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**Position paper on  
the second consultative paper on  
“Revisions to the Basel Securitisa-  
tion Framework” issued by the Basel  
Committee**

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Berlin, 21<sup>st</sup> March 2014

## **I. General comments**

We welcome the opportunity to comment on the second consultative paper in terms of “Revisions to the securitisation framework.” The German Association of the Automotive Industry (VDA) represents the interests of the German automobile manufacturers and their suppliers. As the representative of the key sector of the German economy, the VDA takes its responsibility for approximately 600 member companies and what is meanwhile every seventh job in Germany seriously.

We have focused our comments from the perspective of our originating finance companies of the car manufacturers, the so called Finance Captives Companies.

The Finance Captive Companies are an indispensable partner to the vehicle manufacturers in the marketing of passenger and commercial vehicles. Each year about 12 million new passenger cars are registered in the European Union. Approximately 60 % of the cars sold are either financed or leased with a significant proportion of the finance being provided by the Captives. Automobile finance and leasing companies ensure that the automotive value chain runs smoothly.

The securitisation of customer receivables – so-called Auto-ABS – is a vitally important financing tool for the Captives. It allows for diversification by providing an alternative funding source to deposits, bank loans and other capital market instruments and offers valuable protection against market volatilities. Auto-ABS is an important asset class and in 2013 accounted for 34.6 % of the entire European securitisation market with an issuance volume of 25.8 billion euros. In the US market the Auto-ABS market is significantly bigger with a public issuance volume of 97 billion US Dollars in 2012 (see presentation of Ford Credit on 23 April to the working group of the Basel Committee in London).

We 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. However, we are extremely concerned that the capital requirements for Auto-ABS (auto loan and auto lease securitisation) are still significantly too high, given the high credit quality of Auto-ABS, a long track record and the proven crisis resilience during the last financial crisis.

In order to demonstrate the high quality of Auto-ABS, we have enclosed a table that shows the rating migrations of European Auto ABS to CC or worse between 1996 and 2012, based on an analysis of Fitch Ratings Global Structures Finance:

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%

The performance of European Auto-ABS has always been very good: Even subordinated junior A-tranches have never experienced a downgrade to CC or below.

Thus, a triplication of risk weights in the External Ratings-Based Approach for the most relevant rating classes ranging from AAA to A- seems to be inappropriately high for high quality Auto-ABS.

Further, we have concerns that the calibration of the capital requirements for retail ABS transactions in the IRB approach are not risk adequate and far too high at least for Auto-ABS that in most cases are retail transactions. Typical for retail Auto-ABS compared to Credit Card ABS, for instance, is that the losses are very low since the vehicle serves as collateral for the securitised loans and leases contracts.

In addition, we have some concerns that due to the low risk profile of the securitised loans and thus relatively low credit enhancement levels in absolute values the capital requirements could significantly be too high in the IRB approach compared to riskier securitised portfolios.

We are further concerned that the proposed significant increased capital requirements compared to the current regulation could have some detrimental impacts on the real economy due to rising refinancing costs and lower volume of credit available to finance private customers and SME's.

In total, we strongly recommend to use the results of the Quantitative Impact Study to review the calibration of high quality ABS and to consider in particular the very favourable and stable risk profile of Auto-ABS within the calibration to avoid unintended impacts on the real economy. This seems to be justified given

the significance of the automobile industry in Europa and the United States of America.

ABS is a funding tool for the Finance Captive Companies of the automobile industry to separate pools of auto loans and auto leases from the originated portfolio and truly sell them to a SPV that in turn issues securities backed by assets. By such true sale transactions the originating Finance Captive Company is no longer liable for the credit risks of the securitised loans and lease receivables which means that a bank investor has no legal claim to the bank but only to the SPV whose credit quality depends on the credit quality of the securitised loans. As a result, a bank investor has, due to the risk transfer, no risk towards the Captive Finance Companies but to the SPV and, if needed, to the underlying assets. Hence, such receivables from Auto-ABS do not have to be considered in the large exposure regime towards the group of connected clients led by the car manufacturer and thus are of assistance to maintain the space to fund growth of the car manufacturers and its finance captive companies which is in turn important for growth and employment in the real economy. Rising capital requirements for banks to back Auto-ABS with capital means that capital will be more scarce – which could limit the ability of such credit institution to invest in Auto-ABS which in turn could reduce the availability of funds or will result in increasing funding costs. This will have a detrimental effect on the automobile industry and the customers of the Finance Captive Companies.

