German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments

on the Basel Committee for Banking Supervision's Consultative document "Revisions to the Basel Securitisation Framework"

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 2,000 banks.

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Comments “Revisions to the Basel Securitisation Framework”

In December 2012, the Basel Committee for Banking Supervision (BCBS) published a Consultation Paper entitled “Revisions to the Basel Securitisation Framework”. We would like to thank you for the present opportunity to comment on said Consultation Paper. We greatly appreciate this opportunity. Please find the comments of the German Banking Industry Committee (GBIC) below.

We would like to preface our specific comments on the current proposal and the issues raised by the Consultation Paper by a number of general observations.

I. General Comments

The 2007/2008 financial crisis undoubtedly revealed a series of problems potentially linked to the use of securitisations. This not only concerned the complex structure of individual securitisations but also the treatment of such exposures in banks' risk management. Prior to the financial crisis, particularly US banks had started to grant loans only in order to subsequently place them in the capital market (so-called “originate-to-distribute” business model). As a consequence, these countries frequently witnessed an erosion of their lending standards. Furthermore, it became an increasingly widespread practice to pass the risk of individual securitisation tranches on to other investors in a structured manner (so-called “re-securitisations”). When managing the risks associated with such securitisations, apparently not all banks were able muster the necessary prudence and expertise.

Last but not least, these developments also highlighted the need for improvements in the field of regulatory requirements for securitisations. Both, the Basel Committee for Banking Supervision (BCBS) and the EU legislator responded to this need: First, “Basel 2.5”, saw a clear increase of the regulatory capital requirements particularly for intransparent resecuritisations. Second, Art. 122(a) of the EU Banking Directive (CRD) made it compulsory for banks to apply the same lending standards to exposures earmarked for securitisation as to the bank’s own on-balance sheet exposures. Non-compliance incurs sanctions in the form of higher risk weights. Last but not least, under the provisions of Art. 122(a) EU Banking Directive, banks have to “retain on an ongoing basis, a material net economic interest which, in any event, shall not be less than 5%”.

The current proposals primarily seek to reduce the extent to which the calculation of capital requirements has to draw upon ratings made by external rating agencies. Furthermore, the capital requirements are supposed to become more risk sensitive and ought to avoid any sudden strong changes within one approach or between individual approaches (“cliff effects”). The German Banking Industry Committee (GBIC) welcomes these objectives.

Introduction of an overall cap to capital requirements

Notwithstanding the foregoing, we have major concerns over the fact that, as a result of the new proposals, capital requirements for securitisation positions would generally see a marked increase. First and foremost, this increase is due to the calibration of the individual approaches which – compared to the “predecessors” – is generally more conservative. The calibration would lead to a situation where the aggregate capital requirements applicable to all banks involved in a securitisation transaction would be clearly higher than the capital requirements if the securitised portfolio was held by a bank. For instance, first calculations for a securitisation of mortgage loans with a probability of default (PD) of 5 and a Loss Given Default (LGD) of 20 percent demonstrate that even capital requirements calculated under the Modified Supervisory Formula Approach (MSFA) would result in capital requirements that are almost twice as high as the capital requirements for the securitised portfolio. This is inappropriate. In our view, a

securitisation does not increase the credit risk of the securitised portfolio. The risks potentially additionally associated with a securitisation (e.g. structure risks) do not justify such a mark-up. The review of the proposed capital requirements during the Quantitative Impact Study (QIS) should be used as an opportunity to implement a more risk sensitive calibration and to limit the overall capital requirements for all positions resulting from a securitisation transaction to the capital requirements for the securitised portfolio.

Consideration of the impact on the real economy

Furthermore, the Basel Committee proposal would jeopardise the securitisations’ positive effects for the real economy. New capital requirements shall and must not force banks to completely withdraw from the field of securitisations. Negative side effects for the real economy may occur above all in the field of term transactions, ABCP and if banks purchase receivables to their own balance sheet with a discount schemes. When used correctly, securitisations offer a valuable tool for banks’ risk and capital management.

