

A response by the British Bankers Association to the Basel Committee on Banking Supervision's consultative document on

Capital treatment for "simple, transparent and comparable" securitisations

February 2016

Introduction

The BBA is pleased to respond to the Basel Committee's consultation paper 343 proposing changes to the capital treatment for "simple, transparent and comparable" securitisations¹.

The BBA is the leading association for the UK banking sector representing members on the full range of UK and international banking issues. It has over 200 banking members active in the UK, which are headquartered in 50 countries with operations in 180 countries worldwide. Eighty per cent of global systemically important banks are members of the BBA.

As the representative of the world's largest international banking cluster the BBA is the voice of UK banking.

All the major banking groups in the UK are members of our association, as are large international EU banks, US and Canadian banks operating in the UK and a range of other banks from Asia, including China, the Middle East, Africa and South America. The integrated nature of banking means that our members are engaged in activities ranging widely across the financial spectrum, from deposit taking and other more conventional forms of retail and commercial banking to products and services as diverse as trade and project finance, primary and secondary securities trading, insurance, investment banking and wealth management.

Our members manage more than £7 trillion in UK banking assets, employ nearly half a million individuals nationally, contribute over £60 billion to the UK economy each year and lend over £150 billion to UK businesses.

Many of our members currently use securitisation structures as a liquidity management tool and some of our larger members that have had active securitisation programmes in the past would like to make greater use of this important risk transfer and funding mechanism. Our smaller members also see similar benefits in using securitisation structures.

In responding to the consultation paper we provide some high level comments before referencing particular elements of the consultation paper.

¹ <http://www.bis.org/bcbs/publ/d343.pdf>

Key messages

The reduced capital requirements for STC securitisations are not reduced enough

We support the proposals that simple, transparent and comparable (STC) securitisations should attract reduced capital requirements and see this as a key component in reviving the securitisation market and providing an alternative to bank funding, particularly in Europe where corporates are more reliant on facilities provided by banks than in other parts of the world where there are deeper capital markets.

However it is our view that the reduction in capital for STC compliant securitisations proposed in the consultation paper does not offer a sufficient incentive to revive the securitisation market. Our members look forward to working with the Committee to consider the output from the QIS in order that the revised approach can be calibrated to deliver an impactful, risk sensitive reduction in the capital requirements for STC securitisations.

Divergence should be avoided and reductions harmonised

Deep and liquid global securitisation markets are an important element in ensuring capital markets can support global economic growth and job creation. The application of common criteria across jurisdictions and financial sectors will be an important element in ensuring they can do this.

Wherever possible, capital requirements, across jurisdictions and financial sectors should be identical.

If different components of the financial services industry are required to hold capital against securitisations exposures differently, be they originators/sponsor banks holding part of the credit risk of the underlying assets to meet retention requirements, banks using securitisation structures to manage liquidity risk or insurers, pension funds or collective investment schemes using them to match asset and liability portfolios, this objective will not be achieved.

We encourage the Basel Committee and IOSCO to continue to work together and engage with the International Association of Insurance Supervisors to ensure a common cross-sector and internationally harmonised approach to the risk weighting securitisations. Divergence creates the possibility of regulatory arbitrage, but more importantly prevents the 'joined-up' approach that is required if the benefits of securitisation in supporting economic growth and job creation are to be fully realised.

The application of the risk weighting reductions and eligibility criteria for STC compliant securitisations should be consistent across jurisdictions and not result in securitisation exposures with similar credit risk profiles having different capital treatments depending on the location, or form of the investor or issuer.

A divergence in risk weights could entrench 'home country bias' and reduce cross-border issuance, damaging one of the benefits of securitisations, which is the broad distribution of risk, both across countries and across the full spectrum of participants in the financial markets.

Similarly different implementation dates and transition periods would avoid uncertainty on the part of both investors and issuers in different jurisdictions, which is likely to impede the early re-development of the global securitisation markets.

To this end we also encourage the Basel Committee and the European Commission to work together to ensure that STC and STS requirements are as closely aligned as possible.

The impact of other regulatory requirements should be considered

Whilst the reduction of risk weightings for STC compliant securitisations may be beneficial in encouraging the revival of the securitisation market, although only in our view if the p and floor factors are lowered further, both the Leverage Ratio and Liquidity Coverage Ratio will impact the appetite of banks to originate and hold STC securitisations. We encourage the Basel Committee's sub-group on coherence to review the interaction of the STC framework with the Leverage and Liquidity regimes to ensure they do not work against each other but act in a complementary fashion that enables the overall objective of greater securitisation issuance to be achieved.