### **Different calibration for high quality ABS**

We have some concern that the still too high capital requirements might be the result of a broad approach to find a calibration that fits to all kinds of securitisations. Such a broad approach entails the need for over-conservative add-ons for high quality ABS such as Auto-ABS in order to avoid that the capital requirements are too low and not appropriate for riskier ABS segments. Thus, we advocate for a more differentiated approach that considers the quality of ABS. As a reference point, we recommend the approach proposed by the European Insurance and Occupational Pensions Authority (EIOPA) in its “Technical Report on Standard Formula Design and Calibration for Certain Long-Term Investments” published on 19 December 2013. EIOPA proposed a definition of high quality securitisations (so-called ‘Type A’ securitisations) which benefit from lower capital requirements. We propose using a similar definition in the context

of the Basel Framework for Securitisations. To further increase the risk sensitivity and thus to avoid detrimental impacts on the real economy, we recommend to adjust the floor and the factor “p” in the IRB approach for the most significant ABS segments such as RMBS and Auto-ABS. By an adjustment of these parameters without calling for an own model for Auto-ABS we are of the opinion that this approach would be suitable to strike the right balance between risk sensitivity and simplicity.

To avoid detrimental effects on the ABS market, a more preferential calibration should be implemented for high-quality ABS as well in the External Ratings-Based Approach. This could be achieved by the introduction of a scaling factor  $p < 1$ . This is also important because we assume that even large credit institutions will virtually be forced - due to missing internal rating models for ABS and limited data availability - to use the External Ratings-Based Approach for a while. In addition, the External Ratings-Based Approach will be needed for IRB institutions if certain ABS segments are small or if it is still impossible to build reliable internal models due to the lack of sufficient available data to estimate the required PD's and LGD's in the Internal Ratings-Based Approach for ABS. Thus, we recommend to deliberate whether banking investors should be permitted to use the PD's and LGD's of the originator, if it is ensured by the originator that the PD's and LGD's are validated at least annually and are used for the building of provisions in the company's accounts that are audited at least annually by an external auditor and further are used in the internal capital management of the originating bank. This should apply for originating credit institutions that are no IRB-banks as well as if the internal risk management standards are comparable to those of IRB- banks.

### **Permanent exemption from the Internal Ratings-Based Approach for smaller ABS portfolios of investors**

We are concerned that the requirement for IRB institutions to build IRB models for the purchased ABS could prevent credit institutions from investing in ABS, reduce the number of potential investors and thus could have detrimental effects on the further recovery of the ABS market, its liquidity in the primary and secondary market and at the end on the funding costs and the availability of funds. In addition, we have some doubts that credit institutions will really be able to build own IRB-models for ABS, because the availability of data to build such models could be a problem.

Moreover, it has to be considered that the securitised underlying assets of the different ABS can be very different and thus the available data can vary to a great extent from asset class to asset class and even between sub-asset classes so that it seems questionable if credit institutions will succeed to build a one-size-fits-it-all model that fulfils the banking supervisory requirements for an approval as well. This holds true even more considering that each originator captures different data types in his systems to assess the creditworthiness of a customer i.e. the credit quality of a loan. The use of an internal IRB ABS model would mean that all originators would have to deliver the same data on the underlying assets that are potentially suitable to qualify as risk driver to estimate PD's and LGS's.

Pursuing an approach, that IRB-credit institutions use for their own originated loans to build different models for different portfolios might be no solution because then the ABS portfolios could be too small to build reliable models that fulfil the banking supervisory requirements for approval. Thus, to avoid unintended impacts on the ABS market, a permanent exemption from the requirement to develop an own IRB-model should be envisaged if the costs for the development are too high in relation to the expected benefit or if it is virtually impossible to build a reliable IRB model for ABS.

## **Floor**

Basically, we welcome the lowering of the floor from 20% to 15%. But considering that the floor increases with the maturity of the tranche, the risk weights are, for example for ABS tranches with an average weighted maturity of three years, three times higher than in the current approach. We are of the view that this floor does not adequately address the risks of ABS in the most resilient sectors such as Auto ABS. We believe that the Basel Committee's conclusion that "capital requirements for highly rated securitisation exposures proved to be too low, in the light of the performance during the crisis" does not take into account the outstanding performance of Auto-ABS that proved to be crisis-resilient and passed its stress-test with flying colours during the last financial crisis.

