excessive – gearing to negative phenomena such as US subprime and originate-to-distribute models therefore inevitably leads to an inappropriate treatment of high-quality securitisations, not least also by comparison with other bond segments such as government, bank and corporate bonds and covered bonds.

That effect is illustrated by the following example, which is based on a real securitisation of auto loans with a typical structure. The connection can be generalised and could thus be observed in the vast majority of German auto securitisations. In this securitisation, a blue chip ABS bond (AAA rating) and a subordinated ABS position (A+ rating) are placed with investors by a German automobile manufacturer for financing purposes.

[1] S&P, "Six Years On, Only 1.5% of European Structured Finance Has Defaulted", 6 December 2013. [2] Cerveny / Schmidtchen, "Performance deutscher Mittelstandsverbriefungen in den Jahren der Krise", ZfgK 19/2010.

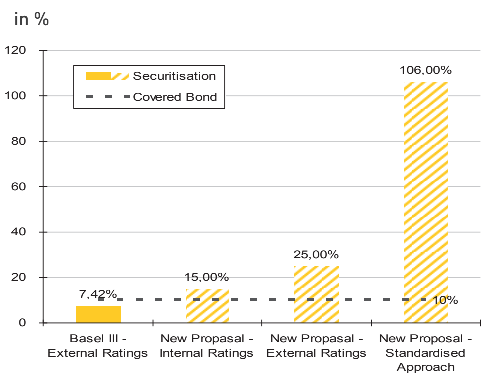
Both are secured by positions of the lowest seniority, which are provided by the manufacturer itself or by affiliated enterprises.

Tranche	Thickness	Rating	Holder
Class A	91.8%	AAA	Investors
Class B	2.8%	A+	Investors
Subloan	3.0%	NA	Affiliated enterprise
Excess security	2.4%	NA	Captive of the Manufacturer

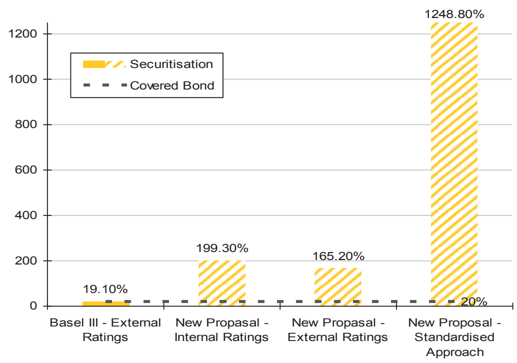
The most relevant feature in this case is the positions placed with investors as regulated financial institutions are often concerned. While their required underlying capital today moves essentially at the level of comparable Pfandbriefe, it would be multiplied by the BCBS' new proposal. The BCBS provides several methods of calculating the risk weighting. They are placed in order of priority: if insufficient data is available for one particular method, the next on the list can be used. It is therefore possible to use (1) internal ratings; (2) external ratings (e.g. Moody's or S&P); or, if neither can be used, (3) the "standard approach". Because of the restrictive data requirements for the calculation of internal ratings and as the positions in question are assessed by rating agencies, in the example given here investors would probably use external ratings.

In order to better assess the consultation paper as a whole, however, the proposed risk weighting for all three approaches, together with, for comparison, the present capital adequacy requirement and the risk weighting for a Pfandbrief with the same rating are shown below[3].

AAA auto securitisation



A+ auto securitisation



[3] Further figures used in the calculation: contract maturity 5 years, KIRB 1.8%, KSA 8%, N approx 2000, ELGD 45%.

It is easy to see that the underlying capital requirements would be multiplied – both under the present Basel III securitisation standard and by comparison with the Pfandbrief. If this regulation is implemented as it is, it would have significant consequences for enterprises that today use securitisation as a means of raising funds:

1. There would be a distinct increase in cost of the financing as the increase in the underlying capital requirements for banks would lead to higher costs.
2. There would be a decrease in the volume of financing as in the current market situation capital is in short supply for banks. That applies, in particular, with regard to the gradual entry into force of the tighter capital requirements under Basel III.

In some cases, the capital requirements for securitisations even exceed those for unsecured loans to enterprises. If that were therefore to lead to securitisations being replaced by unsecured financing instruments, those effects would also be accompanied by an increase in risk in the banking sector.

