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Set up in 1960, the European Banking Federation is the voice of the European banking sector (European Union & European Free Trade Association countries). The EBF represents the interests of almost 4,500 banks: large and small, wholesale and retail, local and cross-border financial institutions. Together these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the European Union.

Subject : EBF final response to the BCBS consultation on revisions to the Basel Securitisation Framework

The EBF welcomes the opportunity to express the views of the EU banking industry in the debate on the revision of the Basel prudential securitisation framework. Asset Backed Securities (ABS) are central to the functioning of the European financial system and Asset Backed Commercial Paper (ABCP) transactions play an essential role in financing the real economy. Securitisation is an integral part of banks' funding and supports the flow of credit to the wider economy. The fundamental revision of the prudential treatment of securitisations put forward in the consultative paper and related documents is therefore one of the most delicate elements of the regulatory reform underway from a European viewpoint.

The EBF position depicted in this paper is organised in three sections: Firstly, the executive summary where the EBF recommendations are laid out; secondly, a review of the background and general considerations; finally, the EBF responses to the numbered questions of the BCBS consultative paper.

Executive summary

- The EBF understands the Committee's intention to set up a stable framework for the prudential treatment of securitisation exposures. Its pursued objectives are undeniably fair however there are 3 overriding facts that should be carefully considered:
 1. The industry believes that the proposed revision is trying to solve problems for which significant measures have already been taken. In particular, a series of policy measures to address the shortcomings that became apparent in the pre-crisis securitisation framework have already been put into force in the EU. The EBF suggests that the Committee evaluates firstly the degree of improvement achieved in the EU securitisation market with the legislation enacted since the start of the crisis before embarking on a new round of changes.
 2. The proposed overhaul of the capital requirements framework for securitisations would have undesirable consequences in a market that is essential to the funding of banks, corporates and the wider economy.
 3. The proposed changes and the basis for calibration do not appear to reflect the characteristics of securitisation instruments originated in the EU. As a result, EU banks' funding capacity could be severely damaged and long-term finance in the EU economy could unwarrantedly suffer.
- With this in mind, the EBF would suggest that the Committee needs to revisit the suggested calibration within the proposal to take account of the rest of the measures in place. These dramatic changes should not be introduced. The proposals produce capital requirements which are many multiples of current requirements for certain instruments. They are based on assumptions which are inappropriate and not calibrated to the EU reality. For example, we understand that the calibration has been based on historic corporate Collateralised Debt Obligation (CDO) models which do not reflect the performance of many asset classes and produce results which are not justified when compared to actual loss performance.
- We would expect a careful reassessment of the terms of the calibration in the light of the forthcoming Quantitative Impact Study (QIS) results. The following are the main concerns as to the substance of the consultative paper:
 1. Insufficient incentive to highly-rated securitised lending over unsecured lending.
 2. Significant capital requirement increase which does not necessarily consider the underlying assets quality and performance.

3. The proposed reforms could actually deepen the cliff effects in risk-weighted assets (RWA), notably for AAA versus AA and A ratings and for re-securitisations, as opposed to meeting the Committee's objective of mitigating them.
 4. Suggested maturity adjustments inappropriate for ABS, overly penal for high-quality (AAA) tranches. Consistency with the criteria of the Basel credit risk framework should be preserved. We would propose a maturity based on weighted-average life as it is commonly used in the industry.
 5. Further consistency between approaches should be sought.
- The calibration of the proposed methodologies is apparently fitted to a CDO based model at the worst stage of the financial crisis. However, the market and the regulatory framework have significantly changed since. On the other hand, the EU-originated ABS market¹ shows a totally different experience in terms of credit losses².
 - The EBF recommends putting forward a Basel 2 arbitrage-free model whereby the sum of capital requirements of the tranches is equivalent to the capital requirements of the underlying pool of assets with a Basel 2 compatible model charge if deemed necessary by the Committee to be added only at the final stage of the Risk-Weighted Assets (RWA) calculation.
 - Given an accurate recalibration of the proposed methodologies in line with the abovementioned Basel 2 arbitrage-free principle, the EBF would recommend that an alternative hierarchy is considered. In outline: the Internal Assessment Approach (IAA) and the Modified Supervisory Formula Approach (MSFA) should take priority over other methods. As an alternative, there would be an accurately calibrated Ratings Based Approach (RBA) method and the Simplified Supervisory Formula Approach (SSFA) as fallback solution. We also suggest that the MSFA be adjusted to allow for pool level inputs for highly granular portfolios as opposed to the current need for individual exposure inputs. This will broaden the scope of the MSFA as it is currently only feasible for own asset securitisations.

¹ According to observed data from Standard and Poor's by mid-2012 the European structured finance cumulative default rate is only 1.1% for the universe of notes outstanding when the crisis surged in mid-2007 despite the negative macroeconomic developments that the EU has undergone since. In contrast, the equivalent measure for US structured finance stands at 14.8%.

The same measure for European ABS is only 0.16%. In the case of mortgage guaranteed bonds, the cumulative default rate of EU Residential Mortgage Backed Securities (RMBS) is next to nothing (0.07%) for the approximately €750 billion outstanding in mid-2007.

² As well as significant parts of the US market particularly autos, credit cards and trade receivables.

- We propose the reforms apply only to new securitisations going forward, and that grandfathering or an appropriate transition period be granted, to cater for legacy exposures and to thereby ensure that economic recovery is not unduly hampered. At the very least, we request that, re-securitisation activity on senior securities be recognised to avoid creating a regulatory cliff effect.

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- **Related documents:**

BCBS Consultative Document: <http://www.bis.org/publ/bcbs236.pdf>;

Foundations of the Proposed Modified Supervisory Formula Approach (WP22): http://www.bis.org/publ/bcbs_wp22.pdf;

The Proposed Revised Ratings-Based Approach (WP23): http://www.bis.org/publ/bcbs_wp23.pdf.

General considerations

1. Shortcomings of the former framework

The consultative paper starts by recalling the shortcomings of the former prudential framework for securitisations that became apparent during the financial crisis that emerged in 2007. Some of those deficiencies have been totally or partially addressed by diverse policy measures which have been developed thereafter. It is understood that the Committee seeks to finalise the revision of the securitisation framework with the proposed document in order to adequately address the problems remarked in its introductory section, namely:

- The overreliance on external ratings;
- The presumed low risk weights for highly-rated securitisation exposures;
- The presumed high risk weights for low-rated senior securitisation exposures;
- The cliff effects in capital requirements.

The EBF is mindful of the need to overcome the failures experienced in the upsurge of the crisis. Nonetheless the EU securitisation market has its own characteristics. Its results should be observed from the viewpoint of origination as well as investment. The metrics used in the calibration should reflect the performance of the EU securitisation market which has withstood the crisis remarkably well producing negligible credit losses. Otherwise, there is a plausible risk of hindering recovery by prescribing an excessive dose of untested measures.

It is therefore imperative to start off by evaluating the current state of play of the regulatory framework which has been largely improved during the last 5 years with the introduction of concrete measures meant to tackle the abovementioned problems among others.

2. Regulatory background

The regulatory landscape for securitisation exposures has already changed substantially since the start of the financial crisis. Several new regulations enacted in the EU (see synopsis of current EU regulations in box 1) have tightened up the prudential treatment of securitisations by means of:

- Alignment of incentives between originators and investors or *skin in the game*;
- Reduction of mechanistic reliance on external ratings;
- Measures to increase transparency;
- Adequate control of credit rating agencies;
- Increased capital requirements;

- Review of *correlation trading books*;
- Heightened requirements for complex structures.

Box 1: Regulations already enforced in the EU related to securitisations

(i) Initiatives to promote a better alignment of incentives: Retention requirement.

- Securitisation sponsors or originators are required to retain a part of the risk of the underlying assets to correct possible misalignments between the interests of securitising institutions and those of investors and to encourage originators to apply rigorous lending policies.
- Introduced into legislation in EU banking legislation which entered into force on 31 December 2010 (CRD II³ Article 122a) and also in other regulations affecting other potential investors in bank-originated securitised products such as investment funds and insurance companies.

(ii) Measures to increase transparency

- CRD III⁴ has amended EU banking legislation to include a wide range of new disclosure requirements which the Basel Committee had recommended, particularly concerning asset-backed securities held in the trading book, the sponsorship terms for off-balance-sheet items and the methodology used for valuating products on the balance sheet.
- the European Central Bank, in order to ensure an adequate risk assessment of the asset-backed securities that the Eurosystem accepts as collateral, published in December 2009 its decision to require loan-by-loan information on the underlying assets backing securitisations, as a factor to be taken into account in the eligibility criteria.

(iii) New regulations on credit rating agencies

- Credit Rating Agencies have now been made subject to specific regulatory supervision in the EU⁵, including registration, measures to reduce conflict-of-interest, requirement to use models that are rigorous, systematic, consistent and subject to validation based on historical experience.

(iv) Increased Capital Requirements in Basel 2.5

CRD III transposed into European legislation amendments made by the Basel Committee to the Basel 2 framework known as Basel 2.5. These amendments have been enforced in the EU by 31st December 2011:

- The adjustments to the Basel II framework announced by the Basel Committee in July 2009, which received several adjustments in June 2010, established that securitisation positions held in the trading book need to be subjected to similar charges as those applied to securitisation positions held in the banking book.
- Additionally, *correlation trading books* were exempted from the full treatment for securitisation positions, qualifying either for a revised standardised charge or a capital charge based on a comprehensive risk measure.
- Also, with the aim of discouraging the issuance of the most complex ABS structures, requirements for re-securitisation have been strengthened by including a new weighting scale created *ad hoc* for these products, specifying increases at times of over 100%. In addition, all the lines of liquidity support for asset-backed securities, irrespective of their maturity, have a credit conversion factor of 50% (formerly, the conversion factor for lines with a maturity of less than one year was only 20%).

³ [EU Capital Requirements Directive II.](#)

⁴ [EU Capital Requirements Directive III.](#)

⁵ [EU Credit Rating Agencies Regulation voted in European Parliament on 16 January 2013.](#)

Significant measures have already been taken to address the shortcomings identified in the crisis and including the specific impact on securitisation and re-securitisation of the European Credit Rating Agencies (CRA / CRA 2 & CRA 3). It should be noted that the current RBA/IAA setup was introduced in Europe on 31st December 2007 and we would argue that the risk associated with securitisation has been appropriately capitalised. The loss experience on ABS originated since this time has been very low and does not warrant the suggested increase in RWAs.

Other policy measures that will affect the regulatory picture of securitised instruments are also in the offing (see synopsis of policy measures underway in box 2), including:

- The Basel 3 leverage ratio.
- The Basel 3 liquidity coverage ratio.
- The Basel 3 net stable funding ratio.
- The fundamental review of the trading book.

Box 2: Upcoming policy measures related to securitisations

(i) The Basel 3 leverage ratio

- Retained positions of securitisation exposures as well as other forms of credit enhancements provided to the vehicle by the originator (e.g. liquidity facilities) will be included in the calculation of the leverage ratio.
- For non-derecognised securitisations, the underlying securitised portfolios (as opposed to the securitisation exposures) are included in the leverage ratio calculation. Credit risk mitigation, synthetic (or unfunded) securitisations, will not reduce the exposures of the underlying portfolios.