Securitisations are particularly helpful when it comes to loans to small and medium-sized enterprises (SMEs). By passing on SME exposures to the capital market, banks obtain new leeway for their lending activities to this customer group. Even during the financial crisis, the credit defaults of German SME securitisations were generally in line with expected losses and did not exceed the amount of the first loss tranches.

Apart from this, securitisations are being used in order to fund exposure portfolios especially of small and medium sized businesses by reverting to the capital market – these are customer groups which usually lack any external rating. In these transactions, banks usually act as liquidity providers. For companies, such conduit structures where mostly retail and leasing exposures are funded by issues of Asset Backed Commercial Papers (ABCP), constitute an important tool for balance sheet management as well as liquidity management. Furthermore, contrary to a direct purchase of the exposures on the balance sheet, they also offer banks further advantages – without making lending more difficult. These securitisations, too, have a proven track record of being extremely stable.

Also in times of crisis, non-financial corporates and banks need be allowed to draw upon a diversified funding . We feel that securitisations constitute an indispensable element in this respect. The proposed regulatory framework would strongly curtail the scope for using securitisations. According to a Moody’s document[1], around 60 billion USD of corporate financing in the broadest sense in Europe, the Middle East and Africa is funded through so-called multi-seller ABCP programmes. In the best case, these companies’ financing would become considerably more expensive under the new regime; in some cases, it would no longer be commercially viable.

Strengthening internal approaches

We agree with the Basel Committee that those approaches should be at the top of the hierarchy which are based on banks’ internal approaches for assessing the securitised portfolios. Hence, in our view, already at the first stage of the hierarchy it should be permissible to draw upon the Internal Assessment Approach (IAA). After all, this approach can be regarded as a tested and tried procedure which should be located at the same level of hierarchy as the MSFA. Banks should choose between the two apparoaches in due time and based on consistent criteria; the guidelines for the segmentation decisions should be agreed

[1] EMEA ABCP Market Summary: Q3 2012 (Exhibit 16).

jointly with the supervisory authorities. Particularly for sponsors of ABCP programmes as well as for investors in ABCP, the option of using the IAA at the first level as an equivalent approach is important. Already under today’s rules, these banks will frequently not be able to calculate the capital requirements for the securitised portfolios based on the IRBA. Hence, for them, the use of the MSFA would not be an option, anyway. They would thus be at a disadvantage compared to banks securitising own exposures.

In our view, the relatively preferential treatment of the IAA is justified. After all, banks using the IAA feature a better risk assessment than external rating agencies. The IAA furthers the goal of increasing independence from external ratings; at the same time it is subject to supervision by the competent authorities. The risk of a securitisation does not depend on whether it is reported on a bank’s balance sheet or whether it is held in the conduit and secured by a liquidity facility. For this reason, we hold the view that it would be appropriate to expand the IAA’s scope of application (which currently only comprises items in the ABCP programmes) to include further securitisation positions (especially but not limited to non-financial corporate transactions).

Realism in drafting the conditions that have to be met for using the MSFA

Furthermore, a realistic conception of the MSFA eligibility criteria is paramount. We see two major problems in this context:

The Basel Committee holds the view that the MSFA should only be applied if and when the bank has an officially approved IRBA approach for each and any securitised exposure in place and, in addition to this, it is capable of calculating the capital requirements for the entire securitised portfolio under the IRBA (K_{IRB}). In our view, this presents an excessive hurdle for using this approach. When banks lack an officially authorised rating rating system for parts of the underlying portfolio, the development of a new separate IRBA rating system and applying for official approval by the competent supervisor just in order to meet the conditions for using the MSFA will generally not be economically viable. Furthermore, non-financial corporates will frequently also lack the necessary data for this. From a systemic perpective, the proposal is bound to lead to a concentration of certain exposures with but a limited number of counterparties. From a supervisory point of view, this appears to be counterproductive. At present, the Supervisory Formula Approach (SFA) may be used if the securitised portfolio largely consists of IRBA exposures. This rule should also be maintained for the MSFA. Otherwise, banks would be forced to choose a different approach if individual securitised exposures were no longer eligible for treatment under the IRBA approach. In turn, this might lead to a situation where, in hindsight, the securitisation transaction turns out to lack economic viability.