It cannot be the intention to produce those effects, which make it necessary to find an alternative way of treating high quality securitisations with a link to the real economy.

We are therefore following closely the current debate on the regulatory differentiation of a high quality segment for the securitisation market and have accordingly, among other things, sent our views to the EBA, in advance of the planned round table on high quality securitisations.

In our view, the aforementioned asset classes of auto ABS, SME balance sheet securitisations and the securitisation of trade and leasing receivables, which are typical of the German securitisation market and have dominated that market for some time, belong without any doubt to the high quality securitisation segment, whose possible basic structure we outline from the regulatory perspective below.

A standard regulatory treatment and a standard understanding of "good" and "bad" securitisations would make the work of supervisors and standard-setters easier, particularly also with regard to impact analyses.

The basic idea accordingly consists first and foremost of generally, in the sense of cross-sectorally (especially banks and insurance companies), singling out a high quality securitisation segment, which would be given preferential treatment in a similar manner to covered bonds under Article 129 of the CRR. With regard to the revision of the securitisation framework, the same risk

weightings should consequently be applied to high quality securitisations (e.g. German auto ABS) and covered bonds under Article 129 of the CRR.

From a general point of view, the introduction of a regulatory high quality segment would achieve the following:

- An abstract, in the sense of not being dependent on an asset class, regulatory division of the securitisation market into two segments, which would then also have a corresponding signalling effect for market players;
- The basis for consistent, cross-sectoral financial supervision;
- Framework conditions that would favour a revival of the (high quality) securitisation market and that would consequently (1) enable the pursuit of multiple goals with regard to financing and balance sheet structure management in the broad sense, and (2) help to enhance the future stability of the financial system;
- Framework conditions enabling specific phenomena of the crisis to be targeted and curbed and ideally avoided without having to break the regulatory rules in an attempt to take account of the not more precisely specified "better portion" of the securitisation market.

The experience of the financial crisis and the regulatory rules that have already been derived from it and implemented, such as Article 405 et seq. of the CRR and existing securitisation quality standards (PCS, TSI, ECB), should be taken as the starting point for defining "high quality".

On that basis, an abstract, general list of criteria should be worked out. It should contain both negative criteria for high-quality securitisation, in the sense of exclusion criteria that are sufficient individually and in isolation, and positive criteria in the sense of requirements that have to be fulfilled cumulatively.

Furthermore when developping criteria for high-quality seciritisation it should be distinguished between Term-ABS and ABCP conduits. Although it is clearly possible to develop one list of criteria and describe in further regulatory technical instructions how one or the other criteria has to be adapted to ABCP conduits (and within this if it applies to ABCP investors or sponsors/liquidity banks) we have choosen to devide this commentary into proposals for Term ABS (as directly below) and ABCP conduits (please see therefore excursion for ABCP).

All negative phenomena that materialised in connection with securitisations during the crisis can be reduced to a few characteristic forms or structural elements. We consider it – also from a regulatory perspective – indispensable and imperative to exclude these characteristic forms and structural elements from the "high-quality" category.

Bearing that in mind, it is evident that all low quality security translations of which we are aware had some features in common: they were re-securitisations, originate-to-distribute transactions or securitisations with a substantial inherent refinancing risk. Those aspects are included on our "negative list" of high-quality exclusion criteria. Furthermore, most bad securitisations also demonstrated very poor transparency. As it would seem consistent with the existing rules as well as not very practicable to define "inadequate transparency" in regulatory terms, we have included this aspect on our "positive list" of high quality criteria.

Exclusion criteria (negative list)

- Originate to distribute (OtD)
- Re-securitisations
- Transactions with the following features:
  - Structural leverage
  - Maturity transformation and refinancing risk[4]
  - Active portfolio management ("arbitrage")

By contrast, we consider the following to be essential features of high quality securitisation transactions:

Requirement criteria (positive list)

- Balance sheet securitisation[5]
- Compliance with Article 405 et seq. of the CRR[6]
- Compliance with minimum requirements regarding representations and warranties, especially with regard to asset backed securities[7]
- Compliance with transparency requirements for the sales prospectus and investor reporting[8]
- Compliance with the ECB collateral criteria (only for term ABS applicable)

Compliance with the minimum performance requirement during the term[9] (some of the criterias would need to be adjusted for high quality ABCP transactions).