(ii) The Basel 3 liquidity coverage ratio

- The original proposal was that securitisation bonds, even those with the highest qualifications or with sovereign guarantee, would be considered as completely illiquid assets for the calculation of the liquidity coverage ratio. This implies that banks should retain a stock of high quality liquid assets equivalent to 100% of the amount of debt securities maturing within the 30-day time horizon of the standard and 100% of the amount of assets that could potentially return to banks' balance sheets due to embedded options in these financing arrangements.
- The revision of the Basel liquidity framework of January 2013 contemplates some degree of recognition as highly liquid assets of certain RMBS. Nevertheless, the range of bonds that comply with the stringent conditions will be very limited.

(iii) The Basel 3 net stable funding ratio

- This standard provides a measure of liquidity risk exposure that acknowledges the need to fund securities in trading inventories or securitisation pipelines in the face of illiquid markets. As specified in the original proposal, banks are required to hold 65% stable funding for all residential mortgage loans that are warehoused in order to be securitised. Moreover, banks have to hold 100% stable funding for all other structured products on their balance sheet, like securitisations, including the substantial amounts of MBS that European banks are holding in the context of central bank operations.

(iv) The Basel Fundamental Review of the Trading Book (FRTB)

- See comments in point 3 below.

3. Trading book positions in the new proposed Basel Securitisation framework

We understand from the consultative document that the Committee does not intend to address trading book securitisation positions within the scope of the new securitisation framework but rather within the scope of the FRTB. However considering the following circumstances: (i) The first consultative paper on the FRTB did not specifically tackle securitisation positions, (ii) the timing of the trading book review is unclear, and (iii) Basel 2.5 aligned the treatment of capital requirements for credit risk of trading book securitisation exposures to that of banking book exposures⁶; we anticipate that trading book positions will be directly impacted by the new proposed securitisation framework and would like to express our concern on the issues it would raise:

- Punitive netting rules: Full netting between long and short positions is only recognised when there is a perfect match between the 2 positions. Partial offset are only allowed under extremely restrictive conditions. Such netting rules are overly conservative and overestimate the true overall incurred risk. We urge the Committee to revisit those netting rules in the spirit of the FRTB which aims at making the standard method more risk sensitive. In particular, more offsetting should be recognised between long and short positions not least to recognise that the systemic components of credit risk will offset to a large extent. Moreover, from 31 December 2013, banks will have to capitalise both long and short securitisation exposures for trading positions outside the correlation book. As a matter of fact, a bank mitigating long risk securitisation positions with short risk securitisation positions will be requested to hold more capital than if it had only held the long risk position with no risk mitigation. It would ultimately pose a disincentive to banks to have well hedged books.
- Determination of exposures for short risk positions: Current rules make nearly no distinction in the treatment of long and short risk positions. Indeed, the exposure calculation is the same for a “long risk” and a “short risk” CDS position. In addition, the same risk weights are applied. Only the maximum loss which serves as a cap is different. This treatment does not reflect the economic risk of short positions. As a matter of fact, the capital charge for short risk positions is in almost all cases equal to the maximum loss the bank could experience which goes far beyond the soundness standards commonly used for capital.

⁶ Basel 2.5-compliant banks currently determine their specific risk capital charge for trading book securitisation positions based on banking book rules:

- For positions included in the correlation trading book, the total capital charge is floored at 8% of the maximum between the capital charge of net positions under banking book rules and the capital charge of long positions under banking book rules.
- For securitisation positions outside the correlation trading book, the capital charge is set equal to 8% of the maximum between the capital charge of net positions under banking book rules and the capital charge of long positions under banking book rules until 31 December 2013. Beyond that date, the capital charge will be the sum of the capital charge of net positions under banking book rules and the capital charge of long positions under banking book rules.

In consequence, current rules combined with the proposed securitisation framework could lead to a massive withdrawal of banks from market making and secondary trading of securitisation exposures. This would be at odds with the essential role of securitisation for the provision of finance to the corporate sector.

4. Financial industry initiatives

It is also worth noting that in addition to the regulatory measures in place the financial industry has promoted initiatives to increase transparency and reduce complexity of securitisation transactions:

- In late 2012 the program of Prime Collateralised Securities (PCS) was launched in Europe. The PCS provides a quality label for which issuers can apply.
- At national level, the Dutch Securitisation Association (DSA) has developed a standard for Dutch RMBS that can be used by issuers.
- In Germany, True Sale International (TSI) provides comparable labels and standards for auto-ABS since 2004 as an initiative of a group of banks with the aim of promoting the German securitisation market.

These measures represent an important improvement in terms of adding transparency and restoring investors' confidence.

5. Impact of the revision

The impact that the revision of the securitisation framework will have on the banking industry will be two-fold: On one hand, on banks acting as originators of asset-backed securities. On the other, on banks acting as investors in ABS instruments as a tool to provide low risk funding to their clients. The outstanding amount of European ABS is near €736 billion of which 30% is held by banks.

The origination is essential for the continuous flow of funding to banks and credit supply to the economy. The main problem that banks will have to contend with is the change in the business rationale of high quality tranches if the proposed hierarchies are implemented. The increase in the cost of capital required to hold these securities will limit the capacity of banks to retain own securitised assets and the additional cost will have to be passed through to end users.

As investors, banks hold a significant part of the ABS in Europe either via Asset Backed Commercial Paper (ABCP) conduits that provide funding to their clients or via portfolios of ABS held on balance sheet. The resultant loss of profitability that these proposed changes will cause could give way to a flight of bonds to other sectors and a reduction in the overall interest in this type of securities.

As a result, borrowers will face two risks which quantification remains to be estimated: The increased cost of credit to pay for the additional capital required for banks holding senior ABS tranches and the potential constraint in credit supply arising from disincentive to invest in such securitisations. The quantitative impact study (QIS) is expected to highlight the magnitude of additional capital requirements caused by the proposed rules.

Another angle to study the impact of the new proposal is the reallocation of assets that it would entail in the balance sheet of banks. The analysis of the proposals suggests that the capital requirement of securitised instruments will be greater than holding the non-securitised assets, forcing more assets to be retained on balance sheet. This fact will be an obstacle notably in a jurisdiction like the EU where the most common model is “originate to hold” and the main role of securitisation is to provide constant funding.

The impact on the wider economy should also be regarded. As a funding vehicle for banks, securitisation supports long-term finance which is necessary to sustain economic growth. The Group of Thirty (G30) has recently published a paper⁷ wherein it is acknowledged that securitisation should be part of the solution to the long-term finance problem. The EBF endorses the claim of the G30 urging policy makers to take the necessary steps to develop corporate bond markets that support the efficient and sound securitisation of long-term debt, particularly in Europe and emerging markets.

Securitisation should be preserved and incentivised to allow small business loans to be packaged into securities and sold to investors thus enabling banks to extend more credit. This is extremely important for the EU economy given that bank lending will remain a central source of financing in Europe. We agree with the proposals of the G30 that confidence in the securitisation market should be achieved by realigning incentives, increasing standardisation, strengthening risk management and mitigating potential systemic risks notably those emerging from the shadow banking system.

We suppose that the revision of the securitisation framework will not just have an impact on the banking industry but also on the real economy. Securitisation is an important funding instrument for the real economy and gives economic agents the opportunity to diversify their funding. Banks acting as sponsors also support the real economy through sponsoring ABCP programs and providing liquidity facilities. The high requirements of the MSFA could penalise banks which are not originators owing to the fact that they have to rely on the information of the industry: Either they could ask the industry for this information thus bearing additional costs or they would have to use another approach which effectively costs more than what the bank turns over to the industry. The Basel Committee should be aware of the burden that it represents for the real economy.

After all, European growth needs further securitisation to fund its economy, particularly households and small corporate, under improved supervision and adequate macro-prudential oversight. Rising capital requirements indiscriminately would not be a step in the right

⁷ Group of Thirty: Long-term Finance and Economic Growth.

direction. Improving supervision and monitoring potential systemic risk developments associated with securitised instruments is, in our opinion, the right way forward.

6. Re-securitisations

6.1. Definition of re-securitisation

The treatment of re-securitisations in the revised framework is most conservative and the definition is drafted widely. It is therefore critical to clarify the definition of re-securitisation and to apply this universally. It currently understandably includes, for example, securitisations of pools of underlying ABS that can be difficult to analyse due to wide range of possible assets and uncertain correlation assumptions (CDOs of ABS).

The definition captures many innocuous securities and ignores their credit enhancement provided by their significant credit support. A simple example would be a *retranching* of a single securitisation exposure. These transactions have provided a solution to the cliff effect in the prevailing securitisation rules and are no different to re-rating the underlying ABS transaction.

Basel 2.5⁸ (BCBS 157) states: “A re-securitisation exposure is a securitisation exposure in which the risk associated with an underlying pool of exposures is tranching and at least one of the underlying exposures is a securitisation exposure”. This requirement for more than one underlying security should be universally implemented and, providing principal payments in a deal are being paid fully sequentially, a transaction with only a single underlying security (itself not a re-securitisation) should be considered as a securitisation, not a re-securitisation. Further, this concept should be generalised such that a *retranching* of a pool of multiple underlying securitisation positions should not be considered a re-securitisation where it can be demonstrated that the *retranching* of multiple securities is determined by simply adding the tranching for each of the individual bonds (i.e. 100% correlation with no benefit given for portfolio effects such as diversification).

A further particular point to note is that some transactions such as Collateralised Loan Obligations (CLO) often have small buckets to hold securitisation positions rather than loans. Typically this bucket is 5% or less of the transaction at launch (although the actual holding is generally only a fraction of that amount) which is significantly less than the over-collateralisation of the senior tranches.

⁸ Enhancements to the Basel II framework (Basel Committee, July 2009).

As it is proposed that only a single securitisation position in the underlying loan pool is enough to taint the transaction as a re-securitisation, CLOs would in this instance often be captured and even the senior AAA positions would be attributed the risk weight of the underlying pool. While new transactions can be structured without securitisation assets (CLO buckets), existing deals cannot readily be amended to remove their existing securitisation holdings. This is significant and would have a large impact in the European CLO market. The revised proposals would disproportionately impact the senior tranches rated AAA-AA where RWA would increase most significantly and may incentivise banks to liquidate these holdings which could significantly disrupt funding to corporates provided by the CLO market.

We would propose that this is not the intention of these reforms, particularly as CLOs are an important source of funding for the real economy, and that the definition of re-securitisation should also be amended to exclude these securities.

To summarise, EBF would like to propose that:

- i. The definition of re-securitisation in the revised securitisation framework should match that used in Basel 2.5 (BCBS 157) so as to exclude *retranchings* based on single underlying transactions, and
- ii. Securities should not be deemed to be re-securitisations if:
 - the total exposure to securitisations in the initial underlying portfolio is 5% or less and the relevant tranche has more than 10% credit support,
 - it can be demonstrated that the *retranching* of multiple underlying securities is simply the sum of the *retranching* of each of the underlying securities, or
 - it is a second loss tranche of an ABCP conduit.

6.2. Refine capital treatment for senior tranches of re-securitisations to reflect coverage of higher quality assets.

Under the revised Basel Securitisation Framework, re-securitisation transactions are required to be analysed under the BCRA. This results in a situation where:

- Non-senior tranches have capital requirements well in excess of the underlying assets because losses are assumed to be concentrated in the junior tranches, and
- Senior tranches receive the same risk weighting as the underlying assets without any benefit for the fact that losses fall first on the junior tranches providing credit support.

