

Capital treatment for "simple, transparent and comparable" securitisations

Response by the Council of Mortgage Lenders to the Basel Committee on Banking Supervision Consultative Document

Introduction

1. The Council of Mortgage Lenders (CML) is the representative trade body for the residential mortgage lender industry that includes banks, building societies and specialist lenders in the UK. Our 133 members currently hold around 95% of the assets of the UK mortgage market. In addition to lending for home-ownership, the CML members also lend to support the social housing and private rental markets.

2. We are grateful for the opportunity to respond to the Basel Committee on Banking Supervision's (BCBS) consultation document on capital treatment for "simple, transparent and comparable" securitisations. In preparing our response to this consultation we have engaged with our members and other interested trade associations. In particular, we have worked with the European Mortgage Federation (EMF). We are happy for our response to be shared between the regulators and for it to be made public.

3. Our views on these proposals necessarily reflect our interest in their impact on mortgage lenders and the mortgage market. Some aspects of our response may also be applicable to the rest of the financial services industry. We have focused on the high-level issues raised by this consultation, but are aware that other lenders and trade associations have responded in detail on some of the technical aspects of the consultation. We would, therefore, fully support the conclusions reached in these separate responses, particularly that provided by the EMF-ECBC.

General comments

4. We consider the securitisation market for residential mortgages (RMBS) an important element in the funding mix for UK lenders. In that respect, we welcome all initiatives designed to improve lenders access to different sources of funding since we advocate lenders to have the ability to raise funds from a variety of diversified source. Diversity includes different currencies, maturities and investor bases. We, therefore, broadly welcome the proposals for "simple, transparent and comparable" (STC) securitisations.

5. Prior to the financial crisis, UK lenders used the RMBS market both as a source of funding and to enable some risk transfer, together with capital relief. Post the financial crisis and the changes in regulation, together with the changing risk attitudes of investors, means that the RMBS market has been primarily a source of funding/liquidity rather than risk transfer. While we would not suggest that the market should return to the pre-crisis state, we do believe that there is scope for changes in regulation and capital treatment to aid the process of risk transfer and place RMBS funding on a more level, in terms of capital held, playing field as alternative sources of funding using mortgage collateral, e.g. covered bonds.

6. Now, the current capital regime makes the issuance of RMBS for funding purposes considerably more expensive than the alternatives using the same asset collateral. Together with other regulatory changes, e.g. Solvency II affecting the capital that investors hold against RMBS assets, there is the possibility that the combined affect of the regulatory architecture would be to further impact the issuance of RMBS to the extent that it may close completely. We believe this would be a retrograde step since, as highlighted above, we consider the RMBS market an important element in the funding mix because of the diversity of funding it offers and the potential for risk transfer thereby reducing the risk lenders hold.

Specific Responses to Questions Raised in the Consultation

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?”

We welcome the introduction of the STC criteria. In our assessment, UK RMBS should qualify as STC securitisations and alongside the disclosure that lenders already supply to the market should aid investors understanding and assessment of risk that such exposures bring. As highlighted earlier, changes in regulation for some securitisations investors e.g. Solvency II and insurance companies may mean that they exit from the market. The additional comfort provided by the designation STC may halt this exit, although we consider changes in Solvency II the critical element to encourage such investors to remain active in the RMBS market.

It follows that the designation STC should provide additional comfort in the long-term performance of RMBS and that it, therefore, makes sense to address the excessive conservatism built into the capital framework and in particular the non-neutrality of the capital framework vis-à-vis high quality securitisations.

However, we would emphasise that, given particularly the breadth of jurisdictions involved and the history of how RMBS securitisation has been used in different jurisdictions, that any new regulatory framework should be principles based. In this way, the regulatory architecture can encompass the different approaches lenders employ when using the RMBS market, but crucially ensure that a minimum standard is employed across jurisdictions.

Q2: “Do respondents agree that, for the purposes of alternative capital treatment, additional criteria are required? What are the respondents’ views regarding the additional criteria presented in Annex 1?”

While we understand the exclusion of both asset-backed commercial paper (ABCP) programmes and synthetic securitisations from the amended calculations suggested, we would emphasise that both do have a role to play within both the overall funding mix that lenders can deploy. In the case of synthetic securitisations, these could have a role to play in the effective risk transfer between institutions and potentially reduce systemic risk. On conclusion of this process for “standard” securitisations, we believe it would be worthwhile to begin to examine whether a similar process could be extended to these alternative types of securitisations.

Overall, however, we do not agree that alternative capital treatment criteria are required unless they are clearly linked to the objectives of STC.

Q3: “What are respondents’ views on the compliance mechanism and supervision of compliance presented in this consultative document?”

We believe that UK RMBS originators will be able to fulfil in full the enhanced requirements around compliance of the STC criteria. In this regard we welcome the papers recognition of the specific, unique origination process around mortgages and, given the use of third party servicers that mortgages should be excluded from the new criterion D17 (A higher standard under fiduciary and contractual responsibilities and the strengthening of linkage between different parties to a securitisation).

We welcome the proposal that the originator/sponsor should, in effect, self-certify the compliance of an individual securitisation with the STC criteria and that the necessary information to make this assessment should be made public. While we understand and indeed believe that investors of securitisations should engage in a full due diligence and understanding of any securities they purchase, including securitisations, we are uncertain whether the requirement that investors also need to determine whether a securitisation is STC compliant is helpful. Such a requirement will put an additional burden on investors both legally and logistically, and may actually deter them from actively participating in the market. We believe that the requirement by the originator/sponsor to

provide publically the required information and justification of why a securitisation is STC compliant is sufficient to ensure that originators/sponsors do not indulge in a less rigorous approach.

We agree that a third party approval be that from rating agencies or regulators would add another cost to the process and have concerns that it may, therefore, reduce the incentive for investors to undertake appropriate due diligence and raise the issue of moral hazard all of which is undesirable.

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

Given the additional confidence, the STC criteria provide regarding the likely performance of a securitisation, we believe that it is justified to amend the regulatory capital treatment for securitisations that qualify as STC.

We welcome the reduction in the risk-weighted floor for senior exposures to 10-12%.

We note that the risk-weighted floor for mezzanine tranches will continue to be set at 15%.

We welcome the change in the p-parameter to a range between 0.6-0.8 under the formula based approaches. Alongside this, we are pleased to note that the external ratings based approach will also be changed to ensure some parity of approaches between IRB and Standardised Approaches.

However, we do not believe that the changes go far enough to produce a more level playing field between different securities using the same, or similar, collateral. We would highlight that the CRR proposals are for a p-parameter of 0.5. We would, therefore, conclude that the BCBS proposals are unduly conservative.

Contact

7. This response has been prepared by the CML in consultation with its members. If you have any comments or queries on this response, please contact the CML representative Jon Saunders, Senior Policy Adviser: jon.saunders@cml.org.uk +44 20 7438 8934