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BCBS Consultative document regarding Revisions to the Basel Securitization Framework

The Division Bank and Insurance of the Austrian Federal Economic Chamber, as representative of the entire Austrian banking industry, appreciates the possibility to comment on the document "Revisions to the Basel Securitization Framework " and would like to submit the following position:

I. Executive Summary

1. Securitisations constitute an important instrument for financing the real economy and are the link between the credit and capital markets. This is true both of term securitisations, used by banks to fund their credit business, and of ABCP structures (ABCP is used in this statement for (i) securitisation platforms, (ii) generally sponsored by a single bank, and (iii) irrespective of the type of refinancing which might be Asset Backed Commercial Papers, secured loans, secured notes or Schuldscheine), through which banks provide their corporate clients directly with liquidity, combined with relief for their own credit lines. Securitisation is used, in particular, as a direct or indirect means of financing larger SMEs, which form the backbone of the economy in many European countries. Typical key asset classes in the European securitisation market are consequently SME loans, trade receivables, leasing receivables and, not least, auto finance. For automobile manufacturers, sales financing – and refinancing – is one of the most significant strategic parameters for maintaining and expanding the business volume.

2. The underlying capital requirements presumably arising from the Consultative Document do not reflect economic reality in Europe or the outstanding development of performance of the European securitisation market, including during the crisis. In that respect, we thus note a marked contrast to the development of the securitisation market in the United States, which engendered the “originate to distribute” business model and, ultimately, supported by a combination of a lax lending policy and a relaxed monetary policy, led to the US subprime phenomenon. From the regulatory perspective, it would seem appropriate to us to adopt a differentiated view and,

ultimately, also a differentiated treatment of the very heterogeneous securitisation markets.

3. Unilateral – additional – regulatory discrimination of securitisations over other products seems inappropriate and should be urgently reconsidered. Ground is increasingly being gained by the realisation that the topic of asset encumbrance is closely bound up with the regulatory privileging of covered bonds, as the variability of coverage makes it possible to offset downgrades at the issuing bank to a certain extent through overcollateralization. There is no such negative, pro-cyclical dynamism in the case of securitisation. As it may also be assumed for the future that uncollateralised bank bonds will become increasingly unattractive to investors because of the bail-in issue, securitisations are a suitable complementary product that enables a diversified approach to raising long-term resources in the capital market.

4. In the meantime, numerous official analyses are also calling attention to the fundamental potential benefits of the instrument of securitisation, e.g. as an instrument for refinancing long-term assets and, in particular, as an instrument to securing funding for the SME sector. A host of regulatory standards for securitisations – in Europe, first and foremost, Article 122(a) of the CRD – have already been implemented and have led, in conjunction with the ECB's loan-level data requirements that apply as from this year, to securitisations, as compared with other credit products, having a benchmark character in terms of transparency, balance of interests and risk management. In the industry, the PCS label at the European level and the German securitisation standard of True Sale International in Germany are helping to enhance the quality of the securitisation market further still.

5. It would therefore also be important to create appropriate framework regulatory conditions that would enable the ABS investor base to be expanded by avoiding regulatory arbitrage and placing investors considering potential investments in a situation that would enable them, when taking their decisions, to weigh up alternatives without any kind of bias.

6. The outstanding quality of European securitisations justifies non-discriminatory regulatory treatment. In this Opinion we refer to the empirical material on both ABCPs and term securitisations as evidence of this quality, provided by True Sale International. A representative study on the German ABCP market published by True Sale International in 2011 showed, for example, that the ABCP transactions reviewed had, fundamentally, both better ratings and lower risk fluctuations than the enterprises involved. Robust structures meant that these customer transactions did not incur losses in the period under review at the liquidity-providing banks concerned or among ABCP investors. Even though no such study is available for the Austrian market, we are convinced from our own business experience that similar results hold true for the Austrian market. With regard to term securitisations, for the crisis period from 2007 to 2012, S&P has calculated that in Europe only 1.1% of the volume of bonds originally outstanding of EUR 2.8 trillion defaulted. In the case of many asset classes such as SME and auto finance, the values are even far better.

7. A non-differentiated calibration of regulatory models for the European securitisation market, based on empirically established figures derived for the securitisation market in the United States with its specific originate to distribute phenomenon, lax lending practices and non-existent right of recourse to borrowers, must inevitably lead to disproportionate results. We would therefore suggest that the current proposals to revise the securitisation framework be supplemented by a "high quality regime" for high quality securitisation positions. For transactions to which this high quality regime

applies, this should lead to correspondingly low risk weightings that remain the same as in the current rules. The allocation to the high quality regime should be based primarily on an assessment of the securitised portfolio and, in particular, be geared to aspects such as the close link of securitised assets to the real economy and the quality of the underlying assets. It is not new for account to be taken of this kind of quality features in supervisory assessment; it has already been enforced for securitisations in Austria by virtue of the implementation of Article 122(a) of the CRD II or Section 22 (f) of the Austrian Banking Act (BWG). Likewise, Article 124 of the CRD IV defines quality features of covered bonds, which distinguish between regulatory privileged covered bonds and other covered bonds. Similarly, features of high quality ABS should also be defined and incorporated into the provisions governing risk weightings of securitisations of that kind.

II. Basic comments

1. Overview

We welcome the opportunity to comment on the Consultative Document “Revisions to the Basel Securitisation Framework” and would like to proceed in our Opinion as follows. In Section II we show why the instrument of securitisation is of vital importance as a means of funding the real economy and of ensuring diversified bank refinancing and ultimately a stable financial system. We therefore perceive the need for a regulatory “level playing field” and present a practical proposal for its structure. This is based on the idea of the very heterogeneous securitisation market being given differentiated regulatory treatment, based on a distinction being made between an explicit high quality segment across all approaches and normal transactions. We consider term securitisations as well as ABCP structures and support our comments in Section III with detailed information on the development in the performance of securitisations during the crisis. Section IV summaries our deliberations once again and leads into Section V, which outlines what we consider a practicable, verifiable way of distinguishing “high quality” that is in line with the economic reality. Our comments and, in particular, sample calculations in Section VI quantify and illustrate the main concerns that we have with regard to the approaches presented in the present Consultative Document or rather the findings derived from it with regard to future risk weightings and underlying capital requirements for securitisation positions.