This gives an overly penal outcome, particularly for senior tranches secured on heterogeneous asset portfolios with low average LGD, and gives no benefit for the risk mitigation provided by over-collateralisation.

Consider, for example, a low risk weight asset portfolio funded only by senior debt. In this instance a worst case assumption would be to risk weight the debt by looking through to the assets. If assets of higher risk weight were then added to this portfolio and they were funded by junior liabilities (applying a fully sequential waterfall), the risk on the senior debt can only have decreased and yet the current proposal to average over the entire pool would require an increase in the risk weight applied to the senior debt.

The EBF therefore proposes that the risk weighting of the senior re-securitisation tranche should be capped at the average risk weighting of the only lowest risk weighted underlying assets sufficient to cover the senior tranche in full.

7. Grandfathering and transitional period

In a market that is currently in the course of recovery and considering the vital role that securitisations play in funding banks and the economy, it is advisable to act with caution as regards the introduction of relevant changes. The abovementioned regulatory measures already in place combined with the industry initiatives have created a safer environment. However, rapid changes of rules could disrupt the current status for existing securitisations. Irrespective of the final approach the Committee should avail grandfathering clauses for existing instruments and a sufficiently long transition period for new issuances.

Banks have material and well disclosed securitisation portfolios which are largely in run-off since 2009. Applying materially higher risk weighted assets (RWA) to such portfolios now naturally reduces capacity for new credit extension and could create systemic risk by requiring significant additional capital requirement within a short timeframe. We would suggest that these are grandfathered under any arrangements. Otherwise we would suggest that a significant transition period would be reasonable to provide banks opportunity to disinvest or reconfigure these portfolios in a controlled way.

Specific questions

1. *What additional costs and benefits of the two hierarchies should the Committee consider? Which hierarchy presents the greater benefits relative to its drawbacks? Which hierarchy would best address the shortcomings identified with the current framework, whilst meeting the Committee's objectives?*

While we agree with the Basel Committee that the new securitisation framework should be (1) prudent, (2) risk sensitive and (3) reduce cliff effects to create an arbitrage free environment where capital requirements pre- and post-securitisation would be aligned, we think the new proposals do not meet these objectives.

1. **Prudent:** A prudent framework allocates capital in line with the economic risk. For the current proposals this requirement is not met given that all proposed methods produce capital requirements that are a multiple⁹ of the capital requirement of the underlying pool.
2. **Risk sensitive:** The proposed methods are not risk sensitive as in the majority of cases, caps or floors are reached.
3. **Reduce cliff effects:** Apart from the RRBA approach where cliff effects are marginally reduced, we find that they are still present in all the other methods.

To achieve the above mentioned objectives we recommend that the method at the top of the hierarchy be based on a model that is arbitrage free, i.e. a model respecting the rule that the sum of capital requirement on the tranches equals the capital requirement on the pool of underlying assets. Any additional layer of conservatism that the Committee deems necessary should be added separately at the end of the calculation.

The overriding concern of the EBF is that none of the proposed hierarchies would bring benefits to the banking industry and the wider market, at this point in time, that could justify the significant drawbacks associated with their potential implementation.

Regarding the last question, addressing shortcomings of the current framework whilst meeting the Committee's objectives the table below shows that none of the approaches would entirely respond:

⁹ On average 3 to 4 times higher.

Priorities -> Alternatives	make capital requirements more prudent	make capital requirements more risk sensitive	mitigate mechanistic reliance on external ratings	reduce cliff effects
MSFA	does not allocate capital in line with economic risk: penalising high quality portfolio and possibly favouring low quality portfolios	No	yes	No Reduction
R-RBA		No	no	Marginal Reduction (cliff effect of rating agency first dollar loss methodology remains)
S-SFA		No	yes	partially
senior high quality tranche	does not allocate capital in line with economic risk: penalising high quality portfolio and possibly favouring low quality portfolios	No	yes	material cliff effect between SHQ and non-SHQ tranches due to model discontinuity
rrba or MSFA/ SSFA				
concentration ratio				
Backsktop approach				

2. As regards Alternative A, could both the revised RBA and the SSFA be accommodated without raising concerns about regulatory arbitrage or level playing field?

The main concern regarding level playing field is the fact that the proposed approaches have apparently been calibrated with data from corporate CDO instruments which do not fully reflect the performance of the EU securitisation industry or the majority of the US market (autos, credit cards, trade receivables, etc). We also understand that the calibration takes account of the mark to market variability of these instruments. However, in practice, ABCP multi-seller exposures in particular, these assets are held on the banking book to maturity and are not marked to market. It is therefore inappropriate to apply the same calibration to all asset classes and securitisation exposure types.

According to observed data from Standard and Poor's¹⁰ by mid-2012 the European structured finance cumulative default rate is only 1.1% for the universe of notes outstanding when the crisis surged in mid-2007 despite the negative macroeconomic developments that the EU has undergone since. In contrast, the equivalent measure for US structured finance stands at 14.8%.

The same measure for European ABS is only 0.16%. In the case of mortgage guaranteed bonds, the cumulative default rate of EU RMBS is next to nothing (0.07%) for the approximately €750 billion outstanding in mid-2007.

Against the abovementioned figures, we would argue that the majority of asset classes within the securitisation market should merit an approach that is more representative of their actual risk profile.

¹⁰ "Transition study: Five years on, the European structured finance cumulative default rate is only 1.1%". Standard and Poor's Ratings Services (August 2012).

As for the proposed SSFA formula, the calibration of parameter p would result in significant regulatory divergence between European and U.S. banks, resulting in a severe competitive impact on the ability of European banks to provide credit *vis-a-vis* their US peers. For example, a AAA rated trade receivables transaction that would attract capital of 20% under the US SSFA (i.e. the minimum floor amount) is increased to 86% under the BCBS calibration of p . This would make it extremely difficult for European corporates to secure lending from banks in Europe. The difference is illustrated in the example below:

Example 1	
Pan-European Trade Receivables	
<u>Inputs:</u>	
“W” input	1.78%
Attachment point	20%
Detachment point	100%
Transaction maturity	1 year
Implied rating level	AAA
SA capital for underlying assets	100%
<u>Outputs (RW):</u>	
Current RBA/IAA	8%
Proposed RRBA/IAA	20%
US SSFA	20%
Proposed BCBS SSFA	86%
Indicative unsecured RWA for same maturity	20%

A typical trade receivables portfolio contains a diverse range of European corporates. Most transactions contain around 500 or more debtors with payment terms of around 40 to 45 days on average. The current IAA analysis uses S&P trade receivables methodology which generally requires a minimum amount of around 15% of credit enhancement at a AAA level but is usually nearer to 20%. The level of credit enhancement is adjusted on a monthly basis in line with the performance of the underlying portfolio such that the bank de-levers its position as the performance deteriorates. As demonstrated above, the proposed alternatives would increase capital against these portfolios by more than 10 times under the BIS SSFA with a p value of 1.5. The factor between the BCBS proposed SSFA and RRBA is also disproportionate as it amounts to 2.5 times.

It should also be noted that whilst the “W” input is in excess of 1.5% of the portfolio balance, this is typically due to administrative issues such as disputes (which is covered by separate dilution reserves) and actual losses seen in these portfolios are

significantly lower than this amount. The loss experience borne by the financiers of these programs has been negligible. In addition, the W input is a dynamic variable and so could result in capital requirement volatility depending on the underlying assets and the capital structure.

3. *As regards Alternative B, which methods could a bank use to conclude that a securitisation exposure is of high-quality? Would the use of these methods likely result in a capital charge consistently related to credit risk across banks and countries? Would Alternative B produce material cliff effects as exposures deteriorate below high-quality?*

The PCS label and industry standards should help the work of investors both in terms of selecting quality transactions and in finding all the information they need for analysing deals in an efficient and systematic way. Consequently, these labels and standards can be a practical tool to allocate securitisation transactions to quality buckets.

Not only investors, but also regulators and supervisors should benefit from these initiatives. Not intended to replace credit ratings, they could be used to identify securitisations which market players identify as of high-quality.

However, these initiatives are not applicable to exposures held in ABCP conduits given the lack of a public rating. In this instance the determination of high quality would need to be made via the IAA methodology to assess if the position was AA- or better. The cliff effect that we are trying to avoid would be extremely prevalent in this scenario. For example, if a small proportion of a previously AA rated exposure was deemed to now be A+ then the whole position would be reclassified as non high quality with the resultant heavy penalties attached to that under Alternative B.

4. *Are there alternative hierarchies or revisions to the two proposed (or a combination of both) that the Committee should consider?*

As commented on question number 1, the recommendation of the EBF is that the method at the top of the hierarchy be based on a model that is Basel 2 arbitrage free, an approach whereby the sum of capital requirements of the tranches is equivalent to the capital requirements of the underlying pool of assets, with a Basel 2 compatible model charge if deemed necessary by the Committee to be added only at the final stage of the RWA calculation. Against this background, we strongly recommend a recalibration that more accurately reflects actual credit loss figures. As regards the methodologies proposed:

- The Committee should also contemplate the possibility of permitting the use of IAA for more securitisation positions other than just ABCP programs. The

possibility of using the IAA on the first level equivalent to the MSFA is especially important for both sponsors of an ABCP program and investors in ABCP programs.

- We believe the current scope of the MSFA only allows it to be used for own asset securitisation where the level of data required is available exposure by exposure. The formula should include the option to use pool level data for highly granular pools (such as retail assets) such that the use of the MSFA can be broadened.
- As regards supervision, the IAA approach is dependent on supervisory approval and the MSFA applies supervisory formulae. Compared to the RRBA, these both approaches provide supervisory direct control.
- The calibration of the approaches should ensure that the respective calculation methods lead to consistent capital requirements *pre* and *post* securitisation. A certain regulatory capital incentive to use the next higher level in the hierarchy should exist. We believe that this also means that the capital requirement under the IAA should be less than the capital requirement under the RRBA. The relative preference of the IAA is justified, in our view, because banks using the IAA can perform a closer risk assessment than external rating agencies. Without excluding the use of external ratings as a benchmark, the IAA supports the objective of reducing overreliance on external rating and grants further control to supervisors. Consequently, the IAA should be extended to other securitisation positions in addition to ABCP programs where it can be demonstrated that there has been the same level of due diligence undertaken as would be the case for a transaction funded via an ABCP conduit.

The Committee could evaluate the impact of an alternative hierarchy like the one described above within the QIS exercise.

5. *The Committee recognises that in some instances and in some jurisdictions, the requirement for two external ratings could be difficult to implement or could impose additional costs on banks. The Committee requests feedback on the relative merits of reducing idiosyncratic, rating agencies' modelling risk with the costs of using two ratings and/or whether exceptions to this treatment should be permitted.*

The regulation requires banks the use of the second best eligible rating if two ratings are available for every exposure according to the Basel credit risk framework. As regards rating agencies' modelling risk, it is our belief that the shortcomings identified in the run-up to the financial crisis have been adequately studied and significantly remedied thereafter. The wide array of controls that regulators have required to rating

agencies has made their assessments reliable and their procedures robust. More importantly, the continuous supervision of rating agencies' operations by supervisors as a result of the regulatory reform guarantees that the production and supply of ratings takes place within a robust framework. The EU has already approved the Credit Rating Agencies (CRA) Regulation and the European Securities and Markets Authority (ESMA) has been mandated to elaborate regulatory technical standards that supplement the regulation in force. Against this background, we consider that the market is ready to make use of the important role that credit rating agencies play in the assessment of risks without the shortcomings that became apparent before the crisis. Ignoring the input from CRAs would mean a waste of resources and knowledge. Regulators have rightfully corrected the old deficiencies of rating agencies and should now permit its use. Moreover, in Europe, CRAs' methodologies are carefully assessed by ESMA which in addition provides overall CRA oversight.