[4] Refinancing risks could, however, be offset with regard to follow-up financing – for example, by specific guarantees such as by the originator.

[5] Essential features of a balance sheet securitisation through which a high alignment of interest between the orig-inator and the investor is established and secured and which would need to be specified further, see (1) No OtD; (2) No differences in the treatment of securitised and unsecuritised assets in the context of distribution channels, incentive structures, lending, servicing, internal/external auditing, compliance with the relevant national and European supervisory standards in the loan process, etc.; (3) Compliance with an upper limit for the securitised bal-ance-sheet share (tbd) in order to avoid a unilateral dependence on the originator's refinancing structure.

[6] Rules covering, in particular, risk retention, lending standards, the provision of information and the due diligence obligation. (Regulaton EU No. 575/2013)

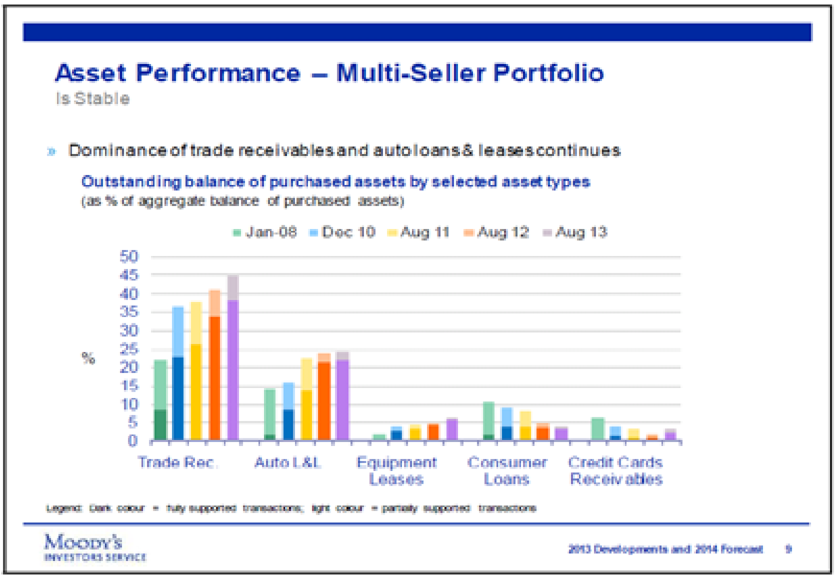
[7] Approval with regard to asset backed securities should include at least the following aspects: (1) At the time of selection or on the pool cut-off date, no asset was in arrears or exceeded the loan commitment or the established limit; (2) Statements on the origination (edible jurisdiction, applicable law); (3) Statements on the method of sale or transfer as well as the risks related to the sale and transfer of the underlying assets; (4) Assurance that a third-party review will be made of a random sample of the assets.

[9] There should be no significant [tbd] difference from the internal/external benchmark and/or triggers [tbd].

Override by guarantee or liquidity facility
As an exception from the basically required additive and complete fulfilment of the above mentioned positive list and by analogy with Article 129 of the CRR (1a and b), the high-quality status should be conferred on securitisations by specific guarantees or provision of a liquidity facility by the sponsor bank.

A practical example of what, beside the already mentioned German auto term ABS would constitute a good example of high quality securitisation is outlined in the following.

ABCP conduits as example for high quality securitisation
Asset Backed Commercial Paper (ABCP) programmes play an important for corporate finance in Germany. This is particularly true for smaller companies, for which own term transactions would not be economically efficient due to the smaller deal size. Most EMEA ABCP conduits are now fully supported by their sponsors and finance real economy assets such as trade receivables, leases or consumer loans.

