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Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

21 March 2014

Re: BCBS 269 – consultative document on revisions to the securitisation framework

Dear Sir/Madam

UBS would like to thank the Basel Committee on Banking Supervision (BCBS) for the opportunity to comment on BCBS 269 – consultative document on revisions to the securitisation framework. Please find attached our response to the consultation.

We would be happy to discuss with you any comments you may have. Please do not hesitate to contact Andrew Bell on +44 20 7568 1385.

Yours sincerely,
UBS AG

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UBS AG response to BCBS 269 – Consultative document on revisions to the securitisation framework

We are supportive of many of the changes made in the second consultative document relative to the first consultative document (BCBS 236). In particular, we fully support:

- The changes to the hierarchy of approaches which in our view make the hierarchy significantly more understandable and straightforward to apply.
- Changes to the calibration which result in lower capital charges for certain securitisation exposures.
- The reduction of the risk weight floor from 20% to 15%, however, we would welcome a lower floor for high quality securitisations where the senior [AAA/Aaa] (sf) is backed by EEA and Swiss assets. In fact, we are unsure about the background on the statement presented in Section 1 that "capital requirements for highly-rated securitisation exposures proved to be too low, in the light of the performance of securitisations during the crisis". In particular, the performance of originally AAA-rated granular ABS and RMBS EMEA has been substantially in line with the original base case with limited downgrades due to performance.
- The removal of the requirement to have two external credit ratings when using the external ratings based approach.
- Greater recognition of future margin income ("excess spread").

We do however still have some concerns with the proposed approach and we would also appreciate clarification of several issues. Please see below our key comments.

<u>Reponses to specific questions in the consultative document</u>

Question 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 respondents' views on how to improve upon the proposed treatment.

Our view is that the explanation for the proposed treatment of derivatives other than credit derivatives is unclear and there is also very little detail provided in the proposed rules text. We understand that the risk weight applied to a swap related securitisation exposure in cases where a bank enters into a swap with a special purpose entity (SPE) should be inferred from the tranche immediately junior to the swap in the waterfall. But we are unclear how the exposure

value of the swap should be calculated as the only guidance given is what we consider to be a vague reference to the approach under the counterparty credit risk framework of the Basel framework. Our interpretation is that it is necessary to calculate the replacement cost of the swap from the perspective of the SPE but we highlight that in practice the bank will find it very difficult to calculate this value as it will not have the necessary information to perform the calculation. In addition, in some ABS and Corporate Securitisation, one way collateral swap ranks pari-passu to the most senior tranche and, therefore, we are unsure if the proposed rule (of referring to the tranche immediately junior) reflects correctly the risk in the seniority of the swap.

We therefore believe that the BCBS should reconsider its approach on this issue and provide detailed guidance as to how any revised method should be calculated.

Question 2: While the formulation of the Internal Ratings-Based Approach 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 respondents' views on ways to simplify the parameterisation of "p".

It is stated that the "p" factor represents the relative capital surcharge for all securitisation exposures compared to the capital requirement for the underlying pool. We accept that the securitisation process can introduce additional risks and complexity (e.g. model risk) that would not be present in the underlying asset pool and we consider it appropriate that such risks are captured in the securitisation framework. We therefore accept that the overall capital requirement post securitisation may be higher than for the underlying asset pool pre-securitisation. But we feel the capital surcharge for many securitisations, particularly plain vanilla transactions with a simple tranching structure, is excessive and results in non-risk sensitive capital charges.

In particular, we note that the "p" factor is highly dependent on the maturity of the tranche. As noted below, we have significant concerns with the proposed approach to defining maturity which we believe will typically overstate actual tranche maturity and thus overstate the "p" factor. More fundamentally, we question whether tranche maturity should have such importance as an input into the "p" factor as we do not consider it to be a key determinant of the incremental risk after securitisation relative to the underlying pool.

We also consider that the distinction between wholesale (granular and non-granular) and retail transactions within the "p" factor is an insufficiently granular distinction to capture the different risk profiles of securitisations across different asset classes. In particular, we believe the formula will be excessively conservative for securitisations of high quality retail assets and penalise the approach of high quality assets senior tranches in certain jurisdictions where the country ceiling does not allow the sponsor to achieve a [AAA/Aaa] (sf) rating (eg: senior ABS Auto Loan in Italy or in Spain can only achieve a rating [A2]/[A3] (sf)) attracting, subject to the cap points, a higher capital than the non-rated portfolio. This will negatively impact the ability of the securitisation market to fund real economy assets going forward. Therefore, whilst we appreciate the aim of the BCBS to reduce complexity in the securitisation framework as far as possible, we do believe the introduction of more granular and appropriately calibrated asset class distinctions within the "p" factor is an area where additional complexity would be justified in order to achieve better risk sensitivity for key real economy asset classes.