2. A differentiated view of the securitisation market is necessary

Securitisations constitute an important instrument for financing the real economy and are the link between the credit and capital markets. This is true both of term securitisations, used by banks and corporate leasing companies to fund their credit and leasing business, and of ABCP structures, through which banks provide their corporate clients directly with liquidity, combined with relief for their own credit lines. ABCP structures are particularly appropriate in the case of smaller volumes which do not, of themselves, produce the volumes required for term securitisation. With the exception of trade receivables, which, because of their generally very short maturities, are usually used for ABCP structures, all other types of assets related to the real economy can basically be refinanced through ABCP structures as well as through term securitisations. In practice, a mixed model is also frequently encountered, in which the assets to be securitised are collected in an ABCP structure until the volume required for a term securitisation is reached. Apart from the aforementioned trade receivables, our further comments will also deal, in particular, with the asset classes of SME loans, leasing receivables and auto finance.

With few exceptions in the past, which can be limited essentially to the CDO market, which is driven by arbitrage considerations, and the "subprime RMBS" phenomenon, which only concerns the USA, by far the greatest proportion of all term securitisations are used to refinance existing loan portfolios of banks, finance companies, industrial enterprises and leasing companies.
ABCP transactions, as an important sub-segment of the European securitisation market, assume considerable importance for the real economy as they constitute an alternative source of finance for enterprises with high volumes of receivables. This is relevant as ABCP transactions are of economic interest to small and medium-sized but also to large enterprises. Transactions of that kind offer enterprises a wider range of sources of finance and hence financial stability. As, for its risk estimate, the sponsor bank in an ABCP transaction draws almost exclusively on the financed asset portfolio, enterprises can thus refinance themselves to the greatest extent possible irrespective of their own credit rating.

Having said that, we suggest that, in addition to the current proposals to revise the securitisation framework, a "high quality regime" for high quality securitisation positions applicable to all approaches is introduced. In making that kind of distinction between high quality and "non-high quality", account should be taken, in particular, of structural transaction features and portfolio quality, in order, by analogy with the definition of "high quality assets" under the liquidity coverage ratio (LCR), to ensure consistent treatment across various regulatory areas. Moreover, it follows the idea of making a quality assessment of a securitisation position on the basis of processes and procedures checked by the supervisory authority, as has already been implemented in the context of Article 122(a) of the CRD II or, in Austria, through Section 22 (f) of the Austrian Banking Act (BWG) (for greater detail, see Section II below).

3. Lessons learned from the crisis: value retention, quality and flexible options for use

The underlying capital requirements presumably arising from the Consultative Document do not reflect economic reality in Europe and are in contradiction to important lessons which emerged clearly in the course of the crisis. This applies both to absolute and also to relative assessments of securitisation, especially if its performance is compared with that of covered bonds and adjusted for distorting effects. Unilateral – additional – regulatory discrimination appears inappropriate and should be urgently reconsidered. In this connection, we would also like to draw attention to the extensive, flexible options for the use of securitisation techniques, as are, not least, currently employed by the public sector to construct support or financing instruments as a means of overcoming the crisis, stabilising markets and funding the real economy.

Undesirable developments and exaggerations in the securitisation market in the United States doubtless reinforced the effects of the financial crisis in 2007, which was caused primarily by relaxed monetary policy and speculative overheating of the real estate market in the USA and was sustained for some time by pro-cyclical effects – especially as a result of mark-to-market evaluations. Viewed with hindsight, however, only an extremely small portion of the risks temporarily involved in the market prices of European securitisations turned into definite losses for investors, as we will show in Section III below. The market price distortions during the crisis among other credit products – in particular covered bonds – were more moderate only because of explicit public support measures or implicit support assumptions by market players. All in all, today both product groups present a similar – heterogeneous – picture, which is reflected in considerable differences in risk premia in individual market segments or asset classes, and hence in an equally differentiated risk or quality perception on the part of investors.

The relative value and the relative potential benefits of securitisations cannot be assessed without looking at the bigger picture and including the related collateralised instrument of covered bonds. A study recently published by Commerzbank[1] shows that there has been a paradigm shift driven by the crisis in the covered bond markets, which becomes apparent mainly in an adjusted creditworthiness structure of the overall market, a higher rating sensitivity and in a revised assessment of the parameter of liquidity. For example, the more than 80% share of AAA-rated covered bonds in 2009 has shrunk to a mere 47% today. At the same time, more than 60% of the ratings outstanding (cp. end-2009: 30%) now only have a buffer of, at most, one rating level in the issuer rating before a downgrading of the covered bond programme is inevitable. Following the collapse of market-making during the crisis, the liquidity situation in the covered bond market is described as "limited" or "down and staying there". By comparison, despite extensive methodological adjustments or tightening by the rating agencies, the European share of AAA rated securitisations is around 66% and is thus far higher. In the case of securitisations, the dependence on the issuer rating is far lower and counterparty risks can be flexibly offset by structural means. With regard to the liquidity situation, in terms of our concept of the high quality segment, if support measures – or assumptions – and current regulatory privileges are excluded, we see no structural drawback for securitisations compared to covered bonds.

4. Potential benefits of securitisations from the perspective of regulators and supervisory authorities

We are pleased that, particularly in recent times the potential benefits of securitisations have been highlighted in a number of official publications and statements, e.g. by the IMF, the G30, the ECB and the ESRB or, in the case of the ESRB report, regulatory consequences have been outlined especially in order to counter the risks arising from the unilateral regulatory privileging of covered bonds to date, which should tend to lead, by implication, to an increase in the relative attraction of securitisations.