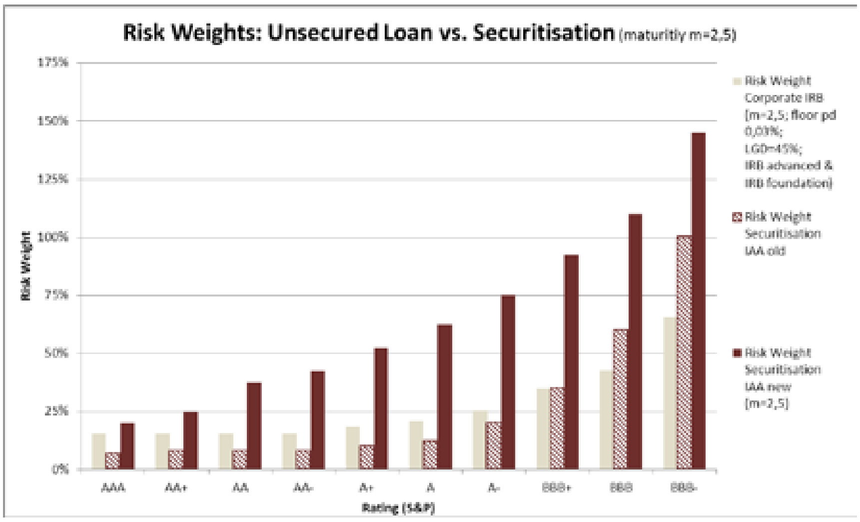


The conduit business, especially the real economy related multi-seller conduit business, has shown a stable and sound performance development, also through the financial and economic crises of 2007/2008 and subsequent years:

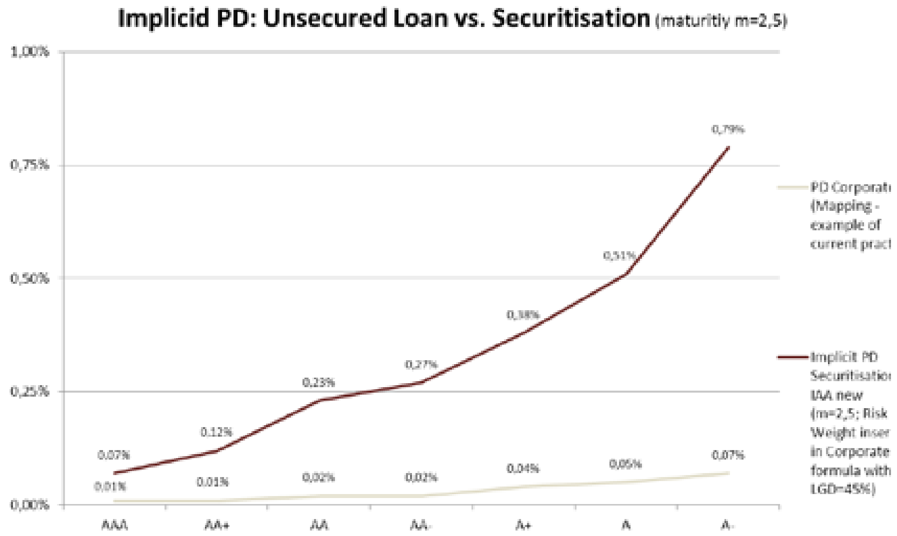
- No ABCP investor in a multi-seller-conduit has ever suffered a loss (zero loss experience);
- Pool assets are based on economic transactions such as delivery of goods

or selling/leasing of cars;
- Underlyings and structures are extremely resilient so that no seller/servicer default has ever caused losses to an investor nor (to our knowledge) to a sponsor bank;
- Structures are typically relatively simple, therefore very low structural or model risk;
- Liquidity facilities are subject to a strict regulatory regime (IAA-approval, LCR) and benefit from the flexibility of the transaction and programme structures (triggers, covenants, dynamic credit enhancements, credit insurance, etc.)

Because of this proven track record, such transactions with a real economic link should qualify as "high quality securitisation" and, as such, should not be burdened by prohibitive risk weightings (as proposed in the Consultation Paper). It is obvious that – comparing different forms of financing small and medium sized companies with corporate customers – securitisation suffers a severe disadvantage compared to unsecured corporate loans.



Inserting the rating generated in the supervisory approved Internal Assessment Approach (IAA), which is typically used to rate transactions in ABCP conduits in the formula for corporate credits, the implicit probability of default (PD) for the identical rating is up to ten times as high as for unsecured corporate loans.



