Position paper
on the consultative document "Fundamental review of the trading book: outstanding issues"

Capital requirements for securitisation positions in the trading book

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VDA
Verband der
Automobilindustrie

VDA represents more than 600 companies of the automotive industry including auto banks (so called captives). We are observing with great care the actual banking regulations with regard to the impact on the finance captures of the car manufacturer.

Although the trading book regulations have less of a direct significance for captives in the automobile industry, a greater indirect relevance becomes evident as regards the refinancing of the captives through asset-backed securities. Asset-backed securities are an important instrument in the refinancing of receivables from vehicle financing and leasing, which in turn are of great importance for sales levels in the auto industry: Each year, more than 13 million new passenger cars are registered in the European Union. Approximately 60 % of the cars sold are either financed or leased. The captives are an indispensable partner for motor vehicle manufacturers in the marketing of passenger and commercial vehicles. They ensure that the automotive value chain runs smoothly.

The regulations on capital adequacy for securitisation positions in the trading book have a direct impact on the market liquidity of these financing instruments. For instance, positions from market-making activities are to be allocated to the trading book. Trading activities in ABS via the trading book support a good market liquidity of this financing instrument. The market liquidity of a financial instrument is in turn important for the attractiveness of a capital investment and thus has a direct impact on the refinancing costs of an ABS.

The higher the capital requirements for securitisation positions are in the trading book, the higher is the associated cost of carry. Ultimately, such costs are reflected in the refinancing costs. Against this background, we have remitted our comments on the last consultative paper as to the fundamental review on the trading book.

We highly appreciate and expressively welcome that the Basel Committee has considered our concern and has set up an own bucket for Auto-ABS in the non-correlation trading portfolio. That helps to avoid discrimination of Auto-ABS against other ABS-segments.

However, we are still concerned that the capital requirements for highly rated high quality ABS including Auto-ABS but not limited to Auto-ABS are generally too high in the trading book. We fear that the capital requirements for these asset backed securities exceed the capital requirements in the banking book. This does not seem appropriate in view of the relatively short holding period in the trading book and will be detrimental on holding ABS position in the trading book with adverse impacts on the liquidity of such instruments. Therefore, at least a cap should be introduced that limit the capital requirements for securitisation position in the trading book to the capital requirement of the banking book.

While it is to be welcomed that double counting on default risk should be avoided it is not sufficient to set the maturity to one year, since this implies that top prime ABS are charged at least with the floor capital requirement in the banking book. However, according to the securitisation framework of the Basel Committee published on 11 December 2014, the floor risk weight will increase from 7% to 15% for IRB banks which is a lit bit more than a doubling of the current capital requirement in the banking book.

In addition, the risk weights for spread risks of high-quality top-rated securitisation positions that have to be assigned to the non-correlation trading portfolio are much too high as well. One reason might be that in contrast to the second consultative paper the Basel Committee has stopped using the rating grades and only differentiates between investment and non-investment grade. This is not risk-sensitive and appropriate for top rated high quality ABS, because the spread risk is usually significantly lower for high quality triple A rated ABS such as Auto-ABS than that of other ABS with a lower but investment grade rating. This fact was considered in the second consultative paper from October 2013 (see paragraph 119 and 120.) but not in the consultative document. To avoid not justified discrimination of highly rated ABS that exhibit significantly lower spread risks the investment grade segment should at least be further differentiated between highly rated ABS with triple A and double A rating on the one hand and other ABS with a rating that is commensurate to “investment grade” on the other hand.

Furthermore, the work of the Task Force of the Basel Committee and IOSCO as to simple, transparent and comparable securitisations should be used to significantly lower the risk weights for qualifying asset backed securities in the non-correlation trading portfolio. This also seems justified because simple, transparent and comparable ABS that are well-established in the market exhibit significant lower spread risks as a complex, difficult assessable securitisation tranches.

As to the paragraphs we have the following specific comments to securitisation under the standardised approach:

Paragraph 50

The risk weights are significantly too high for highly rated securitisation positions with triple A and double A rating. One reason might be that in contrast to the second consultative paper the Basel Committee has stopped using the rating grades and only differentiates between investment and non-investment grade. This is not risk-sensitive and appropriate for top rated high quality ABS. Hence, the investment grade segment should at least be further differentiated between highly rated ABS with triple A and double A rating on the one hand and other ABS with a rating that is commensurate to “investment grade” on the other hand. In addition, we assume that the calibration of the risk weights was highly influenced by the sharp increase of credit spreads during the last financial crisis. However, this was mainly due to fire sales of highly leveraged SIV’s that have disappeared. Thus, the work of the Task Force of the Basel Committee and IOSCO as to simple, transparent and comparable securitisations should be used for qualifying securitisations to significantly lower the risk weights for asset backed securities in the non-correlation trading portfolio. This also seems justified as simple, transparent and comparable ABS that are well-established in the market exhibit significant lower spread risks as a complex, difficult assessable securitisation tranches.

Paragraph 55

We believe that the correlation for simple, transparent and comparable securitisations to non-simple and non-transparent securitisations might be much lower than set out in the correlation table because due to market confidence in simple, transparent and comparable securitisations it is not to be expected that problems in non-simple and non-transparent transactions would spill over to simple, transparent and comparable securitisation. Hence, the lower correlations should be inserted when considering the capital requirements for simple, transparent and comparable securitisations.

Paragraph 109

While it is to be welcomed that double counting on default risk should be avoided it is not sufficient to set the maturity to one year, since this implies that top prime ABS are charged with the floor capital requirement in the banking book. However, according to the securitisation framework of the Basel Committee published on 11 December 2014, the floor risk weight will increase from 7% to 15% which is a lit bit more than a doubling of the current capital requirement in the banking book. Thus, the capital requirements for backing the default risk should be reduced. This holds true in particular for securitisation positions that qualify as simple, transparent and comparable, because the model and structural risk that was used as a rationale to increase the capital floor is much lower for this kind of securitisation.

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