11th April 2014

Basel Committee for Banking Supervision
c/o Bank for International Settlements
CH-4002
Basel, Switzerland

Submitted via website: www.bis.org

GFMA response on to the Consultative Document on Basel III: the Net Stable Funding Ratio – supplemental comments on securitisation

The Global Financial Markets Association (GFMA)[1] (including the Association for Financial Markets in Europe (AFME), the Asia Securities Industry & Financial Markets Association (ASIFMA) and the Securities Industry & Financial Markets Association (SIFMA) welcomes the opportunity to comment on the proposals set out in the Consultative Document "Basel III: the Net Stable Funding Ratio " published by the Basel Committee on Banking Supervision (BCBS or Committee) on 11th January 2014 (Consultation Paper).

This letter sets out GFMA's detailed points on securitisation only, and is intended to supplement the broader letter of even date submitted by the Institute of International Finance (IIF), the GFMA and others (the Joint Associations).

Introduction

The Consultation Paper refers to securitisation explicitly only once, in paragraph 13(d), where it says (approvingly) "The NSFR assumes that unencumbered, high quality assets that can be securitised or traded, and thus can be readily used as collateral to secure additional funding or sold in the market, do not need to be wholly financed with stable funding."

We agree with the Committee that securitisation, prudently deployed and sensibly regulated, can make a very positive contribution to a bank's overall liquidity management. Indeed, banks which found themselves having to rely on various forms of government support during the financial crisis were able to free themselves from that support, and exit government funding programmes, more quickly through securitising their assets than they would have been able to do had securitisation not been available to them.

Economies need securitisation to help finance business and consumers

The Committee states at paragraph 13(b) of the Consultation Paper that "The NSFR requires stable funding for some proportion of lending to the real economy …".

We agree. Indeed, increasingly, policy-makers, heads of central banks and directors of regulatory authorities at the highest levels have recognised and stated publicly that many

[1] The Global Financial Markets Association (GFMA) brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, please visit http://www.gfma.org.

securitisation transactions have high credit quality, transparency and structural soundness and that securitisation plays an important role in facilitating access to capital for businesses and consumers. Accordingly, they say, regulatory policy should be formed and implemented in a way that, while providing necessary guidance and restraint, does not unnecessarily stifle the re-growth of this useful market. They note that many regulatory changes have already been put in place to ensure the safety and soundness of securitisation transactions and markets, and speak of securitisation not as a threat but as a tool to improve bank funding and support economic growth. Annex 1 (*Policy support for securitisation*) sets out a sampling of such statements.

Securitisation increases the availability and reduces the cost of credit to affected sectors of the real economy through the secondary market liquidity that it promotes in the underlying risk. If the NSFR disincentivises banks from holding such exposures, that can significantly reduce the liquidity (and the attractiveness) to investors of holding securitisation exposures. That impact is even greater when it adds to other strands of regulation that deter investors from holding securitisation exposures.

The regulatory response to securitisation

The regulatory response to the financial crisis has already generated a comprehensive and multi-faceted set of rules on securitisation, and many of these rules are still being implemented, extended or awaiting final implementing measures. Nonetheless, notwithstanding high-level policy support for a healthy securitisation market, the regulatory momentum has so far continued to impose multiple, often inconsistent, unwarranted and costly regulatory requirements, piling on burdens that do not apply to other forms of finance.

Among the rules recently proposed or finalised or awaiting implementation, the Basel liquidity ratios include proposals that potentially affect the holding of securitization exposures on bank's balance sheets.

As is mentioned in the Consultation Paper, the liquidity coverage ratio (LCR) while including, as a "Level 2B asset", residential mortgage-backed securities (RMBS) in the High Quality Liquid Assets (HQLA) buffer, the strict criteria for inclusion are likely to exclude many (private) and many European RMBS. Other securitization investments are deemed ineligible as HQLA. Yet these high quality assets also exhibit good liquidity behaviour and should in our view qualify as HQLA and / or be recognised in the NSFR, at least as much as RMBS. See for example Professor William Perraudin's paper on "Covered Bond versus ABS Liquidity" 24th January 2014.

Given all the aforementioned regulatory developments, subjecting securitisation exposures held by banks to disproportionate and unjustified requirements would further discourage banks from investing in, originating or sponsoring securitisation transactions. This would hamper rather than facilitate the opening up of financial markets to expand economic activity.

We note with approval the establishment of the joint committee of IOSCO and the BCBS to provide a much needed and overdue examination of securitisation regulation from a co-ordinated global perspective. Several years after the financial crisis, we believe that the pendulum of regulation has swung too far against securitisation, and a review is justified.

Questions and issues

Term securitisation usually creates longer term liabilities

Paragraph 12(a): "longer term liabilities are assumed to be more stable than short term liabilities".