As a result banks will be discouraged from offering (secured) securitisations and instead be incentivised to offer (unsecured) direct lending (via loans or bonds). The multi-seller conduits market would dry up or only be attractive for those corporates that are not able (any longer) to borrow money from the banking or capital markets in their own name. This does not seem to be an appropriate and reasonable development since it

- shifts corporate exposures from secured into unsecured;
- constrains the corporate sector to obtain funding;
- increases the counterparty risk to large corporates on the bank side;
- makes the remaining multi-seller transactions very expensive for the sellers and less secure for the liquidity banks (as mainly weaker sellers will use the instrument);
- makes the banking sector more vulnerable to economic crises.

Therefore, multi-seller conduit transactions and direct lending business to the corporate sector should have a level playing field in terms of the regulatory regime.

Because such Multi-seller conduits often carry ten thousands of underlying assets which are originated by the corporate sector (e.g. trade receivables) and these assets change every day, sponsor banks cannot calculate capital requirements on a loan–by-loan basis as if the assets where held on their balance sheet. As a result the advantageous IRBA approach is not accessible by sponsor banks. Instead the IAA approach has become the standard tool for calculating capital risk weights in Europe.

In order to ensure comparability between the different forms of corporate financing the risk weights for the IAA must be reduced significantly. Similar risks must have similar equity requirements. This can be done, for example, by reducing the p factor or creating a additional risk weight table for the IAA that lifts the IAA close to IRBA level.

To identify the "right" securitisations or ABCP programmes, a special definition of high quality for ABCP is needed. Such ABCP conduits must have a real economic link, i.e. sellers must use the conduit to fund the distribution of goods or services. Sellers (or their parents) are typically non-banks. Accordingly the definition of high quality should admit as sellers all companies that provide services or sell goods as a main part of their business or otherwise directly support the real economy (e.g. by the financing of goods via leasing or loans). Moreover, the sellers should continue to act as servicers of the assets sold within their normal business procedures and may not originate or service the receivables sold differently from any other receivables (no "originate-to-distribute"). The receivables management must be of high quality and be evaluated and regularly supervised by the sponsor bank (initial and regular due diligence by the sponsor or an independent auditor). Finally, sellers must retain a certain skin in the game (whether by means of a refundable purchase price reduction, reserves or otherwise).

There should also be separate treatment of (bank) investors vs liquidity banks as their roles and regulatory rules differ.

For ABCP investors, possible criteria for "high quality" are:

- Underlying assets of the ABCP do not contain securitisation positions (no re-securitisation) or other securities that are publicly or privately distributed in the market ("no security arbitrage business);
- The conduit must have five or more sellers ("multi-seller");
- The conduit refinances only real economy receivables, i.e. receivables originated by a corporate/SMI or receivables arising out of sales financing ("real economic link");
- The ABCP is fully covered by a liquidity line that also covers the credit risk of the assets ("fully supported liquidity");
- The sponsor fulfils the disclosure requirements under Article 408 of the CRR and Articles 22 – 24 of the RTS from 17 December 2013, as applicable for ABCP transactions ("transparency");
- Aan information memorandum for the ABCP programme is available that describes the structural features (including a detailed investment policy) of the programme and the names and roles of the various counterparts (except for seller or debtor names)involved ("documentation").

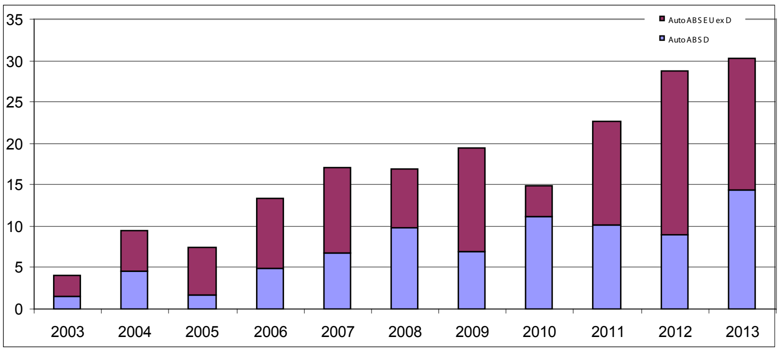
For liquidity banks, possible criteria for "high quality" are:

- The liquidity bank acts as the sponsor of the programme ("sponsor");
- The liquidity line ranks at least pari passu with the ABCP and in senior position ("senior tranche");
- The underlying assets fulfil the criteria "no security arbitrage business" and "real economic link" as above;
- The seller(s) retain(s) an economically relevant portion of the risk[10] ("skin in the game");
- The seller continues to act as the servicer of the assets sold in the same manner as for its unsold receivables and is not insolvent. The sponsor or an independent third party (e.g. an auditor) must have undertaken an initial ample due diligence of the quality of the receivables management process and further due diligences on a regular basis on the validity and soundness of the receivables ("high servicer quality");
- The liquidity bank monitors the performance of the underlying assets and the structure at least monthly ("monthly monitoring").