Securitisation can essentially help to meet the growing need of the financial system for safe assets and hence ultimately increase its stability. Safe assets are needed, *inter alia*, as investment, to collateralise repo-transactions and, not least, to fulfil regulatory criteria such as, in the future, the liquidity coverage ratio. In its Financial Stability Review[2] of April 2012, the IMF pointed out that government bonds alone can no longer play the role of safe assets and recommended a policy of not unnecessarily impeding the supply of safe assets from the private economy as being of higher quality or securitisations and covered bonds that are embedded in safe prudential regulations. All in all, securitisations can help to increase the stability of the financial system by helping to prevent unilateral allocations of asset holdings.

[1] Commerzbank "Covered Bond Telegram", 12 February 2013.

[2] IMF "Financial Stability Review – Chapter 3 'Safe Assets: Financial System Cornerstone'", April 2012.

The recently published report by the G30 Working Group on Long-Term Finance[3] makes it very clear that for long-term growth financing in Europe with, compared to the USA, relatively little developed bond markets alternative financing channels must urgently be found to supplement conventional bank lending. A policy recommendation is therefore to provide support for the development of the markets for corporate bonds and securitisations. Regulators should take this recommendation as an incentive to create an appropriate regulatory framework for the development of the securitisation market for the purposes of refinancing long-term assets. This should allow SMEs, in particular, access to the capital market. A step in that direction would certainly be to expand the existing investor base for term ABS by avoiding regulatory arbitrage and by placing investors considering potential investments in a situation that would enable them, when taking their decisions, to weigh up alternatives without any kind of bias. We therefore consider prohibitive risk weightings or underlying capital requirements that are felt to be relatively disproportionate to be counterproductive, leading to a further shrinking of the investor base and to short-term irreversible damage for the market as the available infrastructure and human resources will presumably be further reduced.

The crisis is known to have led to a clear trend towards increasing the collateralisation of financial transactions, e.g. in derivatives with collateral. Likewise, every form of collateralised refinancing in the broadest sense, e.g. (private) repos, ECB transactions such as LTROs, and in the case of covered bonds and to a limited extent securitisations, too, has shifted more strongly into the focus of investors. If a bank becomes insolvent, a privileged servicing of collateralised creditors follows, to the detriment primarily of those who have invested in uncollateralised bonds and national deposit guarantee schemes. Supervisory authorities, including recently BaFin,[4] ESMA[5] and, not least, the ESRB,[6] are increasingly acknowledging the phenomenon of asset encumbrance and addressing it as a matter for discussion. Asset encumbrance is a dynamic phenomenon and is not only dependent on the development of issue volumes but also on the behaviour of the issuers in the case of a worsening of creditworthiness and on the criteria set by the rating agencies, in that the volume of cover required to achieve or maintain a specific target rating comes into play. As no consequence in the sense of a more advantageous or non-discriminatory regulatory framework with regard to securitisations has been derived, as we understand it, a reversal in the trend is occurring as a result of the aforementioned ESRB opinion. In the future, extensive – and, in our view, welcome – measures should evidently be initiated at the level of banks' risk management and as part of prudential monitoring and, not least, with regard to the creation of transparency for all market players. The advantages of securitisations with regard to asset encumbrance should then automatically come to the fore. As the time frame for the ESRB project extends until the end of 2016 and distinct market effects should presumably materialise only thereafter, we urgently recommend avoiding placing an excessive burden on the securitisation market through current regulatory plans such as the revision of the framework.

[3] Group of Thirty – Working Group on Long-Term Finance: "Long Term Finance and Economic Growth", 11 February 2013.

[4] BaFin "BaFinJournal 07/12 - Asset-Encumbrance: Was wird aus unbesicherten Bankanleihen?", July 2012.

[5] ESMA "Report on Trends, Risks and Vulnerabilities No 1", January 2013.

[6] ESRB "Recommendation of the European Systemic Risk Board of 20 December 2012 on funding of credit institutions", 18 February 2013.

III. Documentation of the quality of securitisations based on a performance analyse for ABCP programmes and term securitisations

1. Performance of European ABCP programmes

In recent years, there has been a fundamental change in the European ABCP programmes, which now function primarily as an instrument used to finance the real economy, as illustrated, for example, in a presentation by Moody's on 15 November 2012 ("Moody's 10th Annual Asset-Backed Commercial Paper Conference"). According to that presentation, between July 2007 and August 2012 the share of arbitrage-driven ABCP programmes decreased from 22% to 4%, and the hybrid share also declined from 22% to 18% ("mixed" programmes, used to finance securities and customer receivables). By contrast, in the five years under review, classic multi-seller programmes, through which the receivables portfolios of customers of the sponsor bank are mostly financed, recorded an increase of 28% to 50%. Roughly 70% of the portfolios of multi-seller conduits consist of trade receivables, auto loans and leases and consumer loans.

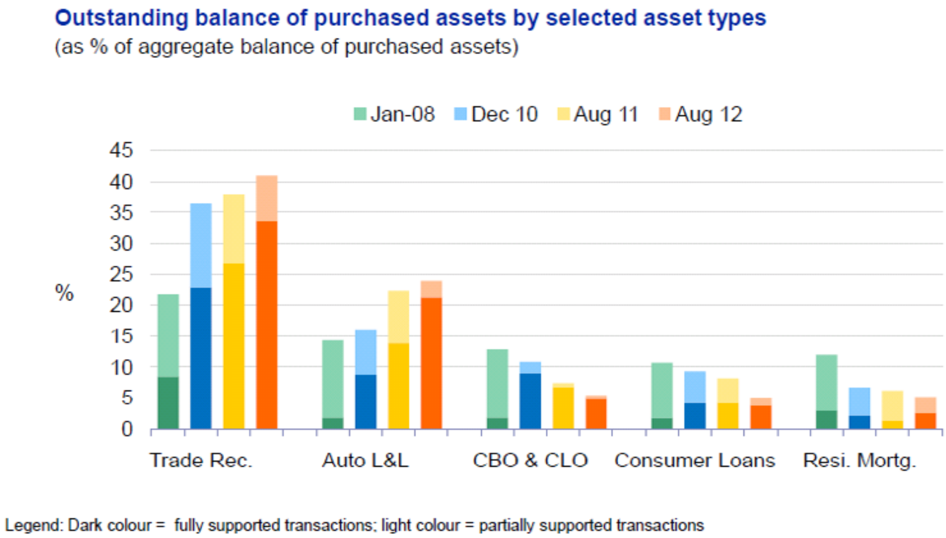

Figure 1: Volumes of purchased assets outstanding

The importance of ABCP transactions for the real economy is shown by the fact that, according to Moody's, the volumes of trade receivables financed via European ABCP programmes amounted in June 2012 to some USD 30 billion.