We agree and many securitisation issues are structured as long term debt issues, for example most RMBS issues have legal final maturities of 25 plus years although in reality have weighted average lives considerably shorter than this – typically at around 5-7 years - as the securitised bonds repay principal at regular intervals as the underlying mortgages are repaid or pre-paid. Issuer call options sometimes serve to protect investors against tail risk of lengthening of average life if a slowdown of prepayments takes place but such options typically are dated several years in the future from issuance, and well beyond the one year horizon with which the NSFR is concerned. We believe RMBS should receive credit for this.

As for other asset classes such as autos or consumer loans, similar structuring principles also often apply although the weighted average maturities are shorter but still generate initial weighted average lives of more than one year.

The concept of weighted average life

This is important in the context particularly of Paragraph 17. Weighted average life is not addressed in the Consultation Paper.

Presumably the Committee proposes to use the concept of weighted average life, rather than legal final maturity, for securitisation in the context of the NSFR? Discussions are taking place on the subject of maturity with the Committee in the context of Basel 269, and while the outcome is not yet known it would be inconsistent if the approach taken to assessing the maturity of securitisations differed between the liquidity and capital regimes.

Many types of securitised assets mature in weeks or days rather than months or years

Paragraph 13(c): "some short-dated assets (maturing in less than one year) require a smaller proportion of stable funding because banks would be able to allow some proportion of those assets to mature instead of rolling them over". We agree. This is especially true, for example, of securitisations of credit card or trade receivables, which include built-in mechanisms to ensure principal payout under the securitised bonds in the event of certain stress events occurring.

What is the proposed treatment of issuer (SPE) call options?

Paragraph 17: could the Committee please confirm in the context of securitisation its approach to *issuer* call options (the issuer in this case being the SPE, not the bank originator). This is not quite the same thing as a bank (originator) call. There are examples in the market of issuer calls not being exercised and of securitisation transactions being allowed to amortise out of the principal cashflows being received from the securitised assets, not from the proceeds of refinancing.

Many securitisations are self-liquidating, and therefore match-funded to maturity

In many securitisations the promise to repay principal to investors is wholly conditional upon receipt of the principal cashflow from the underlying assets, known as the "pass-through" structure. In this way, securitisations by their nature carry considerably less refinancing risk than other forms of financing, secured or unsecured, that require full refinancing at their maturity.

Even RMBS structures that are not strict pass-throughs (for example, master trusts) have significant mitigants to refinancing risk that are not present in other forms of financing. Some practical evidence of this can be seen in the history of the Granite master trust RMBS programme of the former Northern Rock bank in the United Kingdom which of course suffered a run in autumn 2007. While the example of Northern Rock is far from an example of best practice in liquidity management – quite the contrary – the point here is that the master trust RMBS funding programme remained outstanding and converted from a series of soft bullet maturities to a pass-through structure, which went on to become the most liquid and traded bond in the market. In other words, the securitisation structure unwound in a managed way, according to the transaction documents, minimising the refinancing strain on a stressed issuer and reducing systemic risk.

Available Stable Funding factor

Please confirm that term securitisation, as a form of secured borrowing, will qualify for 100% ASF under Paragraph 18(c), to the extent that the residual maturity on a weighted average life basis is one year or more.

Please confirm that term securitisation, as a form of secured borrowing, will qualify for 50% ASF under Paragraph 21(d), to the extent that the residual maturity on a weighted average life basis is not less than six months and less than one year.

Required stable funding: assigning a RSF factor of 65% to residential mortgages held on the balance sheet is too high

See Paragraph 33(a). In light of the points made above regarding the effectiveness of RMBS as a match-funding tool, the large share of the securitisation markets made up by RMBS and the significant reforms made in the securitisation market (both regulatory and market-led), we feel that a RSF Factor of 65% is too high.

Required stable funding: assigning a RSF factor of 85% to non-RMBS asset classes is too high

See Paragraph 34. We appreciate that this consultation is about the NSFR not the LCR, but the treatment of high quality securitisation other than RMBS under the LCR does seem increasingly out of line with the current policy expressed by many senior central bankers which is to encourage a revival in sustainable markets in high quality securitisation. We are not aware of the rationale behind or methodology supporting the Committee's decision to include only certain very limited forms of RMBS, and no other high quality asset classes, in the LCR. Neither are we aware of any consultation with the industry that took place ahead of issuance of the Committee's Final Rules on the LCR.

Asset-Backed Commercial Paper (ABCP) conduits

ABCP Conduits fund the activities of a bank's clients by issuing short term notes (typically limited to 270 days in original maturity, and in practice often with a maturity of less than six months) to institutional market investors (e.g. money market funds, asset managers, corporate treasuries, etc.). These notes are backed by client assets such as trade receivables, auto loans and leases, credit card receivables, equipment and SME loans. Credit and liquidity risks in the structure are mitigated from an investor point of view by the regulated sponsor bank providing credit enhancement and 100% liquidity support to the ABCP Conduit.