The mandatory use of two ratings would not be justified in the current environment as modelling risks have already been substantially mitigated.

The dual rating requirement would create significant issues if applied to legacy positions as securitisation positions are not designed to be amended after launch. Apart from the practical consideration of who pays for the ratings, new rating agencies engaged to rate the structures are likely to require amendments to the terms in order to comply with their rating methodologies. Achieving the approvals for this will not be straightforward and may create perverse incentives between the holders of senior and of more subordinated tranches.

Further ratings have limited value when applied to legacy positions as the existing single rating becomes less based on the modelling of future possibilities and more on the actual performance data. Also the potential for discrepancy between the rating agencies will be limited as the revised re-securitisation rules will remove any dependency on the sectors with the largest modelling potential for differences between agencies (e.g. CDOs of ABS). These points were also recognised in the recent EU CRA3 Regulations that require multiple ratings on only new transactions.

In short, the EBF supports the use of the second best rating where there are two or more eligible ratings available (as is already the case in the actual framework) and the use of only one single rating compliant with regulatory requirements if there is no other one available. Making mandatory the use of two ratings would be a very burdensome and costly requirement for banks while completely ignoring the strict regulated and oversight activity of the CRAs. In particular, the requirement for two credit ratings would be unduly penal on single rated legacy exposures where gaining a second rating would be extremely impractical. The requirement to obtain two ratings should not apply to transactions that were rated before the final rules come into effect.

6. *Is the RBA appropriately calibrated and formulated? Should other risk drivers be incorporated?*

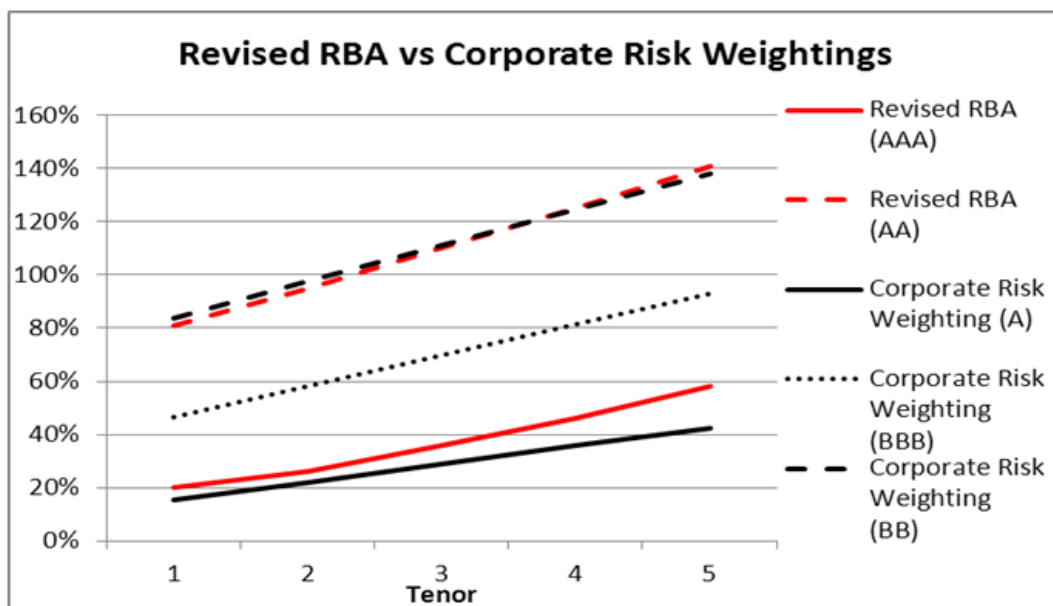
The accuracy of calibration depends to a large extent on the suitability of the input data used for the target portfolio. As commented on in our response to question number 2, the very low loss experience of European securitisation instruments is not adequately represented in the calibration put forward in the consultative paper. In comparable terms, the 12-month-rolling default rate of the whole universe of EU structured finance is slightly higher to 0.5% whereas in the case of RMBS is negligible. However the calibration has been run with a 1-year PD level of 4.7% and an LGD of 60%, which are levels associated with unsecured high-yield bonds (a very small portion of securitised assets).

The main concerns with the calibration refer to:

- (i) highly rated instruments;
- (ii) new cliff effects; and
- (iii) maturity assumptions.

6.1. Insufficient benefit to highly rated securitised lending: Companies operating in asset-intensive industries are currently able to benefit from recognition that secured or asset-backed lending is safer than unsecured lending. The new proposed securitisation risk weights remove substantially all the benefit of securitised financing versus unsecured financing, irrespective of the levels of credit enhancement obtained. In some cases under both the RRBA and the SSFA, asset-backed financing is actually treated more harshly than unsecured lending from a capital allocation perspective.

The unintended consequence of this recalibration will be that the securitisation markets, and the ability to obtain asset backed finance from banks, will be significantly reduced to such corporates, removing valuable funding diversification and impacting growth for these companies. This is especially true for smaller companies where the pricing advantage that banks can offer for this type of low risk funding is significantly lower than their unsecured pricing levels.



Risk weights suggested for longer maturity AAA assets and some shorter maturity AA, A assets are in many cases higher than the risk weights that would be applied to an un-securitised loan facility for the relevant underlying corporate client.

Under the proposed risk weights, it would be more accurate and less expensive in terms of capital to use a look-through approach. However where the look-through approach is not a viable option for investing banks, the senior tranches will become a less appealing investment opportunity.

6.2. Cliff effects in the RBA approach: In the vast majority of cases, multi-seller conduits fund senior tranches of high quality asset pools, i.e., AAA to A equivalent rating levels. The Committee has expressed a desire to avoid the cliff effect of risk weighting that they feel are currently in place. However, the new risk weights suggest that there is 2.5 times the level of risk within an AA rated tranche versus a AAA tranche. Given the difference between a AAA tranche and a AA tranche is typically only 3-4% of the capital structure this implies that the additional 3-4% carries a concentration of RWA equivalent to *circa* 650%. Whilst we appreciate that the current increase from 7% to 8% between AAA and AA is perhaps too low, suggesting a jump from 20% to 51% (1 year) is not a reasonable assumption for senior exposures and bears no resemblance to the actual difference in loss history experienced between these rating levels. This effectively moves a 1 year senior AA tranche into the same capital weighting as a corporate that is rated in the BB+/BBB- range for the same maturity. This has the unintended consequence of making it more efficient for banks to lend without security in circumstances where it is possible to invest prudently via the acquisition of a senior tranche providing the benefit of high quality asset pools as security.

This cliff between AAA and AA will make asset-backed funding highly inefficient in jurisdictions such as Italy and Spain, effectively excluding these jurisdictions from the

multi-seller market. For example, if a pool has more than 10% of exposure to Italian or Spanish corporates the securitised rating is capped at AA. This is very common when funding pools of trade receivables for pan-European corporates who operate in many countries. Despite the fact that these transactions may perform equally well, and sometimes better than those in other jurisdictions, proposed reforms will apply a significant penalty to these corporates by virtue of having operations in these countries and potentially push banks to move away from funding these assets. This has the potential to constrain liquidity and increase costs for corporates and their customers.

6.3. Concerns with the maturity assumptions: The suggested increase in RWAs according to maturity under the RRBA do not take into account that the credit enhancement levels within securitisation already penalise longer dated assets, or the protections that are inherent in multi-seller conduit securitisations.

For example, most multi-seller transactions have a dynamic advance rate whereby the maximum amount of funding is reset every month in line with current portfolio performance. There are also in built performance triggers that automatically amortise the portfolio should performance deteriorate significantly. Accordingly, with respect to the revolving period of the transaction, whether this is for 1 year or 5 years the same level of protection is still afforded with regard to asset performance.

The calibration around maturity will have a severe impact on corporates who generate longer term assets, including auto finance captives, corporate leasing companies, retailers offering credit to their customers, amongst others. To give one example, a AAA auto loan transaction with a weighted average remaining term of 3.7 years would have its risk weight increased by 6 times under the revised RBA approach. For the automotive industry there is currently a significant public ABS market. However, the majority of the captives use the multi-seller conduit market either as additional funding diversification or to act as a warehousing platform for these assets before they are termed out. The proposed rules could potentially make this product unviable meaning that captives will be forced to finance these assets on their balance sheet at greater cost which will lead to restriction of and increased pricing of credit to consumers.

The same principle applies in the consumer credit arena. Many retailers provide their customers with credit lines to assist with the purchase of goods. A large portion of this finance is funded via bank multi-seller conduits. The longer maturity of some of these assets coupled with the fact that these transactions are usually structured to implied ratings of AA/A would no longer make this type of lending viable. This is despite the low risk profile and excellent past performance of this sector.

7. *Is it appropriate to require that in order for the MSFA to be used the IRB approach should be applied for all underlying assets?*

It is not appropriate. In the view of the EBF the prevalence of mixed pools may have been underestimated in the consultative paper.

The MSFA should be available where the bank applies the IRB approach to the “predominant” share of exposures (as under Basel II). For immaterial non IRB share of exposures, the use of a conservative proxy data should be authorised. At least the Basel Committee should provide a threshold for such mixed pools.

8. *Is the MSFA appropriately calibrated and formulated? Does it incorporate the appropriate risk drivers? Is the calibration of tau and omega appropriate? If not, what evidence can respondents provide to support an alternative calibration?*

The main problems identified in the MSFA are the following:

- i. The maturity assumption;
- ii. The expected shortfall methodology;
- iii. The narrowness of the MSFA formula due to cap and floor;
- iv. The little impact of parameters *tau* and *omega* on the MSFA.

i. *Maturity assumption.*

The derivation of the MSFA formula in the BCBS working paper number 22 (WP22)¹¹ is based on an implicit simplifying assumption: that the maturities of the underlying loans are the same as the maturity of the securitisation tranche. It can be argued that this assumption is not accurate. It is very common for market participants to set up long-maturity securitisation structures – in order to minimise legal and administrative costs – where the underlying loans have short maturity and are replenished as necessary. This assumption in the MSFA creates a huge distortion in the cumulative RWA for a securitisation tranche whose maturity is materially different from the actual weighted-average life of the underlying loans. To illustrate this point, we take the ratio of the aggregate RWA of the full capital structure (consisting of sold and retained tranches) over the aggregate RWA of the pool of securitised assets. The outcome under the current SFA and RBA framework is a ratio of around 120%. It will increase to almost 200% under the revised framework.