In January 2011 the True Sale International ("TSI") published a representative study of just under 90 customer transactions by leading German providers of securitisation programmes for leasing and trade receivables.

In each case, the analysis addressed the expected loss rating of the transactions and the corporate/company rating of the purchaser of the receivables. The review period extended from 2008 to 2010.

The study revealed that the ABCP transactions had fundamentally better ratings and lower risk fluctuations than the enterprises involved. In the course of the crisis, the transaction

ratings also regained their original level faster than the corporate ratings, especially as structural elements of the ABCP transactions proved to have a stabilising effect.
The robust structure of the transactions meant that, in the case of customer transactions, no losses were incurred either by the liquidity-providing banks concerned or among the ABCP investor as a result of four seller insolvencies in the period under review.

As a rule no external ratings are available for transactions of that kind, so the sponsors developed elaborate internal procedures, which have been subject to a stringent acceptance check by the national regulatory authorities (internal assessment approach). The following rating categories thus represent the sponsor's internal ratings (derived from the expected losses for liquidity lines).

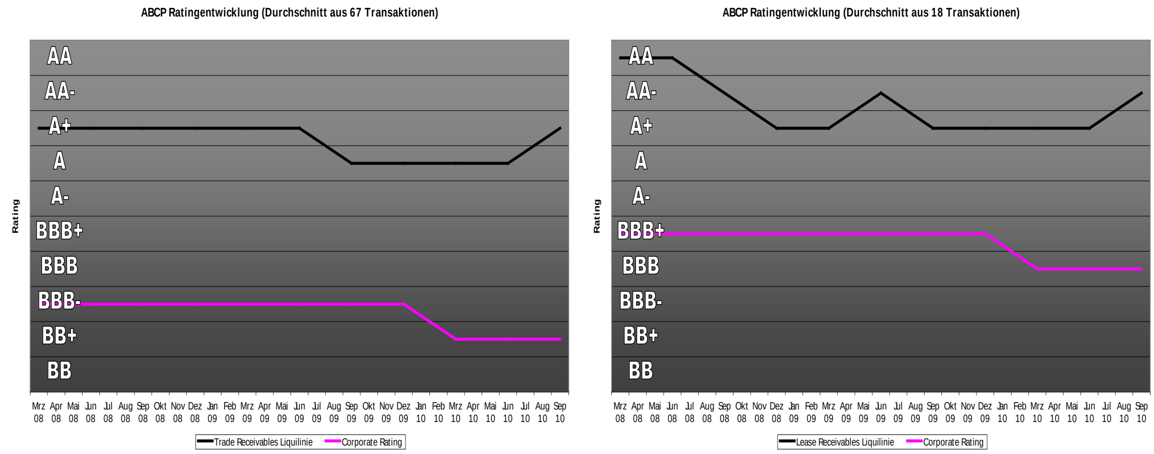

Figure 2a) and b): ABCP rating development of the basic population reviewed

The average internal ratings of trade receivables securitisations were accordingly in the single A category, while leasing receivables generally fluctuated between AA and A+. By contrast, the corresponding internal ratings of the receivables purchasers concerned were in the lower investment grade area and hence 3 to 5 notches below the liquidity lines. Against that background, it seems difficult to understand that sponsors would be burdened, for their liquidity lines, with capital weightings that are in most cases at or above the level of uncollateralised corporate risks.

To give an example, a BBB-rated corporate has an ABCP transaction for his granular trade receivables portfolio. The liquidity line for this transaction is A+ according to the sponsor bank's internal rating procedure (maturity: 365 days). In accordance with the present procedure, this liquidity line would be subject to a capital weighting of 10%. The new calibration takes the capital weighting of the liquidity line from 10% to 71% – seven times the original percentage – while the risk remains unchanged!

If, in the example given above, the transaction were executed with a leasing company with leasing agreements of up to 5 years, the capital weighting would soar from 10% to 124% (!) more than ten times the RWA. That is completely out of keeping with the good performance of German leasing receivables (see Section IV).

For this type of real economy securitisations, we therefore consider it necessary to calibrate the approaches to the underlying capital requirements (essentially, the IAA) available to the sponsor banks in such a way (and, as appropriate, to set them alongside the MSFA) that permits a continuation of that kind of corporate financing that is easy on capital. To that end, a contribution could be made by broadening the scope of application of IAA to structures that are not refinanced through money market paper while at the same time adjusting the capital weightings for mid-range ratings in the single A area, with overall comparable levels as in the MSFA.

Alternatively, another solution might be for the MSFA to be extended so that, as part of a top-down approach, portfolio parameters might also be fed into the MSFA instead of loan-by-loan data (as a rule not available for these transactions). It should be possible to determine these portfolio parameters (essentially, PD and LGD) through IAA models that already exist and for them also to be used for foundation IRB banks without any further, time-consuming IRBA acceptance.

2. Performance of European term securitisations

S&P[7] has calculated that, after five years of crisis or until mid-2012, of an original volume of bonds outstanding of EUR 2.8 trillion, only 1.1% or EUR 30.7 billion defaulted in the European securitisation market. In relation to the original share of AAA bonds in the total volume of 88% or EUR 2.4 trillion, the cumulated default rate is even as low as 0.82%. The final loss for bond investors is further reduced by the relevant utilisation rate.