Short term financial markets have proven to be deep, even at times of crisis. The strong liquidity performance of ABCP Conduits supported by sponsoring banks providing liquidity has been demonstrated in the "Data Submission to European Commission: historic liquidity funding for multi-seller ABCP Conduits" prepared and submitted by AFME to the European Commisson in December 2012: the actual funding provided by banks to these vehicles during stress periods was limited (specifically, from 2005 to 2012, the liquidity funding was never more than 5.45% of the Utilised Portion of Total Commitments), meaning that a substantial amount of commercial paper issued by the ABCP Conduits was rolled over with market investors on an ongoing basis.

Therefore, although of course the nature of ABCP is short term, it should be recognized as ASF to a certain extent, and not be completely ruled out because of its short maturity.

ABCP seems to be directly targeted by the NSFR, so that it is difficult to articulate an argument that is not clearly in opposition to the regulation's general philosophy. That being said, the Joint Associations' letter makes it clear that the NSFR as proposed is a very blunt instrument which does not differentiate between various levels of liquidity risk and would have many negative consequences, for example, on secured financing transactions or on short-term funding provided to clients. We hope to have the opportunity to discuss the Committee's response to these broader issues to explore with the Committee whether some recognition of ABCP could be achieved under the NSFR.

Lastly, in the application of accounting rules, many ABCP Conduits have become consolidated in banks' books in recent years, while some others remain off-balance sheet. Yet the liquidity risk associated with an ABCP Conduit does not depend on its accounting treatment. Consequently, accounting treatment should have no bearing on the NSFR treatment of a bank's liquidity exposure to an ABCP Conduit: such a liquidity facility, which in the normal course of operations would remain unutilized, should attract an RSF weighting in line with the treatment of off-balance sheet commitments. Once such a facility became utilized, the RSF for the resulting assets on the bank's balance sheet would be measured in application of the NSFR rule for such assets.

Conclusions

Part of the difficult of creating regulation for securitisation is that the diversity of the securitisation markets - assets, funding, structures, investor preferences – means that a "one size fits all" approach is rarely appropriate. This was found to be the case in the very constructive dialogue in which the industry has engaged with the Committee in the context of regulatory capital, most recently Basel 269. We respectfully ask the Committee to engage in a similar way with the industry in this, relatively new, context of the NSFR in order to achieve a treatment of high quality securitisation that accurately recognises its strong credit

performance through and since the financial crisis as well as its benefits as a self-liquidating funding tool for the real economy.

Yours faithfully,

David Strongin

Executive Director, GFMA

Annex 1 – Policy support for securitisation

”Yves Mersch, Member of the Executive Board of the European Central Bank in a recent speech at the Deutsche Boerse – Clearstream ‘Exchange of Ideas’ event, London, 7 April 2014

“There is a need to restore coherence across financial sectors in particular amid the unfavourable regulatory treatment of (high quality) securitisation instruments without violating prudential principles. By doing so we must act fast and in a manner that is sensitive to our own European reality. If the Bank of England and the ECB were to put forward a joint statement on this issue at the forthcoming IMF Spring Meetings, it would underline the European determination to decisively move forward.”

http://www.ecb.europa.eu/press/key/date/2014/html/sp140407.en.html

Mario Draghi, president of the ECB, Press conference following the meeting of the Governing Council of the ECB on 6 March 2014

"If we consider just the revitalisation of the ABS market, there are many things that need to change in regulation and in legislation. Today, the capital charges for ABS discriminate ABS unfavourably with respect to other instruments with similar degrees of riskiness. The current capital regulation of ABS was calibrated on a reality which is not the European one. To give you an idea, I can't remember exactly the period of reference, but let's say over five or ten years, the default rate of ABS in the United States was 17.4%; in Europe, it was 1.4%. So you see that the capital charges are certainly not being calibrated on European ABS, which are traditionally of a much simpler, transparent and unstructured form. These things have to be changed, and it will be up to the Basel Committee and the European Commission, as far as legislation within the EU is concerned, to change some of these regulations. Also there are issues like the sovereign cap: ABS are rated according to their sovereign – perhaps with a few points difference, but this often does not make much sense. So there are several issues and, in the end, it may well be the case that, to launch this market, one may need third party guarantees. So, it is a complex thing on which the ECB's staff is working."

http://www.ecb.europa.eu/press/tvservices/webcast/html/webcast_130905.en.html

Mario Draghi, president of the European Central Bank (ECB), quoted in Financial Times 4 March 2014