In its proposals, the Basel Committee appears to assume that mixed pools are an exception. In practice, however, most pools tend to be mixed pools. This is first and foremost due to the fact that, currently, a securitisation position may even be recognised for securitisations under the IRBA approach if merely the majority of its securitised portfolio consists of IRBA positions. The IRBA rules allow banks a certain room for discretion to treat certain portfolios on a temporary or permanent basis under the Standardised Approach.

In our view, the current rules on the use of the IRBA approach with regard to mixed securitised portfolios should also be used for the MSFA. The reason is that this will provide banks with incentives to use this advanced and risk sensitive approach. However, at any rate, for the ratio of not internally rated expsures in a securitised portfolio, an upper limit should be introduced up to which the MSFA may be used.

Furthermore, especially in the real economy customer business involving retail exposures it will hardly be possible to calculate the capital requirements under the IRBA (K_{IRB}) based on the normal IRBA rules (“bottom up”). Hence, we welcome the Basel Committee’s proposal, i.e. that in the framework of the MSFA it should be possible to also calculate the capital requirements for portfolios of purchased receivables by means of a top-down approach (footnote 28). However, it should be equally possible to make a conservative estimate of the capital requirements in the framework of a top down approach without using an officially approved IRBA approach. Hence, we strongly endorse the Basel Committee’s plans presented under paragraph 77 of the paper “Foundations of the Proposed Modified Supervisory Formula Approach” i.e. simplifying the use of the MSFA and lowering the information requirements for banks. In the final analysis, also investors (i.e. parties not involved in structuring the transaction) should be able to use this approach.

For certain transactions (e.g. featuring high correlations in the securitised portfolio), national supervisors should be given the right to prohibit banks from using the MSFA (and the SSFA). From our point of view, this is a source for concern, indeed. At any rate, however, care is required in order to ensure that the use of the MSFA will not have to be discussed with the competent supervisor prior to every single transaction.

Hierarchy B would incur a host of problems

The Basel Committee suggests two hierarchies of approaches for determining the capital requirements for securitisations. Along with a number of important amendments spelt out in the present Comment Letter, the German Banking Industry Committee would like to endorse Hierarchy A.

We strongly reject Alternative B proposed by the Basel Committee. Hierarchy B suggests a categorisation of “senior high-quality securitisation exposures” which, in our view, would clearly increase the complexity during the calculation of capital requirements. Furthermore under the Hierachy B the use of one of the two concentration rate approaches is mandatory for exposures that are not “senior high-quality”. This will give rise to excessive capital requirements for these exposures. This holds true particularly in view of the fact that for certain types of securitisation transactions (e.g. securitisations of trading or leasing exposures via a conduit), more likely than not, there will not be any positions which meet the criteria of “senior high-quality securitisation exposures”. As a consequence - in the absence of any objective justification for this - this would mean that transactions with a proven track record of several years of excellent performance would be subject to disproportionately high risk weights.

In addition to this, pronounced cliff effects would be the consequence if a tranche could no longer be deemed “senior high-quality securitisation exposure”. Last but not least, in the case of “senior high-quality securitisation exposures” the equal treatment of RRBA and the two Supervisory Formula Approaches is inconsistent with Basel Committee’s declared objective of reducing the reliance on external ratings. Hence, more likely than not, for the purposes of identifying “senior high-quality tranches”, not only external ratings but also the assessment by banks will be used. Bank’s assessment should be based on internal guidelines. However, in order to ensure largely harmonised internal guidelines within banks, the Basel Committee should define further criteria which will allow a categorisation. With a view to a harmonised policy across different jurisdictions, Alternative B is not advisable.

Risk sensitive recalibration creates incentives for using advanced approaches

The GBIC would like to reiterate its reservations over the proposed calibration of the capital requirements for securitisation positions. On aggregate, this calibration appears excessively conservative. In our view

this should not be based on absolute “worst case” scenarios which, in turn, are predicated on specific phenomena such as subprime RMBS or arbitrage CDOs (i.e. phenomena which mostly occurred exclusively in the US but not in Europe).