In said five-year period, the rating of around two-thirds of the bonds outstanding remained stable or was slightly upgraded, while roughly one-third of the bonds were downgraded – some of them distinctly. The rating downgrades came about in many cases not because of poorer pool performance than expected but because of worsening national ratings, increased counterparty risks and stricter rating criteria being applied by the agencies.

In terms of rating changes and default rates, the performance of the European securitisation market can thus be described overall as robust. The picture is even more positive if the very heterogeneous overall market is differentiated on the basis of individual asset classes. For instance, the cumulated default rates for consumer ABS (0.03%), RMBS (0.07%) or SME securitisations (0.23%) are well below the above-mentioned average value of 1.1%. By contrast, the performance of multiple securitisations (3.44%), structured credits (5.1%) and CMBS (4.55%), in particular, is below average.

The reasons for the very different performance developments of individual asset classes are complex. The main ones that should be cited here are the originate-to-distribute business model, the construction of arbitrage products that are unrelated to the real economy, and structural differences in the underlying credit markets, such as, for example, lending standards and legal standards such as the right to have recourse to the borrower. At this juncture, it should be pointed out that the securitisation markets are very heterogeneous and that individual market segments are very different from one another in terms of their quality or their risk profiles and hence a regulatory approach based on the principle of “one size fits all” is misleading or leads to underlying capital requirements that, in individual cases, are not adequate.

In particular, we would like to point out in this connection that a calibration of regulatory models for the European securitisation market, based on empirical values that were obtained

[7] S&P “Five Years On. The European Structured Finance Cumulative Default Rate Is Only 1.1%”, 23 August 2012.

for the US subprime RMBS securitisation market (originate-to-distribute, historically under-regulated, recourse to real estate or borrowers), inevitably lead to disproportionate findings that are out of keeping with the economic reality, even if viewed conservatively. For instance, the above-mentioned S&P study indicates for the USA a cumulated downgrade rate of 51% (Europe: 32.8%) and a far higher cumulated default rate of 14.84% (Europe: 1.1%) an. This is essentially attributable to the very poor performance of the US subprime RMBS market. At no time in Europe or particularly in Austria have there ever been lax lending practices such as those that were at the root of the problem or a corresponding distension of an entire credit market segment with a low credit rating such as the US subprime market. This important structural difference also becomes apparent, *inter alia*, in the completely different anticipated lifetime portfolio losses of various asset classes. The following table[8] thus illustrates not only the significant difference in the levels of US and European asset classes. The table shows the average cumulated lifetime losses currently expected by Moody's for individual RMBS categories at portfolio level as a percentage of the original transaction volume.

Jg./Asset-Klasse	US Subprime	Alt-A	CES	HELOC	UK Prime	UK NC	UK BTL	Dutch RMBS	Spanish RMBS
2005	18,60%	12,70%	31,00%	18,00%	4,20%	4,20%	2,06%	0,54%	1,26%
2006	38,70%	25,40%	63,00%	45,00%	9,40%	9,40%	1,94%	0,66%	2,21%
2007	48,60%	29,40%	72,00%	46,00%	7,20%	7,20%	2,38%	0,50%	3,84%
2008	n/a	n/a	n/a	n/a	5,40%	5,40%	2,63%	0,63%	2,87%
2009	n/a	n/a	n/a	n/a	4,00%	4,00%	n/a	0,78%	2,42%
2010	n/a	n/a	n/a	n/a	n/a	n/a	2,50%	0,55%	9,75%
2011	n/a	n/a	n/a	n/a	n/a	n/a	2,50%	0,73%	6,16%
2012	n/a	n/a	n/a	n/a	n/a	n/a	n/a	0,65%	4,68%

Figure 3: Anticipated cumulated lifetime losses at portfolio level

According to a study by Fitch Ratings,[9] globally in the period from 2000 to 2011, for an original bond volume outstanding of USD 9.5 trillion, only 1.5% was ultimately booked by investors as a loss. Over the entire lifetime of the bonds, losses amounting to 4.9% are expected. Of the losses incurred to date, only 57.4% out of a volume share of 28.3% concern US RMBS. If the losses are segmented on the basis of the year of issue, more than 99% relate to the years up to and including 2008.[10] This is primarily due to ensuing more stringent lending criteria and more robust transaction structures (e.g. excess).

There is certainly no question that at times in the course of the crisis, huge market value losses were incurred by portfolios of structured products. However, large parts of these market value losses have been reduced and corresponding value recoveries have been recorded. Given the market price risk component included in the new Securitisation Framework for the purpose of taking account of potential mark-to-market losses, we consider it appropriate to point out that, in this respect, it would be desirable to create a level playing field across various collateralised and uncollateralised instruments.

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[8] Moody's "Global Structured Finance Collateral Performance Review", 4 February 2013.

[9] FitchRatings "Global Structured Finance Losses 2000-2011 Issuance", 22 October 2012.

[10] To explain this quality leap, the study states: "No losses are expected on transactions issued from 2008 onward, reflecting the increased credit protection provided to investors since then. In addition, Fitch introduced revised rating criteria for all asset types, starting in 2008, to provide a more robust analytical framework to address the default and recovery risks of the underlying collateral."

3. Performance of German term securitisations

The very good performance development of key German asset classes can be illustrated by taking the example of auto ABS (loans or leasing receivables) and SME CLOs. As an example of auto ABS, we will take the Volkswagen Driver (loan) Series or VCL (leasing receivables) Series and, as an example of SME CLOs, the transactions in the PROMISE series.

Solely with its German transactions, Driver auto ABS have so far achieved a cumulated issue volume of around EUR 18 billion. To that must be added some foreign transactions and more than EUR 15 billion in issue volumes under VCL leasing transactions. Numerous subsidiary bond tranches in both series have been given a rating upgrade during their term owing to above-average portfolio development. There have been no downgrades so far.[11]

The rating development ultimately reflects the very good pool performance of both series, some of which has even exceeded the expectations of the agencies, with minimum cumulated loss rates that are currently well below the 1% mark (see the following figures).