## **Phase-In**

Due to the fact that even large credit institutions will take some time to build internal rating models for ABS, there should be a phase-in time to attenuate the

effects of increasing capital requirements between the current IRB-approach that is based on external ratings as far as available and the future External Ratings-Based Approach that will have to be applied for a transitional period or permanently for smaller ABS portfolios.

## **II. Specific comments**

### *Paragraphs 22, 23 - Tranche Maturity*

The definition of Tranche Maturity is ambiguous. We interpret the calculation of the Tranche Maturity in a way that the weighted-average maturity of the tranche corresponds to the weighted-average maturity of the contractual cash flows of the underlying assets. We would be grateful to clarify the definition.

Further, we assume that the requirement that the contractual payments must be unconditional and not dependent on the actual performance of the securitised assets is independent from the waterfall of the ABS transaction that is typically agreed in ABS transactions, where the contractual cash flows from the underlying assets flow first to the senior tranche, then to the junior tranches, following the mezzanine tranches and finally to the first loss position. If this understanding was not correct, then the provision should be adapted in a way that the waterfall-model in a tranching transaction, that is the core of ABS, will not be affected. Otherwise, credit institutions would be forced for each ABS tranche to calculate the tranche maturity on the legal maturity which would increase the capital requirements dramatically due to the major impact of the parameter Tranche Maturity for the determination of the capital requirements and which would not be appropriate.

### *Maturity in replenishing transactions*

In the current proposal the longest possible maturity of any asset added to the pool during the replenishment phase has to be added to the remaining replenishment period. This seems too conservative. Understanding the uncertainties in the calculation of maturity in replenishing transactions, we propose to take into account contractual safeguards where existing. If, for example, the weighted average maturity of the replenished pool is contractually limited to a certain value, this term should be used instead of the longest maturity of any single asset. This definition would follow the idea that only contractually documented values can be used, but the resulting value would be much closer to the

actual realised maturity. Since the limit is only a maximum value, this definition still would be conservative.

*Paragraph 48 - Application of the IRBA to mixed portfolios*

We welcome that the new proposal allows transactions to use the IRBA for mixed pools of IRBA and SA assets. However, the need to apply the risk weight of 1250% to the SA assets adds a stringent degree of conservatism even for transactions which consist almost solely of IRBA assets. To avoid this, we propose the use of the risk weights from the general Standardised Approach for these assets up to a certain threshold if there is no evidence that there is a significant increased risk of such SA assets compared to the average IRBA assets. A threshold of 10% could be reasonable and provide sufficient safeguard.

*Paragraph 54 Calibration of the supervisory parameter “p”*

The calibration of the supervisory parameter “p” appears in terms of the parameters “D” and “E” not appropriate for securitised retail portfolios. The parameter “D” is part of the product with the parameter LGD and the parameter “E” is part of the product with the parameter Tranche Maturity Mt. Especially, the calibration of the parameter “E” for the securitised retail portfolio is in all combinations three times higher than in the securitised wholesale portfolio. This appears not appropriate. Moreover, it is not fully clear what exactly “wholesale” means. If the securitised corporate portfolio is meant then this term should be used for the sake of clarity and consistency.

Intuitively not comprehensible is that the parameter “D”, that is to be multiplied with the parameter LGD, is so high for high granular retail ABS tranches irrespective of the seniority. On the other hand, the parameter “D” is less than the half for non-senior granular wholesale tranches compared to retail tranches.

Altogether, we recommend to review the calibration based on the loan level data of the QIS II in terms of risk sensitivity and to revise accordingly.

*Paragraph 60 - Risk weights in ERBA*

In our view, a triplication of risk weights in the External Ratings-Based Approach for the most relevant rating classes ranging from AAA to A- seems to be inappropriately high for high quality Auto-ABS. Thus, we advocate to review the calibration based on the results of the QIS considering in particular the very fa-

vourable and stable risk profile of Auto-ABS within the calibration to avoid unintended impacts on the real economy.

#### Question 1

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#### Question 2

We do not consider further simplification of the factor “p” to be appropriate. In fact, the quality of the securitisation of the transaction should be an additional parameter to calculate “p”. Finally, we advocate to differentiate a little bit more between the most significant ABS segments like RMBS, Auto-ABS and others. (see also our general comments).

#### Question 3

We favour the introduction of an overall pro rata cap.

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