During the calibration of the individual approaches it should be ensured that the respective calculation approaches lead to consistent capital requirements at one level of hierarchy. Apart from this, there should be a capital requirements based incentive to use of the respectively higher level of hierarchy. In our view, this also means that the capital requirements calculated under the IAA should, firstly, be lower than the ones determined under the RRBA; furthermore these capital requirements should be comparable to the ones under the MSFA. Neither is the case at present. With a view to the fact that under the current proposal the KSA caps would have to be applied for all senior tranches, a recalibration of the capital requirements calculated using the IAA would be appropriate.

Furthermore, we are of the opinion that the calibration of the RRBA and the SSFA is inappropriately conservative. We feel that the risk weights in the RRBA are utterly excessive. This is particularly true when compared to the capital requirements for corporate loans. One potential consequence could be that banks would have to back unsecured corporate loans with less regulatory capital than funding through the securitisation of corporate exposures. Hence, banks would be incentivised to accept higher risks during their lending transactions. First and foremost, the proposed calibration of the RRBA should reflect the fact that, during the financial crisis, the external rating agencies have made considerable adjustments to their rating methodologies and that, meanwhile, the risk drivers (e.g. “tranche thickness”, “maturity or high risk underlying pools”) are included in the published ratings. As far as the SSFA is concerned, we suggest lowering the parameter “p” to 0.5 (similar to the way it is currently handled in the United States). This would result in an instrument which can also be applied by investors and which would still lead to higher capital requirements. Furthermore, it would seem as though the floor for the risk weights had been defined in an arbitrary manner and without any empirical evidence. The proposed floor of 20 percent is too high. It should reflect the underlying assets. Also, it should differ in terms of the approach used. This will create incentives for banks to further develop and apply IRBA rating systems, MSFA and IAA.

Whilst, essentially, we prefer Hierarchy A, there is one major problem associated with this: the criteria for using both the MSFA (not applicable when it comes to mixed securitised portfolios, no applicable top down approach) and also for using the RRBA (two ratings) have been conceived of in such a way that banks will frequently have no other choice but to use the BCRA which would incur inappropriately high capital requirements. Also based on the foregoing, we hold the view that there is an urgent need to incorporate the facilitations suggested in our present Comment Letter.

Furthermore, the Basel Committee should calibrate the approaches under due consideration of the proposed definitions for risk drivers. We gained the impression that the conservative calibration of the approaches was carried out without regard to the definition of certain risk drivers. From our point of view there has not been a sufficient consideration of the interaction between the conservative calibration and the conservative definitions used, thus further enhancing the conservative nature of the calibration. For instance, in our preliminary understanding, the Basel Committee regards the maturity as a risk driver and made certain adjustments to the calibration. However, we have difficulties in comprehending the rationale why the definition of the maturity is at the same time conceived in such a way that predominantly the legal maturity or, moreover, the cap will be applied thus meaning that basically the worst case scenario is assumed for the maturity (cf. Q16 for alternative solutions). In our view, this is far too conservative and further amplifies the effect of this risk driver. We therefore invite the Basel Committee to reassess the

extent to which new risk drivers and their definition will further amplify the conservative alignment of the calibration thus resulting in further aggravation.

In addition to this, given the level of the proposed capital requirements, we suggest waiving the application of the so-called 1.06 scaling factor to securitisation transactions. As is widely known, during the introduction of Basel II, this factor which applies under the IRB framework to credit exposures should ensure that the aggregate capital held by banks does not drop. However, given that Basel III will see a marked increase in aggregate capital requirements, meeting this goal will hardly pose a problem even in the absence of said multiplier application. Furthermore, also the securitisation positions to which the scaling factor would have to be applied would be unclear. This is due to the fact that, under the current proposals and in our preliminary understanding, the differentiation between KSA and IRBA securitisation positions will have been largely abrogated.

The Quantitative Impact Study (QIS) is supposed to assess the impact of the proposed rules. If our expectation is correct that its results will lead to a recalibration of the individual approaches, in our view it would be constructive if, in turn, the impact of the revised rules was analysed under a further QIS.