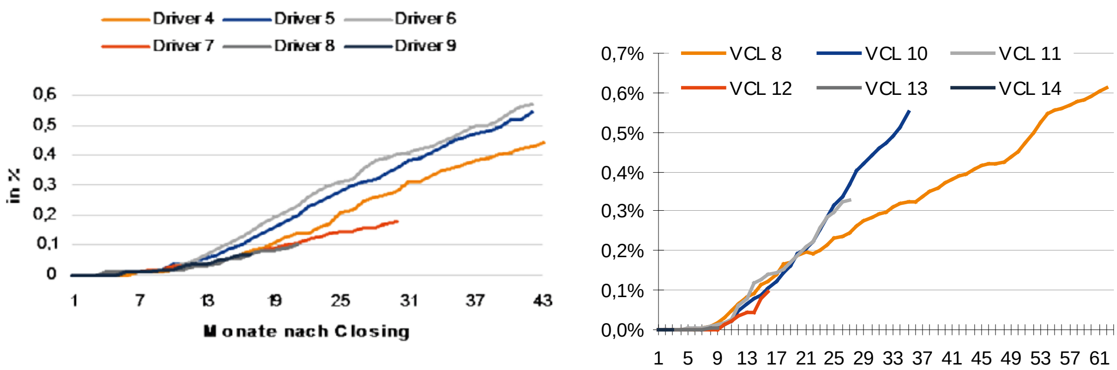

Figure 4 a/b: Cumulated portfolio losses in % of the original pool volume for auto loans (Driver Series) and auto leasing (VCL Series)

Even within European auto ABS, which is developing very well overall, German auto ABS occupy a leading position (see the following figure).

[11] For further details of the Driver Series, see DZ BANK "ABS & Structured Credits – Driver Ten", 16 January 2013.

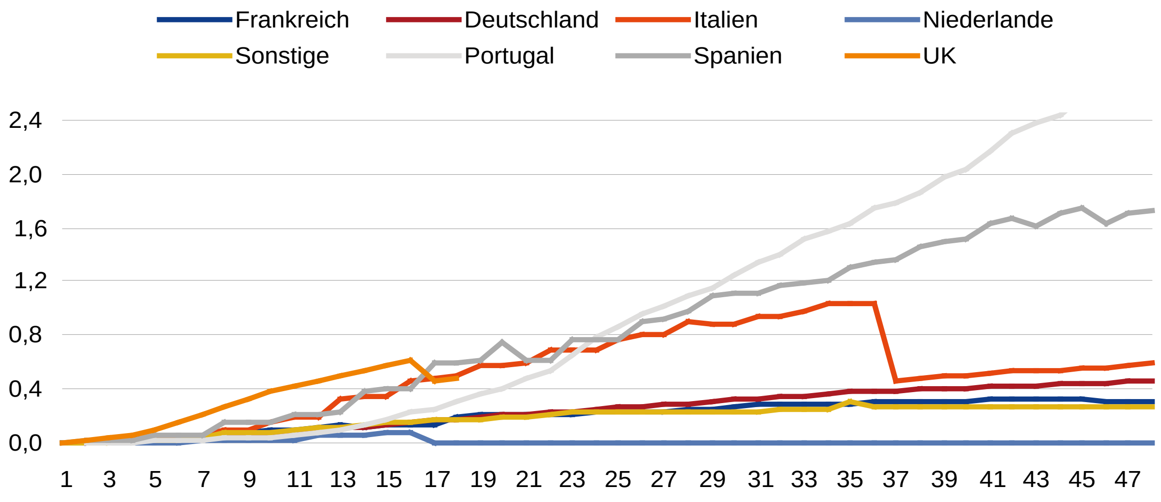

Figure 5: Cumulated portfolio losses of European auto ABS in % of the original pool volume; Source: DZ BANK, Moody's, Bloomberg; January 2013.

Since 2000 24 synthetic German SME CLOs[12] with a total volume of some EUR 40 billion have been placed in the market via KfW's PROMISE platform.[13] The pool performance developed very well across all transactions, with, apart from a few exceptions, a cumulated default rate of below 2% and relatively high utilisation rates, which has ultimately led to realised portfolio losses that are generally well below 1%, as the following figures show.

[12] As already mentioned, a clear distinction must be made between the on-balance-sheet transactions in the PROMISE series described here and arbitrage-type transactions such as were issued in the period from 2005 to 2007 as the only noteworthy and inglorious example to date of originate-to-distribute in so-called mezzanine programmes in Germany. In the portfolios securitised in this way, numerous defaults occurred very quickly, which ultimately also led to a large number of marked rating downgrades of bonds. *De facto*, this transaction model no longer exists. For a detailed comparison of the performance of German mezzanine and on-balance-sheet transactions, please refer to the literature, e.g. Frank Cerveny/Markus Schmidtchen "Performance deutscher Mittelstandsverbriefungen in den Jahren der Krise", in *Zeitschrift für das gesamte Kreditwesen* 19-2010, pp. 1020 ff., 1 October 2010.

[13] With additional SME CLO transactions by foreign originators amounting to around EUR 10 billion and synthetic RMBS in the PROVIDE series, a total of 69 transactions, representing a volume of EUR 125 billion, have been executed via KfW platforms since 2000.