Question 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 support the use of the pro-rata calculation of the maximum capital requirement. It is not clear to us why such an approach would lack prudence and indeed we believe not including it would result in excessive conservatism.

Furthermore, we fail to understand why the cap is equal (for SA and IRB banks) to the "average risk weight applied to the underlying exposures" and not a lower number considering that the senior tranche, by its nature, should be "hedged" against a certain level of losses. Moreover, it is unclear why a mezzanine tranche should have a risk-weight that is substantially higher than the underlying exposure.

<u>Other comments on the consultative document</u>

Definition of maturity

The proposed definition of tranche maturity is final legal maturity unless certain conditions are satisfied in which case the Euro weighted average maturity of the contractual cashflows of the tranche can be used. We are concerned that this approach to defining maturity will effectively result in the vast majority of non-short term securitisations ending up in the 5 year maturity bucket which in many cases will not reflect the expected time for repayment of the tranche. The implications of this are very significant as the capital charge for tranches of 5 year maturity will

be significantly higher than for those of 1 year maturity under both the internal and external ratings based approaches. Thus the definition of maturity is in some ways as important to the overall capital charge for a tranche as the calibration of the risk weights themselves.

To better reflect the economic reality of the timing of tranche repayments, we consider it appropriate that the definition of maturity must reflect the weighted average life (WAL) of the tranche based on contractual payments and also provide scope for recognition of pre-payments. We understand that the BCBS wants to ensure a consistent approach to defining tranche maturity across banks and therefore wants to restrict the ability of banks to internally model tranches. However, we believe it is possible to reconcile any limitation on the use of bank internal models and assumptions with the use of a WAL approach that takes into account both contractual and pre-payments by using standardised assumptions for parameters such as pre-payment rates. This would limit the scope for individual bank discretion whilst more accurately reflecting the allocation of cashflows and repayment of tranches. It should therefore mitigate the potential for a non-risk sensitive approach where all transactions are treated as having a 5 year maturity, irrespective of their actual expected maturity.
In addition, we are unsure why a minimum constant prepayment rate (CPR) has not been recommended in the determination of the WAL. While we appreciate that it is difficult to define a standard CPR across all jurisdictions, recent reports (see Fitch, Global Housing and Mortgage Outlook, 21 January 2014) suggest, that even in the most challenging macroeconomic conditions, CPR has rarely reached 0%.

Penalty for failure to comply with the due diligence requirements

Paragraphs 31 to 35 of the proposed rules text set out due diligence requirements that banks must satisfy in order to use the Basel securitisation framework. For any exposure for which a bank cannot perform the level of due diligence required, it must apply a 1250% risk weight. We consider this "penalty" for non-compliance with the due diligence requirements to be excessive and something that will act as a significant impediment to the emergence of a robust and well-functioning global securitisation market.

We are particularly concerned that the requirements set out in paragraphs 32 – 34 are relatively high level and leave material room for interpretation of exactly what standards need to be met. In light of this, we are concerned that potential investors will be unable to get comfortable that they can objectively demonstrate that they have met the requirements and will choose not to invest in securitisation at all given the highly punitive capital impact of being unable to satisfy the requirements.

As an alternative to the proposed 1250% risk weight approach, we believe it would be appropriate for the Basel framework to be based on the approach in the EU Capital Requirements Regulation under which a progressive additional risk weight is applied for due diligence breaches, starting with a 2.5 multiplier applied to the original risk weight. We consider this to be a more risk-sensitive and balanced approach and one which creates better incentives as the additional capital charge increases with the duration of the infringement, thus incentivising investors to address any due diligence weaknesses in a timely manner.

Application of a 1250% risk weight to standardised assets in a mixed pool

We appreciate the additional flexibility introduced in the second consultative document for mixed pools and the removal of the requirement that a bank must be able to calculate IRB parameters for all of the underlying exposures in order to use a K_{IRB} based approach. However, we consider that the proposal to apply a 1250% to all exposures for which IRB parameters cannot be calculated (or alternatively apply the SA hierarchy of approaches for the whole pool) is inappropriate. In our view, it should be permitted to risk weight the exposures for which IRB parameters cannot be calculated using the SA hierarchy of approaches and then applying the approach set out in paragraph 48. (1) of the proposed rules text (with step 3 of the process amended to reflect the SA risk weighting of the non-IRB exposures rather than a 100% capital charge).