The ECB president said last month: “We think that a revitalisation of a certain type of [asset-backed security], a so-called plain vanilla [asset-backed security], capable of packaging together loans, bank loans, capable of being rated, priced and traded, would be a very important instrument for revitalising credit flows and for our own monetary policy.

http://www.ft.com/cms/s/0/544e68ea-a2cd-11e3-ba21-00144feab7de.html?siteedition=uk#axzz2wPfK8AZl

”Yves Mersch, Member of the Executive Board of the European Central Bank in a recent speech , discussing the necessary requirements for the recovery in SME funding: Speech to the Institute of International European Affairs, Dublin, 7 February 2014

"This is why I have been vocal in supporting the revitalisation of the securitisation market in Europe, which has virtually dried up in recent years. I see this as an important tool to help banks manage the credit risk associated with lending to SMEs. However, for it to recover it is critical that the regulatory treatment of asset-backed securities (ABS) is based on real data and not the legacy of the US sub-prime disaster. We have a very different experience with ABS here in Europe: between mid-2007 and the first quarter of 2013 the default rate on ABS in the EU was only around 1.4%, whereas it was 17.4% in the United States."

http://www.ecb.europa.eu/press/key/date/2014/html/sp140207.en.html

Mario Draghi, president of the ECB, at Davos, quoted in January 2014

"What other assets would we buy? One thing is bank loans. . . the issue for further thinking in the future is to have an asset that would capture and package bank loans in the proper way."

http://www.ft.com/cms/s/0/6646e826-86ab-11e3-aa31-00144feab7de.html#axzz2wPfK8AZl

Mario Draghi, president of the ECB, at Davos, quoted in January 2014

"Right now securitisation is pretty dead,” the ECB president said adding, "that there was a possibility of buying asset backed securities" if they were “easy to understand, price and trade and rate."

http://www.ft.com/cms/s/0/6646e826-86ab-11e3-aa31-00144feab7de.html#axzz2wPfK8AZl

The Economist, 11 January 2014

"Most structured products performed well through the crisis[…] Defaults in Europe remained low despite the recession." "Lenders across Europe are under pressure to improve the ratio of capital they hold to loans made. One way of doing this is […] through securitisation, by bundling and repackaging loans and selling them to outside investors such as insurance firms or asset managers, they could lend more money to credit-starved companies."

Andrew Haldane, Director of Financial Stability at the BoE, 10 December 2013

"… securitisation could be the "financing vehicle for all seasons" if proper standards are maintained […]. In a world where we are squeezing risk out of the banking system we would

want a simple, safe, vibrant set of channels for non-bank financing to emerge and securitisation is one of those…"

http://www.ft.com/cms/s/0/fdeeb11e-61bb-11e3-916e-00144feabdc0.html#axzz2wPfK8AZl

Yves Mersch, Member of the Executive Board of the ECB, 13 November 2013

"… we should promote other forms of financing to complement the banking channel […] through strengthening capital markets and in particular securitisation […] We need to revive this market. This implies removing some key impediments to its functioning."

http://www.ecb.europa.eu/press/key/date/2013/html/sp131113.en.html

Mark Carney, Governor of the Bank of England, noted in a discussion about restoring SME lending, 28 August 2013

…"a well-functioning securitisation market - does mean more efficient balance sheets for the financial sector as a whole which frees up capacity, which then can have a knock on effect."

http://www.bankofengland.co.uk/publications/Documents/speeches/2013/speech675trans.pdf

Governor Daniel K. Tarullo, Federal Reserve, 3 March 2013

"The growth and deepening of capital markets lowered financing costs for many companies and, through innovations such as securitization, helped expand the availability of capital for mortgage lending."

http://www.federalreserve.gov/newsevents/speech/tarullo20130503a.htm

Commissioner Michel Barnier, 21 February 2013

"Et nous devons aussi nous demander comment donner un nouveau souffle au marché de la titrisation de manière à améliorer la transformation d'échéances par le système financier."

http://europa.eu/rapid/press-release_SPEECH-13-150_fr.htm

Thomas J. Curry. Comptroller of the Currency, 14 February 2013

"Securitization markets are an important source of credit to U.S. households, businesses, and state and local governments. When properly structured, securitization provides economic benefits that lower the cost of credit."

http://www.occ.gov/news-issuances/congressional-testimony/2013/pub-test-2013-29-written.pdf

Thomas J. Curry. Comptroller of the Currency, 28 January 2013

"The credit-availability pendulum has swung, as it was bound to do, in reaction to poor performance of the underlying assets, home price instability, and a lack of investor demand for anything other than a government guaranteed product. As these factors abate, underwriting standards will need to find a new equilibrium of risk and reward for a sustainable mortgage market. Getting the securitization pipeline flowing again is a critical component in turning this picture around"

http://www.occ.gov/news-issuances/speeches/2013/pub-speech-2013-19.pdf