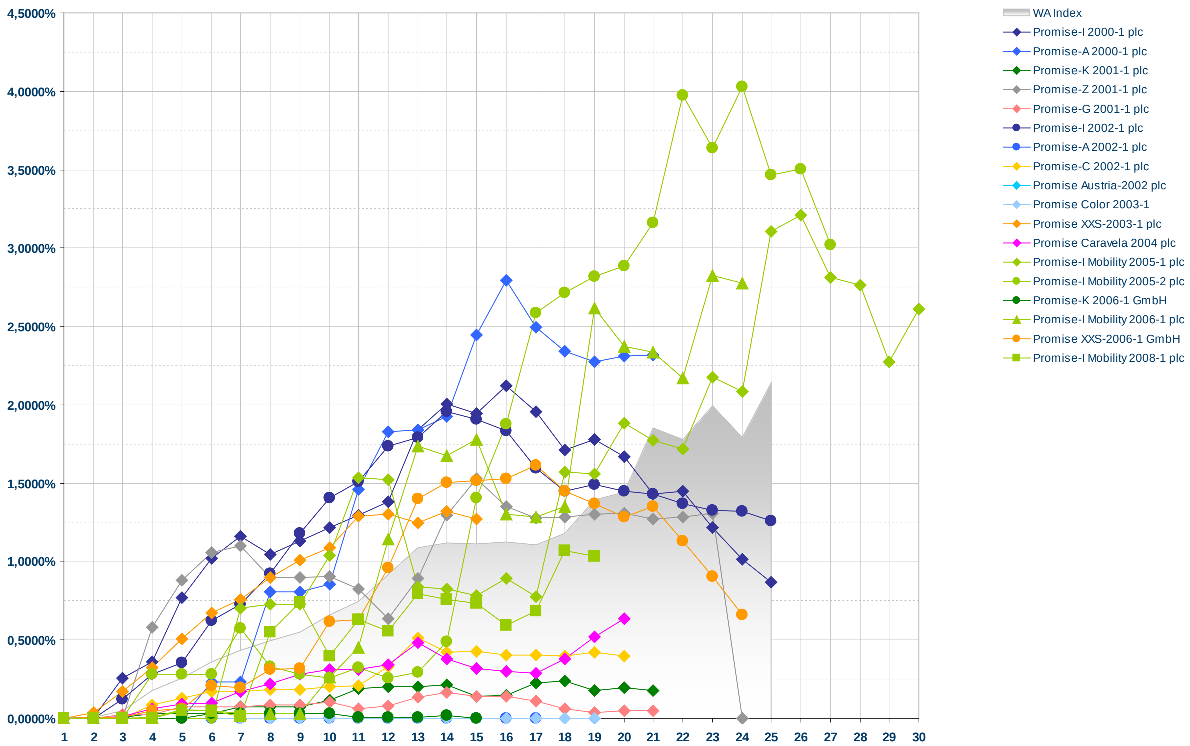

Figure 6: Cumulated portfolio default rates of SME CLOs in the PROMISE Series (in % of the OB; end-2012)

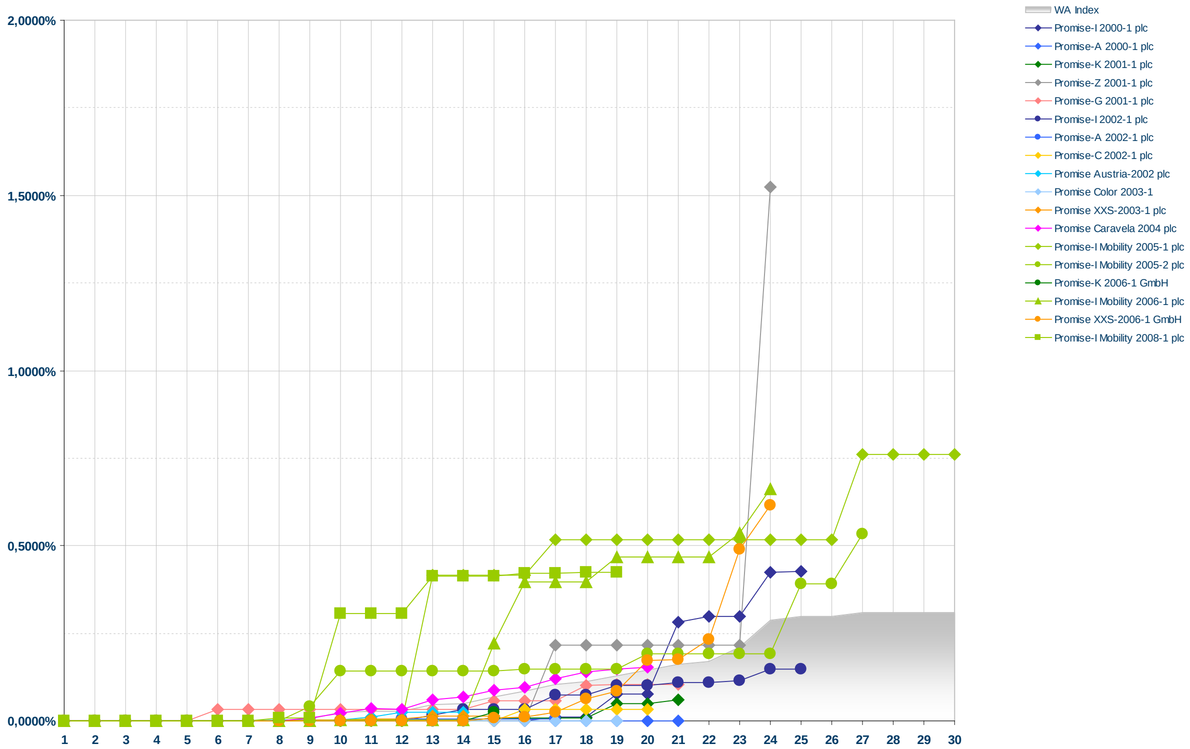

Figure 7: Cumulated realised portfolio losses of SME CLOs in the PROMISE Series (in % of the OB; end-2012)

IV. Conclusion

It remains to draw attention to the major importance, which is likely to increase in the future, of securitisations as an instrument used to fund the real economy. To fulfil this task, a regulatory framework is needed that contributes to the quality and transparency of the markets and that places as many investors as possible in an unbiased position when weighing up various investment alternatives. The risk weightings arising from the current proposals will have a prohibitive impact for many investors, similar to after the final stage of Solvency II, and force them out of the market.

When viewed from the perspective of financial stability, this effect must be called into question as investors and banks are being deprived of diversification opportunities and unilateral steering or promotion of individual products will generate knock-on effects such as excessive asset encumbrance, which will be accompanied by high risks for the future of the financial markets.

Owing to the risk weightings proposed in the Consultative Document, the attractiveness of ABCP transactions as a refinancing instrument for corporates, SMEs and leasing companies will also be very much reduced as a result of the associated increase in costs. As it will be difficult to offset the loss of this source of refinancing for bank customers by alternative financing instruments, regulatory change of this kind would lead to direct impairment of the real economy.