No national discretion concerning use of the RBA / SSFA

Under Alternative A, the proposals of the Basel Committee envisage at the second stage a national discretion under which national supervisors may choose to apply either the RRBA or the SSFA to their banks. We object to this because this can lead to considerable competitive distortions. Especially the Basel Committee should seek to arrive at internationally consistent rules. In our view, it should be left to banks’ discretion to choose – in a consistent manner- either the application of the RRBA or of the SSFA with regard to certain positions. Notwithstanding the foregoing, individual countries in which the reference to external ratings is legally forbidden could be granted the right to prohibit their banks from using the RRBA.

Waivers for existing transactions

At any rate, the rules should only apply to securitisation transactions finalised after the new rules came into effect. The pricing of the securitisations currently on the market was based on the assumption that the rules which were in effect back then would continue to apply throughout the entire duration of the transaction. Hence, an increase of the capital requirements for existing securitisation positions would retroactively render numerous transactions financially unviable. Given that the confidence in the securitisation markets still has not been re-established, selling these positions is but a limited option for banks. More likely than not, the only option currently available consists in passing on these positions with major markdowns to shadow banks (particularly hedge funds) that are currently still unregulated. Hence, there should be a grandfathering clause. Whilst not limited to, this grandfathering clause should contain a waiver for the need to have had the securitisation position rated by two credit rating agencies before being able to use the RRBA.

Adequate consideration of the maturity

Under the MSFA and under the RRBA, the capital requirement should *inter alia* depend on the maturity. At this point, in the event of fixed interest and repayment plans for a tranche, banks should be allowed to use the “weighted average term to maturity of the contractual cash flows”. In our view, on principle, this method will probably not lend itself to securitisation positions. After all, it is an intrinsic feature of

securitisations that the amortisation and thus the maturity of the tranche would depend particularly on the position of the tranche in the waterfall including the loss allocation resulting from this. According to the proposal, it is required that “the contractual payments must be unconditional and must not be dependent on the actual performance of the securitised assets”. In our view, this requirement can hardly be met. Due to the reasons mentioned above, banks would generally be forced into a predication on the longest, contractually permissible maturity. This would result in an exaggeration of the actual term to maturity. Hence, when determining the residual term to maturity, investors should be granted the right to work with forward looking statements concerning default rates and expected utilisation proceeds. As an alternative, the weighted average life could be used as input. Furthermore, documents on securitisations frequently limit the average maturity. Potentially, this information, too, could be used as a basis for determining the term to maturity.

We concur with the Basel Committee for banking supervision’s view that, as far as revolving securitisation transactions are concerned, the contractual maturity of a pool specific liquidity facility potentially underestimates the actual period of time during which a bank is exposed to the risk that this facility will be drawn upon. However, the BCBS proposes determining the term to maturity for liquidity facilities in the case of revolving securitisation transactions by means of the “longest contractually possible remaining maturity of the asset that might be added during the revolving period”. We hold the view, that this proposal is excessive. Instead, we suggest adding the average maturity of the securitised portfolio to the liquidity facility’s maturity.

Reducing the complexity of the proposals

In our view, the forthcoming rules on calculating the capital requirements for securitisations should be easier to handle than the existing rules. Whilst it is correct that the stronger harmonisation of the rules governing KSA and IRBA securitisation positions may result in a general reduction of the rules‘ complexity, this benefit would, however, be undermined again by the introduction of further differentiations (for instance high-quality, senior quality and other tranches) as well as the consideration of further inputs (e.g. maturity). Besides, particularly the use of the Modified Supervisory Formula Approach (MSFA) would be rendered even more difficult by the fact that the latter should only be applicable if and when banks are capable of calculating the capital requirements for the underlying portfolio completely on the basis of the IRBA.

In the final analysis, in order to ensure easier and more harmonised application, we would welcome it if the review was used as an opportunity to reduce the overall complexity of the regulatory framework governing securitisations.

Review of the interaction with other regulatory frameworks

We would like to suggest synchronising the proposed review of the Basel Securitisation Framework with other, closely related regulatory initiatives such as for instance the reference to the Basel Committee's “Fundamental review of the trading book” (page 34). However, in turn, this document contains no reference to securitisations in the trading book. Another example concerns the work by the financial Stability Board (FSB) regarding the shadow banking system. These proposals include special mandates for work on securitisations and shadow banking units.

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II. Specific Comments

1. Hierarchy of the approaches

Q1. 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?