[10] Not necessarily 5%, due to accounting reasons on the corporate side (retention must not substantially exceed the expected loss in order to gain risk transfer).

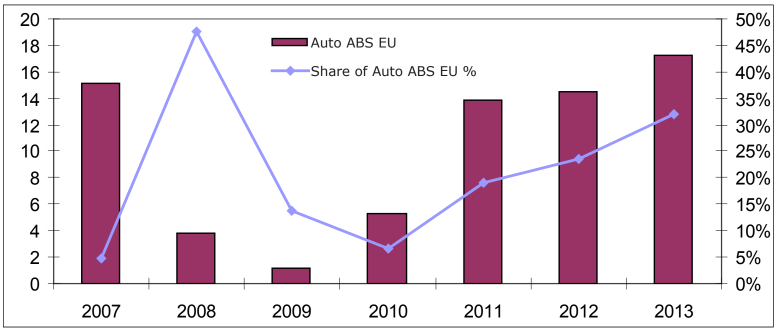
Annex: Background information on auto ABS

Figure 5: Volume of new emissions of European auto ABS EU (red) and Germany (blue) 2003-2013



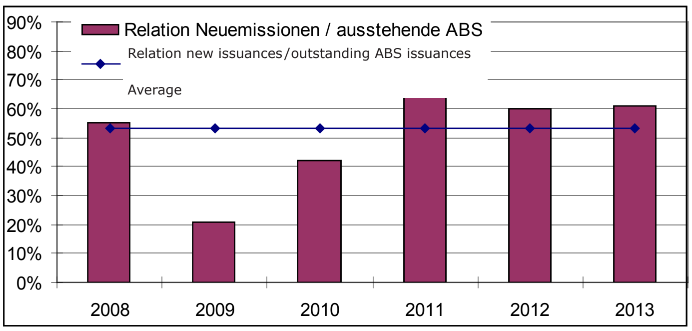
Source: JPM, DZ BANK

Figure 6: New emissions placed with investors 2007-2013



Source: JPM, DZ BANK

Figure 7: Short maturities and high primary market activity



Source: VWFS

Figure 8: Average 1-year rating migrations of EU auto ABS 1996-2012

	Paid in Full	AAA	AA	A	BBB	BB	B	CCC	<= CC	Withdrawn
AAA	17,4%	80,6%	1,6%	0,2%	0,0%	0,1%	0,0%	0,0%	0,0%	0,1%
AA	18,7%	3,8%	71,2%	3,2%	2,7%	0,0%	0,0%	0,2%	0,0%	0,2%
A	12,8%	0,5%	5,7%	77,2%	3,0%	0,3%	0,1%	0,0%	0,0%	0,5%
BBB	13,4%	0,3%	0,4%	2,8%	76,5%	2,1%	2,5%	0,8%	0,5%	0,7%
BB	15,9%	0,0%	0,0%	2,8%	5,6%	65,4%	3,7%	4,7%	0,9%	0,9%
B	12,0%	0,0%	0,0%	0,0%	16,0%	12,0%	36,0%	16,0%	8,0%	0,0%
CCC	8,9%	0,0%	0,0%	0,0%	0,0%	2,2%	4,4%	51,1%	33,3%	0,0%

Source: Fitch "Global SF 2012 Transition and Default Study", March 2013

Figure 9

Downgrades to CC and below within one year - Fitch Rating (1996 - 2012)	
AAA	0,00%
AA	0,00%
A	0,00%
BBB	0,53%
BB	0,93%
B	8,00%
CCC	33,33%

Links

» **research study by S&P**

» **analysis by Moody's**

» **German SME securitisations as an example**

TSI – What we do

Securitisation in Germany and TSI – the two belong together. True Sale International GmbH (TSI) was set up in 2004 as an initiative of the German securitisation industry with the aim of promoting the German securitisation market.