Because of the heterogeneity of the securitisation market, we fundamentally consider that to treat all securitisations without differentiating between them on the basis of a “one size fits all” approach will not be expedient from the perspective of the regulator either. All in all, excesses in individual asset classes occurring primarily outside Europe would lead to rules that unjustifiably penalise large parts of the overall market, make it unattractive for investors and ABCP sponsor banks and actually stifle it.

In Section V of this Opinion we take specific numerical examples to show the inadequate feasibility and the lack of consistency of the various procedures presented in the Consultative Document, as well as, as we see it, absolutely disproportionate results, given the outstanding performance of the European securitisation market even during the crisis, as described above. These are clearly out of keeping with the prevailing underlying reality – in Europe – and will lead to an exodus from the market before they have even been implemented, with lasting damage being done to a fundamentally exceptionally valuable and beneficial instrument. Unilateral regulatory privileging of covered bonds will sooner or later lead to undesirable follow-on effects, which jeopardise financial stability at the system level. As securitisations are the only valid alternative that can be used to complement covered bonds, we urgently advocate the creation of a corresponding regulatory level playing field.

Our analysis in Section V of the approaches presented in the Consultative Document first reveals inadequate practical feasibility as necessary information, such as, in particular, K_{IRB}, is regularly unavailable to the investor or, in the case of ABCP, the sponsor or the application requirements for the MSFA have been drawn to narrowly. Keeping complexity as low as possible and operability as high as possible, particularly with regard to the possible feasibility for procedures for the trading book, the various approaches should also represent genuinely viable alternatives for the banks. The calibration of the various approaches should lead to consistent results but also to results that lead, on the one hand, in sound relation to the capital requirements, to a securitisation tranche with account being taken of structural collateralisation, and, on the other hand, of the underlying non-collateralised portfolio of receivables. Not least, the results should, as already stated, appropriately reflect the long-term good quality of European securitisations. To separate the wheat from the chaff with a view to risk and accordingly provide evidence of the differentiated underlying capital requirements, we propose that the various approaches be calibrated using different parameters for the high quality and non-high quality segments.

We would like make it clear to the BCBS that the following forms of securitisation do not, and will not, have fundamentally nothing to do with what we understand as "high quality" and that they do not play a role in our considerations – i.e. the considerations of the finance industry – on a meaningful further development of the market, although, at least in Europe, the product variants are already almost totally marginalised:

(1) Re-securitisations in the form of CDO^n, as they have at best an indirect relation to the real economy and are primarily driven by arbitrage or margin generation and financing aspects doe not play a role.
(2) Any kind of arbitrage transactions, even outside re-securitisations, such as (synthetic) CDOs or leveraged loan CLOs, which are at least predominantly driven by arbitrage or margin generation and financing aspects play only a secondary role.
(3) Originate-to-distribute transactions such as older forms of US subprime RMBS, whose basic structure do not allow for any balancing of interests between the originator and the investor.
(4) Forms of securitisation with a substantial inherent refinancing risk, as is the case, for example, in many CMBS transactions, as the underlying commercial real estate finance is mostly due on maturity and when the bonds mature, follow-up financing and/or additional capital is required. This makes the repayment of CMBS dependent to a considerable extent on future market conditions that are difficult to forecast.

V. Proposed introduction of a high quality regime

The various approaches of the Basel Committee with regard to the future determination of the risk weightings for securitisation positions are based primarily on structural features of the transactions and on the external rating of the positions. Compared to the current rules, all proposed hierarchies and procedures amount to a marked increase in the risk weightings.

Even if the Committee justifies its proposals on the basis of experience gained of the performance of securitisation positions during the financial crisis, this global and comprehensive intensification of the capital requirements for securitisations does not take fair account of the differentiated performance of securitisation transactions during the financial crisis.

Our introductory analysis of the securitisation market over the past few years indicates rather that problematic transactions can be largely restricted to specific market segments and that large parts of the market functioned according to expectations and without disruption even during the crisis.

The need for a fundamental increase in the risk weightings solely on grounds of the prudential classification of a credit risk position as securitisation positions definitely cannot be derived from the market analysis. Rather, alongside the transaction structure of which the Committee has taken account, the decisive feature for the performance of securitisation positions has proved to be the quality of the securitised portfolio.

The proposals of the Committee regarding the revision of the capital requirements for securitisation positions should, in our opinion, therefore be supplemented by a “high quality regime” in the various methodological approaches (MSFA, RRBA, IAA, SSFA, BCRA, etc.). In that regime, high quality positions should be taken into account together with risk weightings that, unlike in the current rules, remain unchanged. The definition of “high quality” should be integrated as an independent calibration into all methodological approaches to determine the risk weightings of securitisation positions. In addition, the “high quality regime” should be applied not only to the two hierarchies A and B proposed by the Committee, but also more broadly defined than the “senior high quality” referred to in hierarchy B. The allocation of a position to the “high quality regime” should be based primarily on the assessment of the securitised portfolio.

The actual criteria for allocation to “high quality” should be geared, in particular, to securitised receivables having a close relationship to the real economy and to the quality of the collateral.

An approach that takes account of quality features of the portfolio as well as the pure transaction structure and the rating in the prudentially relevant internal assessment of a securitisation position is not new and has already been put into practice in the institutions by virtue of the implementation of the CRD (Article 122(a) of the CRD II or Section 18 (a) and (b) of the Austrian Banking Act in Austria).

Furthermore, Article 124 of the CRD IV also defines quality features of covered bonds that entail regulatory privileging of the corresponding products. The criteria referred to by the supervisory authority in that Article draw on the experience of the markets. We support this correct approach and recommend also implementing a “high quality” segment in the various procedures of the new capital regime for securitisation positions.

Kindly give our remarks due consideration.

Yours sincerely,

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Division Bank & Insurance
Austrian Federal Economic Chamber

Annex 1: Literature and sources

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