As has already been pointed out in the general comments, provided a number of amendments are made, the German Banking Industry Committee endorses Hierarchy A. However, we reject Alternative B. First, this is due to the fact that Alternative B would lead to an increase of the complexity of the rules. Furthermore, for tranches that are not most senior high-quality, Alternative B would lead to inflated capital requirements.

In addition to this, we would like to point out again that for many customer related real economy transactions (securitisations of automotive loans, retail loans etc.), meeting the stringent conditions for the use of the MSFA would involve a considerable extra workload; Whilst not limited to, this particularly applies to the data which would have to be provided. Especially in view of the requirement that the bank has to be capable of calculating the capital requirements for every individual exposure in the pool on the basis of the IRBA, use of the MSFA would be rendered largely impossible. This is due to the fact that the necessary data would have to be made available by companies the exposures of which were securitised. These data are, however, usually not recorded by these companies which is due to the fact that they are not being used during their regular business operations or, moreover, in risk management. Should banks use the MSFA for customer transactions, clients would have to make each and any data available (even in cases where the “top down approach” for acquired exposure portfolios was used in order to calculate the K_{IRB}). The corresponding costs would have to be borne directly by the real economy.

Q2. As regards Alternative A, could both the revised RBA and the SSFA be accommodated without raising concerns about regulatory arbitrage or level playing field?

We only have concerns over a level playing field and incentives for regulatory arbitrage (cherry picking) to the extent that national jurisdictions are given a choice which would force all banks in one country to either use the RRBA or the SSFA – which seems to be the case under the current proposals. However, if it is left to the bank‘s discretion whether – following a choice based on consistent criteria – it will apply one of the two approaches to certain positions this would clearly defuse the problem. Notwithstanding the foregoing, we see it as a source of major concern that, currently, the two approaches do not lead to comparable capital requirements. For instance, more often than not, the RRBA results in a higher risk weight than the SSFA. During the present recalibration attention should be paid to comparable capital requirements.

The following example presents the risk weights of the current RBA as well as of the proposed RRBA and SSFA on the basis of an automotive securitisation. It illustrates the lack of comparability between the capital requirements under the RRBA and under the SSFA. Furthermore, the table illustrates the impact on the risk weights in the RRBA of the Weighted Average Live (WAL) maturity proposed by us (cf. Q16) compared to the final legal (FL) maturity proposed by the Basel Committee.

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						RBA	RRBA		SSFA[2]
Class	Rating	Credit Enhancement	Thickness of the tranche	WAL[3]	FL[4]		WAL	FL	KSA RW 83%[5]
A	AAA	9.2%	90.8%	1.82	5	7%	26%	58%	104,8%
B	A	5.95%	3.25%	2.23	5	20%	279%	410%	1129.5%

Compared to the current RBA, when considering the legal final maturity, the risk weight in class A sees an 8-fold increase whereas the risk weight under the SSFA increases by as much as 15 times. At this juncture, it becomes evident that the capital requirements of the two proposed approaches are clearly different.

Furthermore, the table demonstrates that our proposed definition of the maturity as WAL would mitigate the effect of the increasing risk weight under the RRBA. Basically, the WAL would meet the Basel Committee's requirements of using the maturity as a risk driver. At the same time, the WAL would be a definition that is close to practical realities that would incur no further amplification of the approaches' conservative alignment.

Q3. 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?

We would like to reiterate our objection to the Basel Committee's proposed Alternative B. Under Alternative B, the Committee primarily suggests distinguishing between "senior high-quality tranches" and "all other tranches". This differentiation should be based on a the long-term credit rating between "AAA" and AA-". In our view, however, not only external ratings but also assessments by the banks should be used in order to categorise "senior high-quality tranches". These assessments should be informed by internal guidelines. In order to ensure largely consistent internal guidelines, the Basel Committee should define further criteria which allow a categorisation. At this juncture, a definition by national supervisors would potentially endanger the level playing field. Last but not least, we would like to reiterate our caveat that the proposed definition of "senior high-quality securitisation exposures" would clearly increase the complexity during the calculation of capital charges.