In addition, it should be stressed that the incorporation of the maturity parameter in the MSFA creates a double counting for retail assets since maturity effect was already

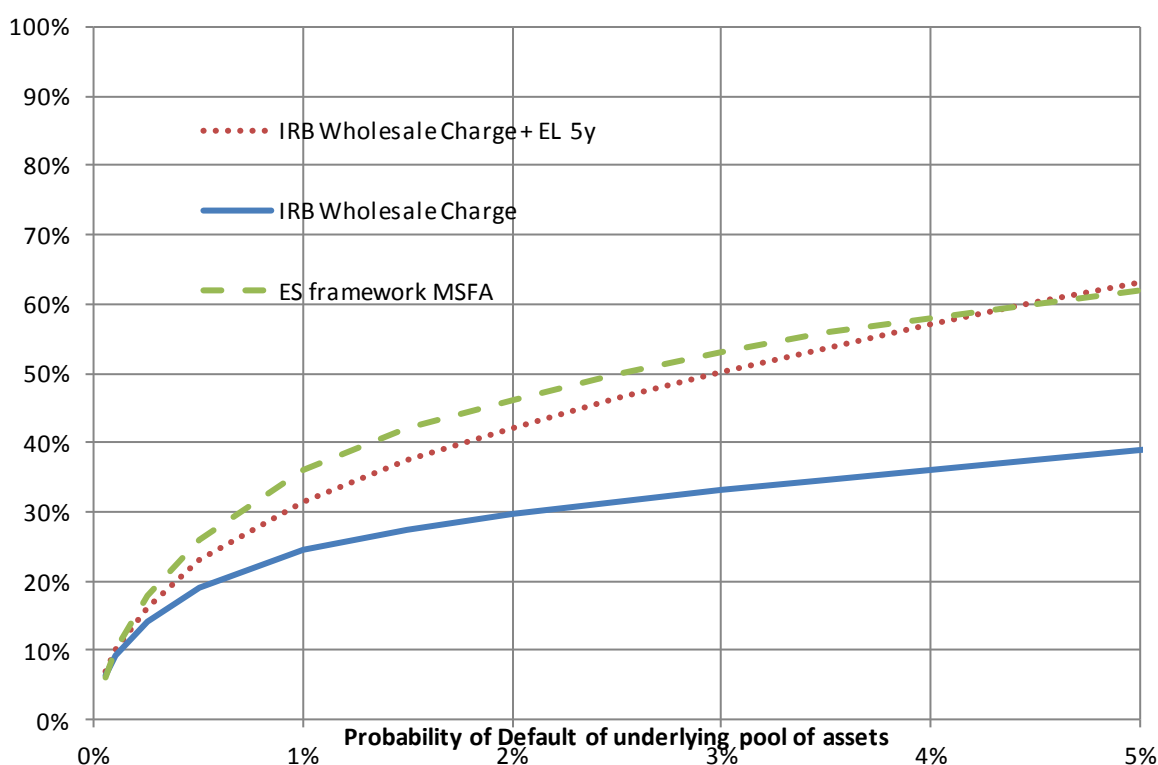
¹¹ *Foundations of the Proposed Modified Supervisory Formula Approach* (BCBS, January 2013).

taken into account by the Basel 2 AIRB by increasing the applicable 1 year correlation at 15%.

ii. Expected shortfall methodology.

Another problem with the MSFA formula is the proposal to switch to an expected shortfall methodology. As discussed in paragraph 17 of BCBS WP22, the new methodology can usefully be approximated and compared with the capital charge that would result from adding lifetime expected credit losses to the usual IRB approach.

As a matter of example, we have reproduced the Committee's Chart 2, but focused it on a range of probabilities of default (PD) from 0% to 5%, which we feel is more representative of most securitisations (i.e. underlying pools with a rating equal or better than "single-B") than a chart including theoretical securitisations of assets up to 100% PD.



What this chart shows is that the new ES framework under MSFA consistently returns an even higher capital charge for this range of assets over a 5-year maturity than adding expected losses over the same period to the IRB capital charge.

It may be theoretically appropriate to take into account expected losses over the whole life of assets when assessing a capital charge. However we object to this new methodology on two accounts:

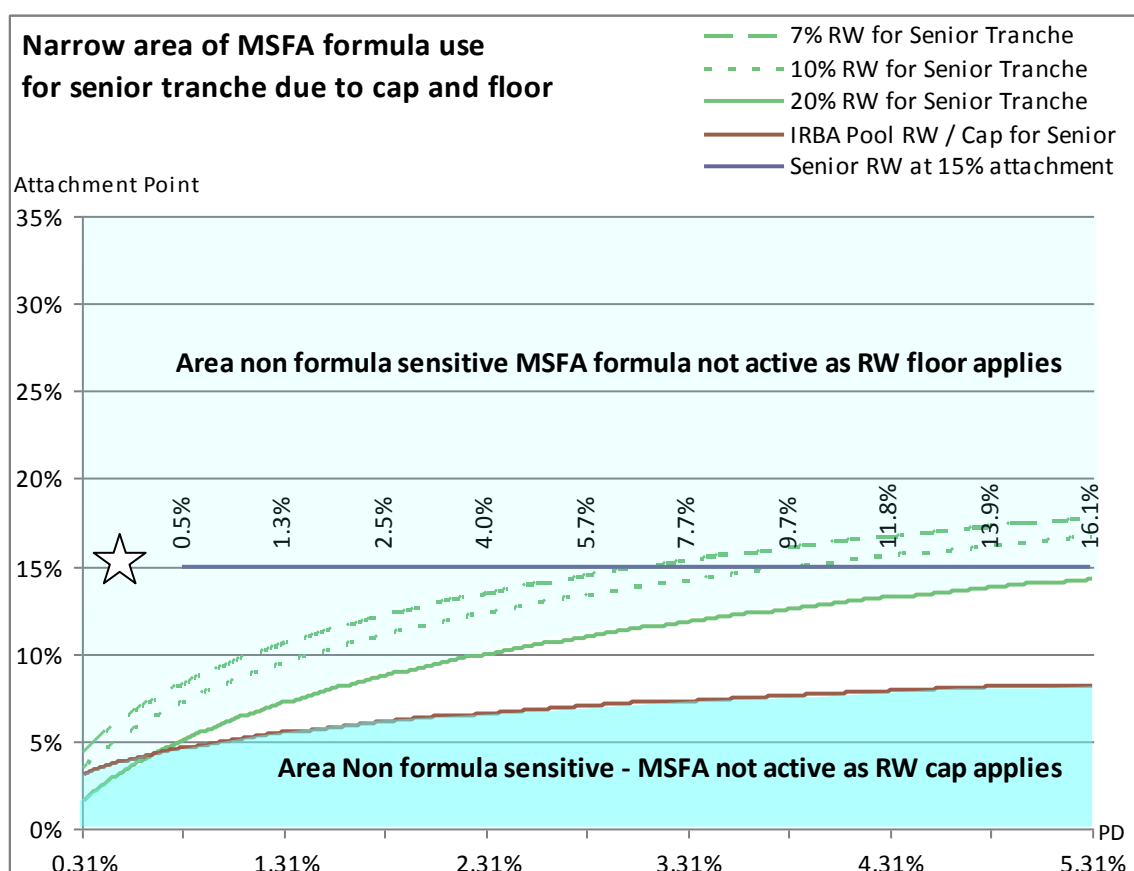
1. It is not in line with the rest of the Basel II/III framework which does not take into account (for unsecuritised assets) expected loss beyond the 1-year capital

horizon. It opens a considerable and unjustified gap in capital treatment between securitised positions and other assets with maturities beyond 1 year.

2. If expected losses are taken into account, then so should income or “excess spread” expected from the securitised assets. In fact it is a continuing weakness of the SFA/MSFA formula that it does not take into account such income, which represents the strongest investor protection in certain securitisations like credit cards or auto loans. As pointed out by the Committee in paragraph 18 of WP22, it is true that certain securitisations suffered losses far exceeding the excess spread, due to the extremely poor performance of the underlying portfolio. But that does not preclude taking into account such excess spread which has proven efficient in many other cases.

iii. The narrowness of the MSFA formula due to cap and floor:

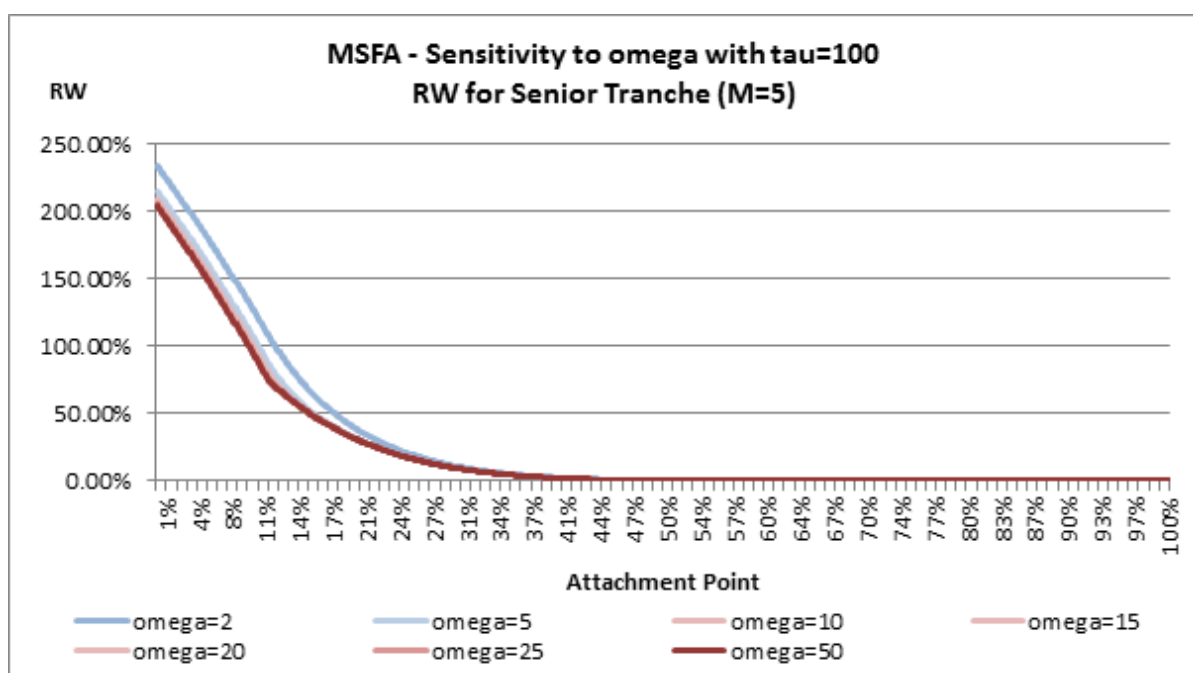
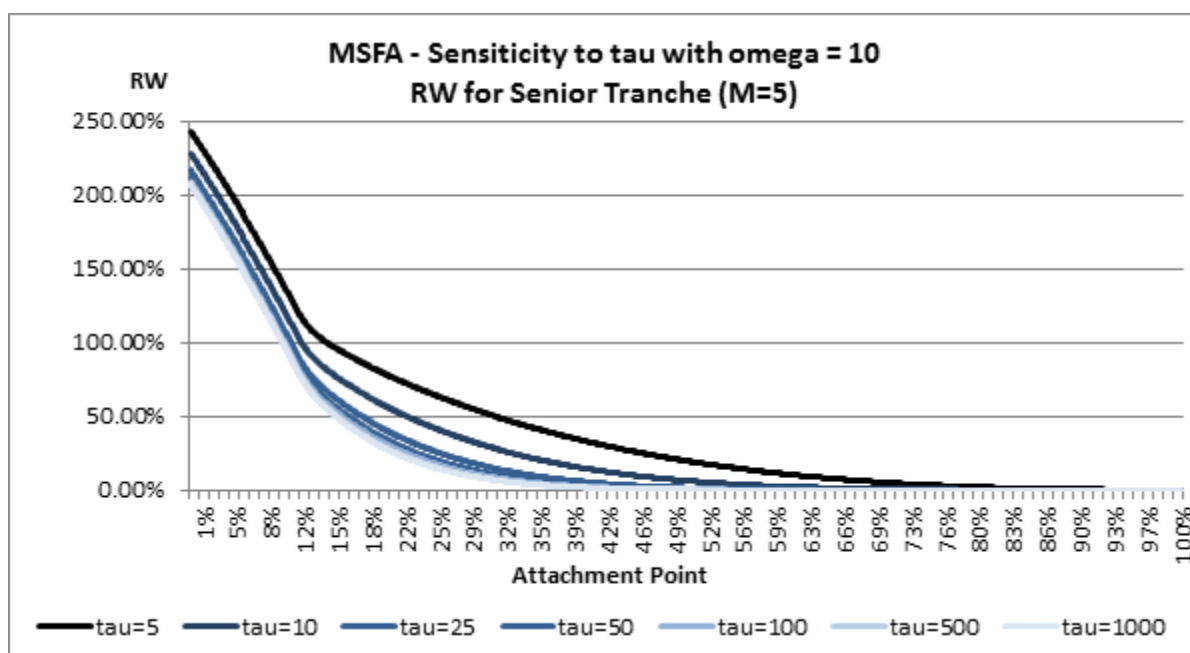
The application of the MSFA formula is very limited due the floor and cap being very close. As a result, the MSFA is not risk sensitive as it applies solely within a very narrow envelope that is shown in the example below (a prime UK RMBS case). As prime RMBS typically attach at 15% with PD below 1%, the floor will always be reached for prime RMBS is the MSFA model.