In the last nine years TSI has strongly supported the development of the German securitisation market. Its concern has always been to give banks an opportunity to securitise loans under German law on the basis of a standardised procedure agreed with all market participants. Another objective is to establish a brand for German securitisation transactions which sets a high standard in terms of transparency, investor information and market making. And finally the goal is to create a platform for the German securitisation industry and its concerns and to bridge the gap to politics and industry.

Nowadays TSI Partners come from all areas of the German securitisation market – banks, consulting firms and service providers, law firms, rating agencies and business associations. They all have substantial expertise and experience in connection with the securitisation market and share a common interest in developing this market further. TSI Partners derive particular benefit from TSI's lobbying work and its PR activities.

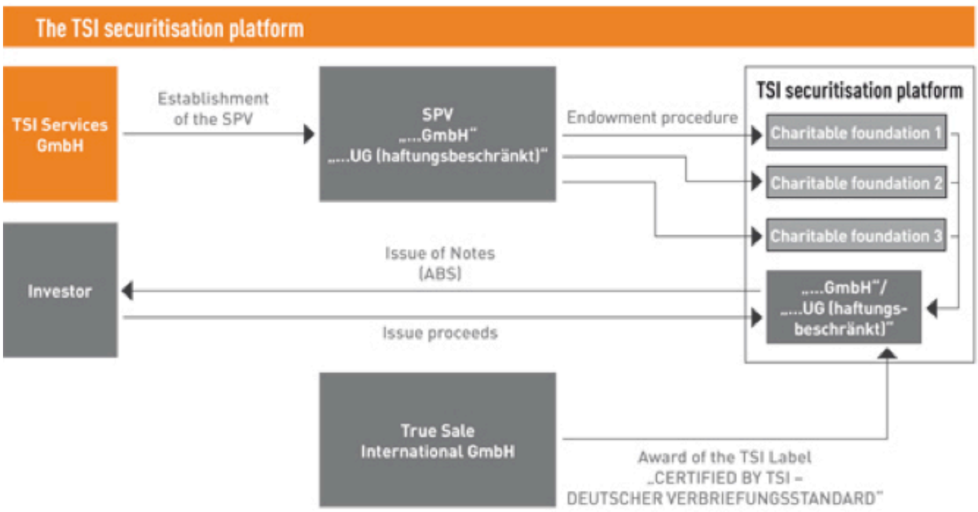
TSI securitisation platform

TSI has been providing special purpose vehicles (SPVs) under German law since 2005. In far more than 80 transactions (as of February 2013), German and other originators have already taken advantage of German SPVs as part of the securitisation process.

The TSI securitisation platform comprises three charitable foundations, which become shareholders in the SPVs set up by TSI. The charitable foundations provide support for academic work in the following fields:

- Capital market research for Germany as a financial centre
- Capital market law for Germany as a financial centre
- Corporate finance for Germany as a financial centre

The three charitable foundations are committed to promoting scholarship and science with a focus on capital market and corporate finance topics.



CERTIFIED BY TSI – DEUTSCHER VERBRIEFUNGSSTANDARD

The high quality of German securitisation transactions reflects the high quality of the standards applied to lending and loan processing.

The brand label DEUTSCHER VERBRIEFUNGSSTANDARD is founded on clearly defined rules for transparency, disclosure, lending and loan processing. Detailed guidelines and samples for investor reporting ensure high transparency for investors and the Originator guarantees, by means of a declaration of undertaking, the application of clear rules for lending and loan processing as well as for sales and back office incentive systems. The offering circular, the declaration of undertaking and all investor reports are publicly available on the TSI website, thus ensuring free access to relevant information.

Events and Congress of TSI

Events of TSI provide opportunities for specialists in the fields of economics and politics to discuss current topics relating to the credit and securitisation markets. The TSI Congress in Berlin is the annual meeting place for securitisation experts and specialists from the credit and loan portfolio management, risk management, law, trade and treasury departments at banks, experts from law firms, auditing companies, rating agencies, service providers, consulting companies and investors from Germany and other countries. Many representatives of German business and politics and academics working in this field take advantage of the TSI Congress to exchange professional views and experience. As a venue, Berlin is at the pulse of German politics and encourages an exchange between the financial market and the world of politics.