Short term asset backed and synthetic structures matter too.

We welcome the Committee's continuing consideration of the potential widening of the scope of STC criteria to include Asset Backed Commercial Paper (ABCP) programmes which can provide a cost-effective, receivables based, source of funding for smaller corporate entities. Whilst we understand the Committee's concerns about inappropriate maturity transformation based on their performance during the global financial crisis we but believe this risk is now significantly reduced by the introduction of the Net Stable Funding Ratio (NSFR) and Liquidity Coverage Ratio (LCR) requirements. Excluding ABCP from the STC regime will create an unnecessary burden for banks and the business they finance given that the LCR and NSFR requirement have been specifically designed to mitigate the maturity transformation risk that ABCP programmes highlighted in the wake of the global financial crisis.

We note that the Committee is determined that synthetic structures should remain outside the scope of the STC framework. The recent EBA report on synthetic securitisations² correctly distinguished between synthetic transactions undertaken for arbitrage purposes compared to synthetic structures used by banks for legitimate risk transfer of core assets they originated as part of their ordinary banking business. It showed that the default performance for traditional securitisations and these "business-as-usual" synthetic structures was similar. So where banks use synthetic structures to transfer risk from their balance sheet we would welcome a further review by the Basel Committee and IOSCO of their position on the applicability of the STC framework to this second type of synthetic securitisations.

STC compliance should be principles based

Whilst we think some of the additional guidance in relation to the criteria is helpful, subject to our more detailed comments below, we prefer a principles based approach, focusing on the criteria themselves. Where it is felt that guidance is critical to the interpretation of the criteria for regulatory capital purposes it should be incorporated into the criteria themselves. If it is not they should be deleted.

² <https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-26+EBA+report+on+synthetic+securitisation.pdf>
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If the Committee decides to retain the additional guidance it should be clear that it should not be, or be able to become, a binding requirement and a statement from the Basel Committee confirming this is the case would be very welcome, albeit that we believe this to be the Basel Committee's current intention.

Q1. Do respondents agree with the rationale for introducing STC criteria into the capital framework? Are there any other aspects that the Committee should consider before introducing STC criteria into the capital framework that are not already reflected in the rationale above?

Yes. We support the rationale for introducing internationally agreed STC criteria into the capital framework for securitisation. But as we note above additional guidance and clarification should only be introduced where absolutely necessary and has international relevance and applicability. For instance where the additional guidance would be dependent on legal interpretations that would differ between jurisdictions such differences should be accommodated by a mutual recognition approach. This would avoid silo-ing and creating a home country focus, creating multiple STC regimes to the detriment of the depth and the liquidity of the securitisation market.

Q2. Do respondents agree that, for the purpose of alternative capital treatment, additional criteria are required? What are respondents' views regarding the additional criteria presented in Annex 1?

We broadly agree that some, but not all, additional clarification and guidance may be helpful but that, where necessary, as we note above, consideration should be given to their inclusion in the criteria themselves, whilst keeping them principles based. We comment below on some of the proposed additional guidance.

A1 – Nature of assets

We agree that homogeneity of asset type is in principle an important additional criterion but are concerned that a number of elements of the additional guidelines may present problems in the UK, where for instance there are three distinct legal systems, England and Wales, Northern Ireland and Scotland. As we note above a mutual recognition approach would ensure that the relevant elements of each system of law are identified as being equivalent.

Similarly the requirement for all exposures in the pool to be in the same currency will present difficulties in packaging SME exposures where the trade financing transactions on which they rely may be denominated in a range of different currencies depending on the country of residence of the SME's customer or supplier.

A2 - Asset Performance History:

The additional guidance in relation to asset performance, requiring the identification and assessment of performance history, ideally over at least one economic cycle will be difficult to meet. It is likely that different investors will have different views of the length of economic cycles rendering this additional requirement open to interpretation and thus unlikely to promote a harmonised approach.

Investors should be permitted to make their own assessment of the time frame over which they subject projected cash flows to stress, and the parameters used in performing such stress testing.