This fact undermines the overall incentive for banks to enter into securitisation transactions as the impact of the MSFA formula is limited to the narrow space between the cap and the floor.

iv. Impact of τ and ω on MSFA:

On the other hand, varying independent parameters τ and ω has little impact on the MSFA (see charts below). The MSFA is sensitive to τ and ω when the parameters are at extremely low levels (τ below 50 and ω below 5) but not when τ and ω are increased above these levels thus making the calibration of the MSFA model inconsistent with “arbitrage free” principles.



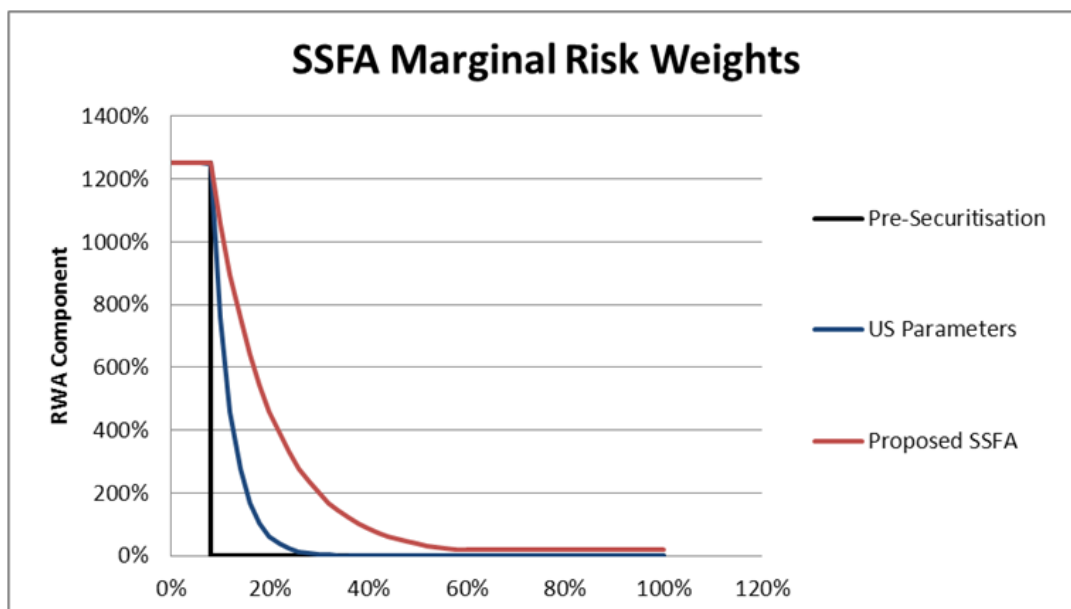
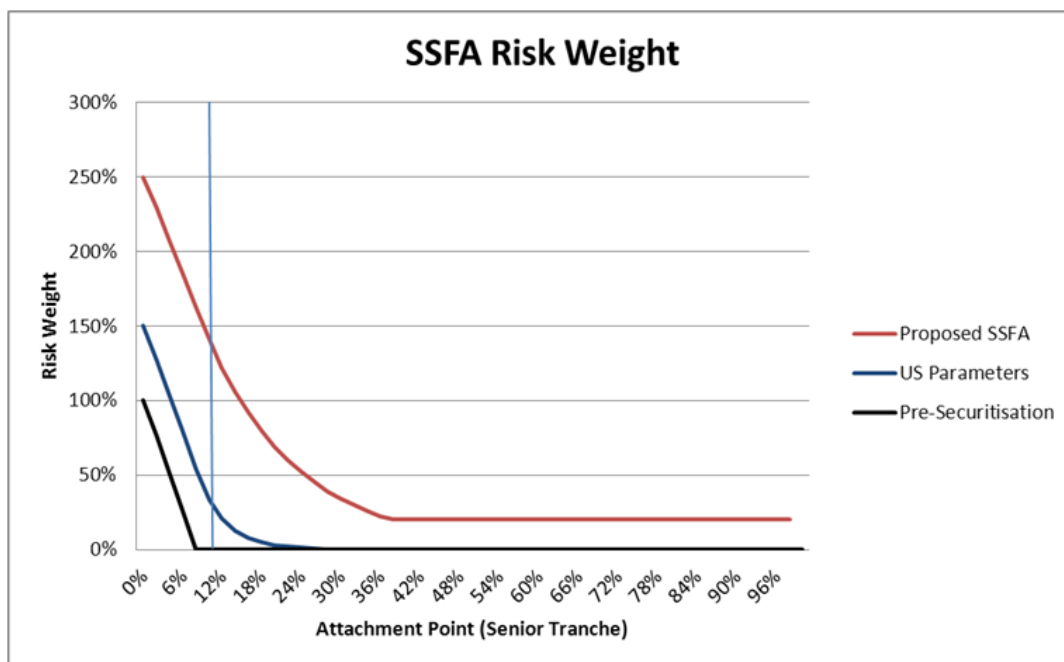
9. *Is it prudent to allow the use of the MSFA by banks making use of the foundation IRB approach (i.e. not calculating internal estimates of the underlying loans' LGD)?*

We do not foresee a material risk as a result of allowing the use of the MSFA to banks under the foundation IRB approach. Members of the EBF think that including the Foundation Internal Rating Based (FIRB) approach would not pose any significant problem for the following reasons:

- The outstanding overall exposure under the FIRB approach is relatively small compared to the total exposure to securitisation instruments.
- The loss given default (LGD) applied under the FIRB approach is sufficiently conservative.
- Banks are meant to move towards advanced models and there is an incentive to do so as long as LGD is generally lower under the Advanced Internal Rating Based (AIRB) approach.

10. *Is the SSFA (particularly the constant term p) appropriately calibrated? Please provide justification and evidence, to the extent possible, for alternative appropriate levels of calibration?*

The theory behind the SSFA is to establish a single RWA formula that assigns a risk weight to specific tranches based on the attachment and (where applicable) detachment points of the tranche within the securitisation structure. The charts below illustrate the Risk Weight and Marginal Risk Weight for a senior securitisation tranche as a function of credit enhancement, assuming an underlying asset pool with 100% average risk weight and no delinquencies.



The SSFA attempts to use a single formula to determine the risk weightings of tranches including high-quality senior tranches, mezzanine tranches and first-loss positions. This fact, together with the calibration of the ‘p’ parameter, results in some anomalous results for high-quality senior tranches. Most notably:

A securitisation with 12% credit enhancement – i.e., substantially greater enhancement than the capital required against the underlying assets – would be risk-weighted 120%, implying it is riskier than the underlying assets themselves

The SSFA would require extreme levels of credit enhancement in order to obtain a risk-weight less than unsecured lending direct to the corporate. This effectively makes

asset-based financing either uneconomic, or so asset-inefficient that it is unsupportable.

These anomalies arise from marginal risk weights that imply a securitised asset is 2.5 times riskier than the same asset held on-balance sheet, a requirement that stems from the requirement to assign 1250% risk weights to junior tranches. Consequently the current SSFA approach implicitly contradicts the standard approach to risk weighting as logically an institution should be indifferent between holding the asset pool on its balance sheet and holding 100% of the risk tranches in a securitisation based off the same asset pool, given the underlying risk is identical. A more balanced approach would apply more realistic marginal risk weights to senior tranches.

If a value of 0.5 is assigned to the supervisory adjustment factor, parameter p , the result of the SSFA would be closer to reality and at least the playing field with the US would be levelled.

11. Is the SSFA properly formulated or should other risk drivers, such as maturity, be incorporated?

As discussed previously, we believe that maturity of a transaction is already taken into account to a large extent within the current methodology. For instance, the amount of credit enhancement within a transaction takes into account the maturity of the assets and the stressed losses that may occur during the revolving and the collection period. The proposed calibration for maturity is much too severe and does not give any benefit to the protections that are already built in. The suggested steep curve from a 1 year to 5 year maturity will force banks to keep asset backed lending on a very short maturity resulting in instability for both corporates and banks funding plans. It also penalises companies with longer term assets, typically those funding the retail sector, despite their excellent performance.

Should maturity be introduced as a further risk factor, the current suggestion that the “ $p = 1.5$ ” within the SSFA calculation to address maturity increases capital by *circa* 10 times in some cases. This gives no benefit to shorter maturity transactions and encourages both banks and corporates to extend very long term facilities in order to increase the yield required to cover the increased capital requirements.

12. Has the BCRA been appropriately calibrated and formulated?

The BCRA is used for exposures that cannot be adopted into other methodologies. To this extent, it is justified that it should have a conservative calibration. We would argue that the form of the model has a significant shortfall in that it does not reference the attachment point of any exposure and as such gives no benefit for any over-collateralisation. An example would be if a bank holding the most senior €50 of a transaction where the capital requirement on €100 of underlying assets is €10. The capital requirement on this exposure under these rules would be €5. If the investor

were to sell the most senior €20 then the capital requirement would actually increase to €7.5 on the remaining now a subordinated position. This will clearly remove the incentive for banks from selling positions where it may otherwise be in their interests to do so. To avoid these inconsistencies, we would propose that the backstop model should be in the form of a supervisory formula approach, perhaps with a more conservative calibration, in order to recognise over-collateralisation.