The minimum requirement performance history requirement - 7 years for non-retail exposures and 5 years for retail exposures - may be difficult for some originators to fulfil and discourage new entrants and new asset classes, which would run counter to the one of the objectives of the STC approach.

So we recommend that this additional requirement for capital purposes be deleted.

A4 – Consistency of underwriting

We fully support the requirement for originators to disclose when they have changed underwriting standards but do not consider that the additional requirements add anything, reflecting as they do good banking practice as embodied in the Basel Committee's supervisory standards, guidelines and Core Principles. They should be deleted. However if the Committee determines that the additional guidance should remain we recommend change the emphasis to ensure that underwriting standards for retained and securitised assets are the same.

A5 – Asset selection and transfer

We question whether it is necessary to require the legal opinion on the true sale and transfer of assets to the securitisation vehicle to be given by an independent third party. Qualified lawyers in our members, who operate to their own regulatory body's requirements, are capable of giving an independent opinion and this should be permitted.

We therefore recommend the removal of the term 'third-party' from the additional requirement and its incorporation into the criterion itself.

B8 – Currency and Interest rate asset and liability mismatch

The additional requirement is a helpful clarification of the use of hedging. We support its retention in an expanded criterion.

B12 – Alignment of Interest

Whilst we note that no additional language has been proposed in relation to the 'Alignment of interest' criterion we would appreciate an indication from the Committee of the role of mutual recognition, which we support, in satisfying this test.

C13 – Fiduciary and contractual responsibilities

We understand the rationale for this additional guidance regarding 'strong systems and reporting capabilities' but think it proposes criteria that it will be difficult to assess in a non-subjective way. We therefore recommend the removal of this additional guidance, believing it to be already adequately covered in the criterion itself.

D15 - Credit Risk of underlying exposures

We note that the underlying exposures must meet the conditions under the standardised approach. The degree to which we support this proposal, which in principle we do, will depend on the finalisation of the revised standardised approach for credit risk.

D16 – Granularity of the Pool:

The new granularity definition is helpful for retail exposures but will be more problematic for wholesale transactions, particularly at the end of a transaction's life when concentrations of connected clients may potentially build up and investors are required to undertake dynamic analysis. We recommend that the granularity requirements only apply at the inception of the transaction.

D17 – Relationship between the originator and the servicer of the securitised assets:

We are unclear of the rationale for requiring the servicer and the originator to have a common parent entity, which will unduly restrict our member banks' business models as they develop different, more efficient, servicer approaches in the future driven by advances, for instance, in blockchain and other FinTech capabilities. In addition this criterion is contrary to one of the fundamental structural hallmarks of securitisation methodology: the ability to insulate the securitisation from financial problems of the originator through the ability to transfer servicing to a third party.

Q3. What are respondents' views on the compliance mechanism and the supervision of compliance presented in this consultative document?

The combination of multiple, subjective criteria and the potential penalties involved, implies a significant amount of regulatory risk for investors and originators, particularly newer and smaller ones. Whilst we recognise and support the principle that investors should remain responsible for undertaking proper due diligence in order that they understand the risks that a securitisation structure exposes them to, we do not support the Committee's proposed self-certification proposal.

We strongly believe that a third party entity should undertake the STC certification as a complement to the STC compliance attestations made by the originator. This would remove an element of the regulatory risk that investors and originators alike would face which, we believe, will act as an impediment to the development of a vibrant STC securitisation market.

A third party certification mechanism would also have the benefit of ensuring common interpretation of the criterion across all jurisdictions and throughout the life of the transaction, which can only be beneficial.

Were regulatory bodies to be responsible for policing compliance with STC requirements it would be important to ensure a consistent interpretation of the STC requirements over time. Any change in capital requirement for an STC securitisation exposure would have a negative impact on the investor and the attendant regulatory uncertainty may undermine the attractiveness of the STC regime.

Q4. What are respondents' views on the alternative capital requirements for STC securitisation presented in this consultative document?

We recognise that the Committee has gone some way to adjust the capital treatment of STC compliant securitisations but do not think that the current proposals go far enough. The risk weight floor for IRBA institutions will be significantly higher than the current treatment and we recommend that the 7% floor be retained for STC securitisations under the IRBA approach.

We believe that there are strong arguments for reducing the p factor even further in order to reduce the capital multiple of securitisations in comparison to other secured instruments like covered bonds.

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