13. What factors should the Committee consider in weighing whether the F parameter should be set at 2 for senior as well as non-senior tranches to avoid arbitrage opportunities?

The concentration ratios act in such a way that the BCRA is necessarily conservative before the F factor has been applied. The example shown in the proposal shows that holders of the most junior tranches would be required to hold capital equal to the capital on the underlying pool even before the F factor is applied, and therefore double the underlying capital if $F=2$. The concentration ratios work to then compound this by looking through and ignoring any subordination. The effect of this is clearly conservative - in the example shown, if $F=1$ then the capital required on the tranching is 75% more than that required on the underlying. With $F=2$ then this increases to more than 200%.

We also note that this F factor is only set to 2 for non-securitisation collateral.

The EBF would therefore suggest that setting $F=2$ is unnecessarily conservative and should be set to 1 for all asset classes.

14. How prevalent and material are securitisation exposures backed by mixed pools?

The BCBS mentions securitisation exposures backed by mixed pools in the context of proposals concerning the BCRA. It seems the Committee assumes that mixed pools are very unusual. In practice, however, many securitisations including most ABCP and many cross-jurisdictional CLO are backed by mixed pools. The question of how to treat mixed pools is therefore material.

15. Is the proposed treatment for mixed pools appropriate, or should another approach be employed?

The Committee should reconsider its proposal for mixed underlying pools (page 29 of the consultative paper). There is no need to limit the permitted approaches to the conservative BCRA. Alternatives might include:

- i. The right to use the SSFA for the whole underlying pool, or
- ii. The right to use both the MSFA and BCRA.

The applicability of the MSFA is complicated by the fact that this is only to be used when the institutions are able to calculate the capital requirement for the underlying portfolio completely under the AIRB. The Committee should reconsider this requirement. If the Committee wants to ensure a practical relevance of the MSFA it should take into account the existence of mixed pools and should implement a lenient threshold of Standardised Approach (SA) positions.

16. Is the definition of maturity appropriate, in light of the Committee's objectives?

The BCBS WP22 explains the derivation of the proposed MSFA formula. The paper deviates from the IRB framework which assumes a 1-year capital horizon. For maturity exceeding one year, the MSFA would essentially result in the capital charges across all tranches of a securitisation exceeding the IRB charge for the underlying pool. It would be appropriate for the maturity to be defined the same way as in the wholesale IRB framework.

We would propose a maturity based on weighted-average life as it is commonly used in the industry.

In our response to question number 8, we have already referred to the distorting effect of the assumption underlying the MSFA approach, namely that the maturities of the underlying loans are the same as the maturity of the securitisation tranche. The differences are shown in the table below through a simple example: assuming that tranche maturity is 3.5 years and Weighted Average Maturity ("WAL") of the underlying assets is 1 year, the distortion under the MSFA formulation can be seen from the differences in the calibration of expected loss and unexpected loss:

	AIRB	SFA/Kirb	MSFA
Expected Loss	<i>Based on WAL of underlying assets (1 year)</i>	<i>Based on WAL of underlying assets (1 year)</i>	<i>Based on tranche maturity (3.5 year)</i>
Unexpected Loss	<i>Based on lifetime credit losses (1 year)</i>	<i>Based on lifetime credit losses (1 year)</i>	<i>Based on tranche maturity (3.5 year)</i>

The misalignment in RW is more pronounced for securitisation transactions with:

- a. longer maturities - this creates a disincentive for banks to issue longer maturity securitisation transactions, which will potentially result in higher re-financing risks for bank balance sheet securitisation programmes.
- b. short-dated underlying assets, such as working capital and trade finance assets, maturity is not set at the weighted average life of such assets to reflect the lower credit migration risks of the assets. This creates a disincentive for banks to securitise short-dated assets. Because of their maturity, these are traditionally the most illiquid assets to distribute by other means. This may limit banks' appetite and ability to extend working capital loans or trade financing to borrowers.

Another possibility would be the contractual maturity. If it is not possible to use these kinds of maturity, the final legal maturity would be the main use case and the cap will be applied. If the Committee will stick to its proposal to implement the maturity as one risk driver, we propose the definition should not lead to a maturity that is always the worst case. The Committee should consider a definition which is more practical.

When determining the maturity of a securitisation exposure, the maximum period of time a bank is exposed to potential losses from the securitised assets should be taken into account. According to the consultative document, the maturity for a total return swap would be based on the maturity of the protected position. We propose to distinguish between total return swaps with physical settlement and those with cash settlement. In the latter case, the maturity of this securitisation exposure should be the maturity of the instrument and not of the protected position.

17. Is the proposed 20% risk-weight floor set at an appropriate level? Please provide justification and evidence, to the extent possible, for alternative levels for the risk weight floor.

The overall impact of the floor at 20% will be significant owing to the fact that the bulk of securitisation exposures are in the AAA/AA external and internal rating brackets.

It is in this floor where the major threat to the functioning of the securitisation market lies affecting both originators' retained tranches and investors' stakes.

The 20% risk weight floor is too high and will make a wide range of securitisation activities uneconomic, particularly securitisations of high quality assets. A fixed floor introduces an artificial risk weight on senior tranches of high quality pools and too low risk weight for low quality pools which is not consistent of the aim of risk-sensitiveness of the regulatory framework.

Therefore we propose that the floor should be risk-sensitive, i.e. be set in function of the risk weight of the pool.

18. Should the risk-weight floor for short-term exposures be the same as for long term exposures?

As outlined previously, we do not believe that there should be the suggested significant differentiation between short term and long term exposures given the in built protections within structures to address this risk. Instead, we believe that a different floor should be applied for senior versus non senior exposures to reflect the significantly reduced risk associated with senior exposures.

19. Are the proposed caps and their interactions with the proposed floor risk weight appropriate?

The fact that the caps are reached in most securitisations demonstrates that the proposed risk weights are not appropriate. This is even more clearly demonstrated with senior tranches of high quality assets, where caps will often be below floors. In case of conflicts, the cap should be applied in priority over the floor. The existence of caps is a useful protection, but it should only be applicable in rare situations. Caps have been designed so as not to recognise any benefit to the sale of a portion of the risk through a securitisation. As such they do not bring a benefit but only protect against useless penalisation.

20. Are there other approaches that could provide a more risk-sensitive treatment while still being prudent and operationally straight-forward to implement?

21. Are the assumptions used in developing and calibrating the approaches discussed above appropriate in view of the Committee's stated objectives? Please provide empirical justification for alternative assumptions to those noted above.

We would insist on considering the proposal depicted in questions 1 and 4 under the name of "Basel 2 free arbitrage model".

As explained throughout this response document the underlying assumptions are overly conservative and do not portray the reality of the vast securitisation market. This is especially the case in the EU where credit loss experience is virtually next to nothing.

The EBF would like to draw the attention of the Committee to the three key qualitative factors which support the strong performance of European RMBS, yet may not be taken into account by quantitative models:

- Full recourse to borrowers;
- Origination mostly undertaken by regulated banks;
- Extensive legal framework to protect consumer from over-indebtedness.

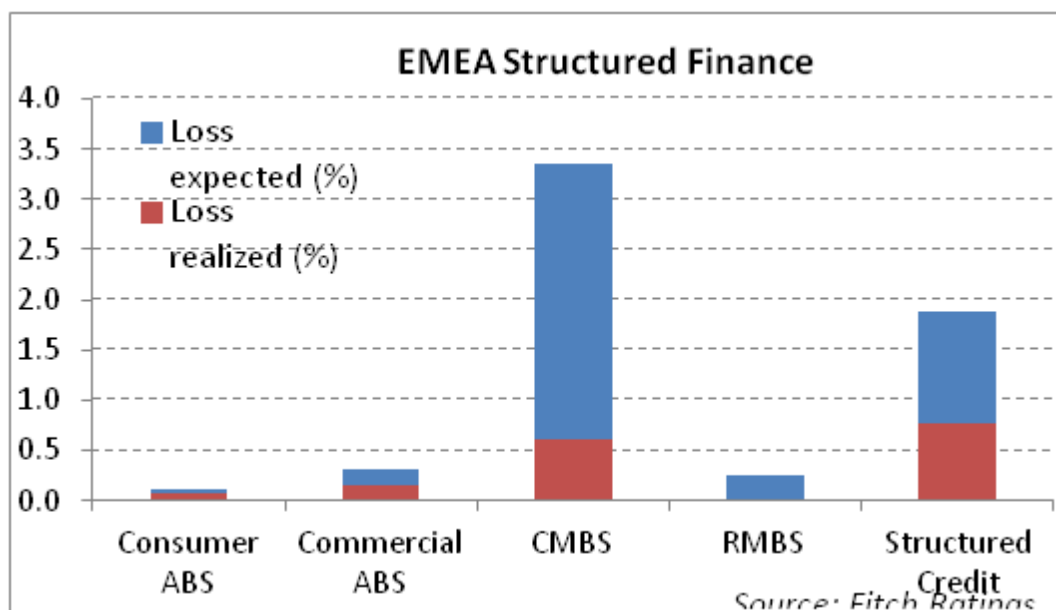
This would contrast with origination of US mortgages where recourse to borrowers is illegal in many states, and where when legal in some other states, jurisprudence may not allow banks to actually enforce such recourse.

We therefore would advocate for recalibrating the methodologies in accordance with the “free arbitrage” principle presented in this document.

22. Is the proposed treatment of retail securitisations using the same approaches as for corporate securitisations appropriate? Would additional complexity (in the form of an additional formula to adjust the AVCs of retail underlying exposures) be justified to remove the double-counting effect of maturity effects?

It seems to us that using a calibration based on corporate exposures to develop a methodology that would then be applied to other types of exposures, including retail, entails important drawbacks: (i) It does not take into account the specificities of retail transactions, and (ii) it can induce false effects that are specific to the corporate market on retail transactions. Conducting a comprehensive calibration that also takes into account historical data on retail transactions in different jurisdictions (US, EMEA, APAC) would yield more accurate results. A calibration specific to corporate exposures should only be applied to securitisations of corporate loans, and a calibration specific to retail exposures would be more relevant to securitisations of retail loans.

The main element specific to retail pools that is today missing in the methodology suggested by the Basel Committee is in our view the granularity. It can be argued that in conditions of extreme systemic risk granularity will not save the performance of securitisations, however in less extreme conditions it will have a positive impact. To illustrate this we can compare losses incurred by retail securitisations like RMBS or ABS versus corporate securitisations like Commercial Mortgage Backed Securities (CMBS) or Structured Credit, using the results in a report by Fitch Ratings which compares performances of Structured Finance transactions during years 2000-2011.



The performance of retail securitisations, as ABS and RMBS, has been very strong in EMEA countries (total loss 0.2% for RMBS, 0.1% for Consumer ABS), whereas we can see that losses on CMBS and Corporate Securitisations are steeper (total loss 3.4% for CMBS and 1.9% for Corporate Securitisations).

23. How could concerns that securitised retail exposures have high default risk or high correlation be managed? Please provide data supporting any modifications to the proposed approaches, particularly the MSFA and revised RBA, to account for differences in risk based on underlying exposure types.

The resilience of the retail securitisations in European countries to the US subprime crisis suggests that their evolution is more dependent on local origination practices and legislation than on the evolution of global economy, therefore we would encourage regulators to adjust if needed the parameters in order to account for increased default risk or high correlation only if the local jurisdiction would require it.

24. Is the relative calibration of the approaches appropriate? Please provide empirical data to support any conclusions.

We have alluded to the calibration in questions 2, 6 and 19. In understanding that question 24 refers to the comparison of calibrations of different approaches, this question should be revisited in the light of the results of the QIS underway.

There can be large differences between the amount of capital required under the RBA/IAA and SSFA. For example, the SSFA does not take any account of the amount of excess spread produced by a portfolio of assets. Therefore an asset class such as consumer credit is severely penalised under the SSFA as the more-than-90 (90+) day delinquencies are higher than seen in corporate portfolios. However, they also produce

a large amount of excess spread that compensate for these losses that can be taken into account under the IAA approach but not under SSFA. For example, an indicative consumer credit transaction's RWA can range from 96% under the proposed IAA to 181% under the proposed SSFA.

The SSFA also does not take into account the fact that corporates have different write off policies. Accordingly, Company A that writes off assets sooner will see better results under the SSFA than Company B that chooses to keep assets on its balance sheet for longer. Company B's 90+ day delinquency bucket culminates into a much larger number. However, both securitisation programs will stop funding against assets at the same level of delinquency so the risk profile of the transaction is similar but produce very different results under the SSFA.

Should there be an option for local regulators to opt for either the IAA or the SSFA, there will be an uneven playing field across Europe with both companies and their local banks having to deal with differing conditions.

We find there is an inconsistent approach to re-securitisations as the BCRA refers only to the detachment point and lacks even the ability of the SSFA to take into account the attachment point. This can lead to incongruities in the capital assigned to re-securitisation positions based on whether or not they are deemed to be senior. By way of examples:

- (i) Consider a bank holding the most senior €50 of a re-securitisation where the capital requirement on €100 of underlying assets is €10. The capital requirement on this exposure under these rules would be €5. If the investor were to sell the most senior €20 then the application of the F factor of 2 would mean that the capital requirement would actually increase to €7.5¹² on the remaining now a subordinated position.
- (ii) Consider a bank holding two positions in securitisations with identical underlying. In the first it holds the most senior €100 position in a securitisation of €200, in the second it holds the most senior €100 position in a securitisation of €110. The risks will be very different and yet the capital requirements are the same.

This is because the BCRA focuses only on the detachment point and not the attachment point. We feel this is too simple an approach that is open to inconsistency and would therefore propose that a supervisory formula approach would be more suitable.

¹² $\text{€}30 * 8\% * 2 * 12.5 * (10 / 100) / 0.8 = \text{€}7.5$

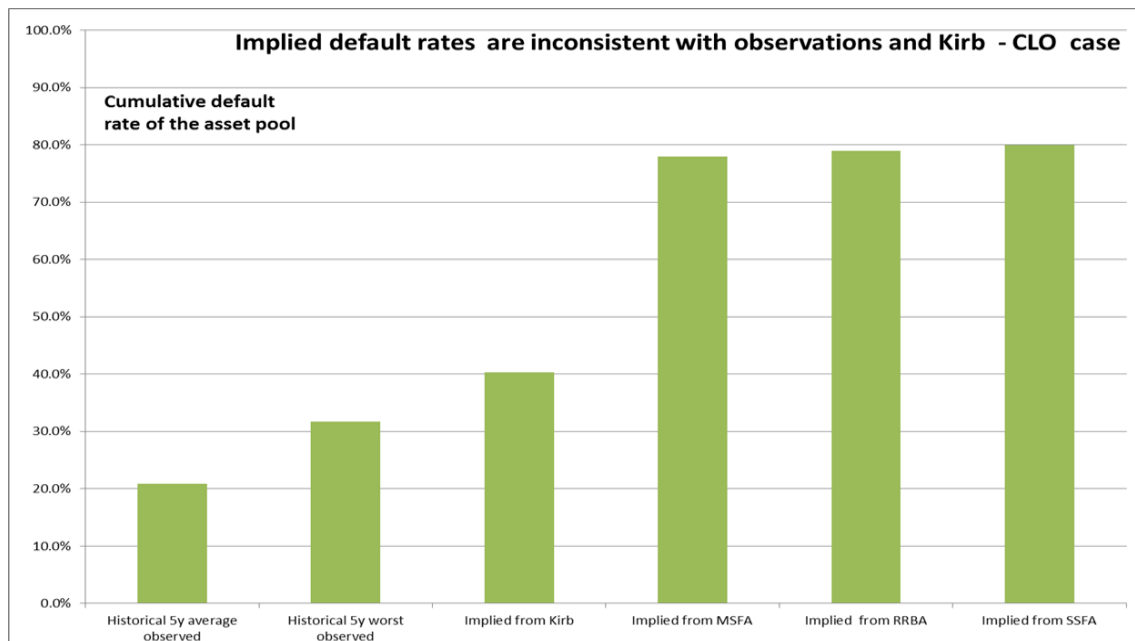
To solve this incoherent situation, the EBF would propose that the supervisory approaches should also be available for re-securitisation positions under a different p -value calibration.

Regarding the intention of the Committee to consider to what extent and in which specific instances the Basel II 1.06 multiplier that applies under the IRB framework should be applied, it is our view that there is no need to add another multiplier given that the calibration of the proposal is overly conservative.

Concluding remarks on the calibration of the proposals:

1. The asymmetry embedded into the calibration of all formulae leads to much higher risk weights on the tranches compared to the risk weight on the underlying pool.
2. The proposed calibration results in significant inconsistency between the capital charge for the securitisation positions and the historical performance of the underlying pool.

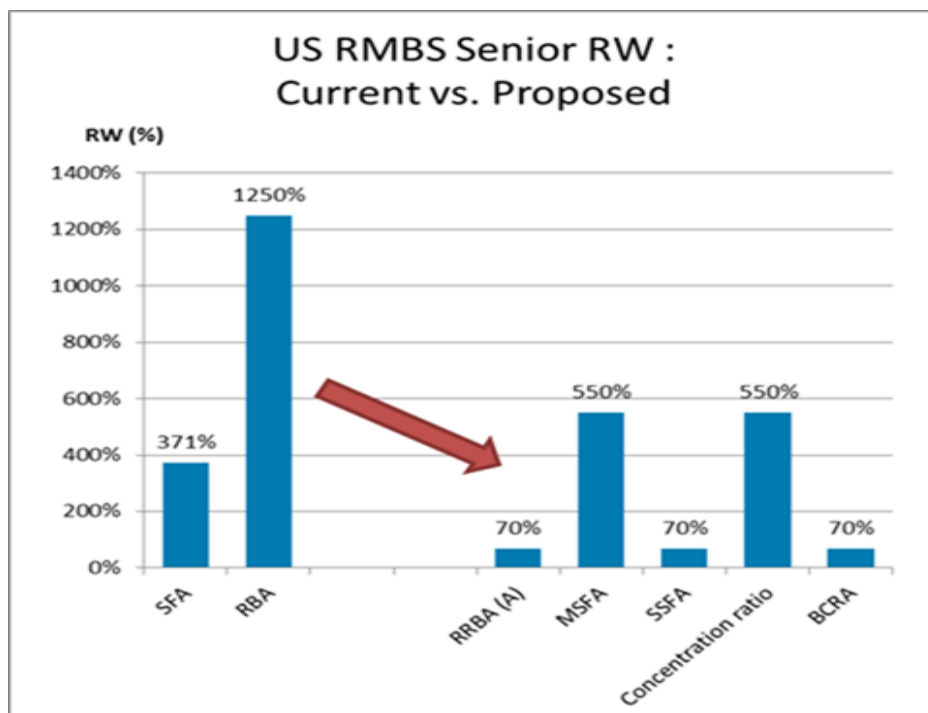
We have calculated the cumulative default rate that would be necessary on the pool to cause a loss on the senior tranche equivalent to the capital charge under the proposed methods. We have assumed for this calculation stressed parameters for LGD (loss given default) of 50% above the historical average of 35% and stressed constant prepayment rate of 15% below the historical average of 25%. We have stressed these parameters to take into account the fact that in an extreme scenario of default both recoveries and prepayments are well below historical averages. With these parameters, we find that the capital charges under the proposed methods (MSFA, RRBA, SSFA) imply cumulative defaults of around 80%. A level of 80% of cumulative defaults is inconsistent with the worst historical data and is twice the default rate implied by the Kirb. By the simple virtue of transferring the assets in a securitisation Special Purpose Vehicle (SPV) instead of keeping them on bank balance sheet, then suddenly their default rates implied in the capital charge doubles under the proposed methods compared to the Kirb.



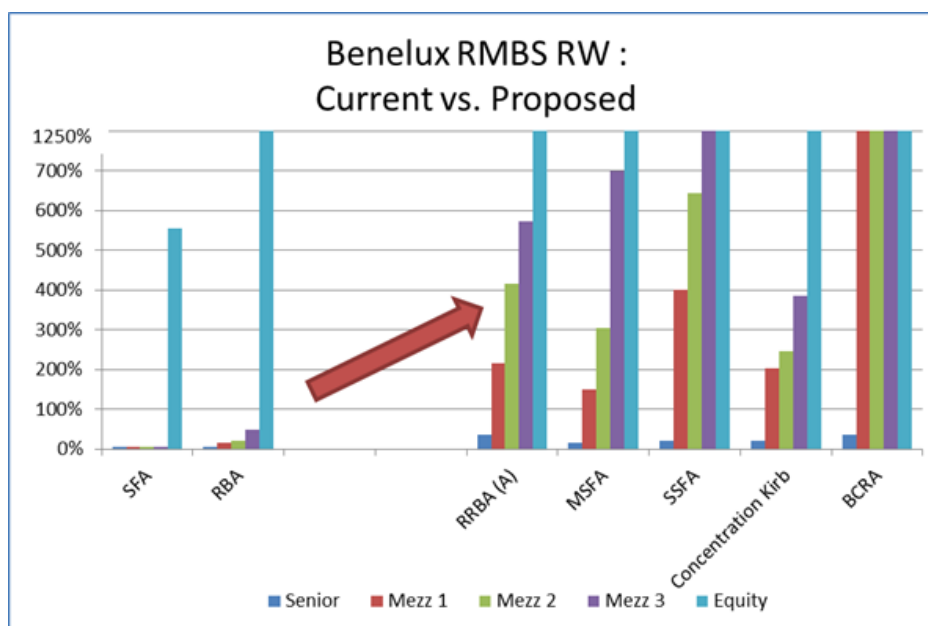
3. The cliff effects will be maintained, despite the intention of the Basel Committee to reduce it

4. The new proposals will be detrimental for securitisation of high quality assets while favouring securitisation of low quality assets. As a matter of example, the graph below shows that the senior tranche of a low quality pool transaction rated CCC¹³ and currently attracting a risk weight of 1250% will see its risk weight improved under the proposed methods:

¹³ US subprime RMBS rated CCC with senior attachment point at 23.77%, pool estimates of PD 14.6% and LGD 75% and pool risk weight of 413% under AIRB.



On the contrary, a high quality RMBS¹⁴ will see its risk weight increased under the new proposed methods:



¹⁴ Benelux RMBS rated AAA with senior attachment point at 8.30%, pool estimates of PD 0.4% and LGD 22.5% and pool risk weight of 16% under AIRB.