Given the mandatory use of one of the two concentration ratio approaches, particularly in terms of securitisation positions which fail to meet the requirements of senior-quality securitisation exposures, Alternative B is bound to lead to excessive capital requirements. This is especially true given that certain types of securitisation transactions (e.g. securitisations of trading or leasing exposures *via* a conduit) will generally be characterised by an absence of positions that can be qualified as "senior high-quality securitisation exposures". What is more: pronounced cliff effects might materialise whenever a tranche is no longer regarded as a "senior high-quality securitisation exposure". Last but not least, when it comes to "senior high-quality securitisation exposures", the equal treatment of the RRBA and the two supervisory formula approaches is incompatible with the Basel Committee's declared objective of reducing the use of

[2] Without considering the cap.

[3] Weighted-average life maturity

[4] Legal final maturity

[5] The portfolio under investigation was comprised of 30% corporate exposures (KSA risk weight = 100%) and 70% retail exposures (KSA risk weight = 75%).

external ratings. On the whole, Alternative B assumes an excessively high risk and thus excessively high capital requirements.

In a comparison between alternatives A and B, Alternative B seems to reflect the Basel Committee’s concerns over the applicability of the MSFA and the RRBA / IAA for non-senior high quality exposures. Under Alternative A, non senior-high quality exposures may still be valued by the corresponding approaches in their entirety. However, under the provisions of Alternative B, they need to be assessed by means of a more simplified approach. From our point of view, a more detailed explanation is required concerning the reason for which, under Alternative B, non-senior high-quality senior exposures are only eligible for treatment using the concentration ratio K_{IRB}.

Q4. Are there alternative hierarchies or revisions to the two proposed (or a combination of both) that the Committee should consider?

As has already be mentioned under our general comments, notwithstanding our proposed detailed amendments (cf. above), the German Banking Industry is essentially in favour of Hierarchy A. At this juncture, however, we should like to highlight that the following aspects need to be taken into account when finalising the definition of the hierarchy.

We agree with the Basel Committee that those approaches should be at the top of the hierarchy which are based on banks’ internal approaches for assessing the securitised portfolios. Based on the foregoing, at the first stage of the hierarchy in our view it should be possible to also use, on an equal footing, the Internal Assessment Based Approach (IAA) along with the MSFA. Both approaches are based on approaches that have been approved by supervisors. Hence, – for instance compared to the RRBA – they offer the supervisor direct control and intervention rights.

At this point, the permission to use the IAA (along with positions *vis à vis* ABCP programmes) also for other securitisation positions should be contemplated. Banks should choose between the two approaches in due time and based on consistent criteria; the guidelines for the segmentation decisions should be agreed jointly with the supervisory authorities. Particularly for sponsors of the ABCP programmes as well as for investors in ABCP, the option of using the IAA at the first level as an equivalent approach is important. Already under today’s rules, these banks will frequently not be able to calculate the capital requirements for the securitised portfolios based on the IRBA. Hence, for them the use of the MSFA would not be an option, anyway. They would thus be at a disadvantage compared to banks securitising own exposures.

In this context, we object to the Basel Committee’s proposal of an initial mandatory assessment of the applicability the MSFA under Hierarchy A. The reason for our objection is that we see this as excessive red tape.

On the second level of hierarchy, banks should be free to choose between either the Revised Ratings Based Approach (RRBA) or the Simplified Supervisory Formula Approach (SSFA) as equal alternatives. Banks should choose between the two approaches in due time and based on consistent criteria. Banks’ internal guidelines regulating the use of the individual approaches should be agreed with the competent supervisors.

We object to the national discretion proposed by the Basel Committee where only one of the two approaches may be chosen. This is due to the fact that this might result in considerable competitive

distortions. However, individual countries where a reference to external ratings is prohibited by law, should be granted the opportunity to deny their banks the use of the RRBA.

The modified Hierarchy A proposed by us envisages a prioritisation of the MSFA and IAA approaches ensures the largest possible independence from external ratings. Whilst we perfectly understand the supervisory authorities’ intention of reducing the dependence on external ratings, the benefit of the external ratings, the different regulatory initiatives for improving the independence of agencies and the quality of the external rating as well as the progress in the credit rating agencies' processes and methodologies should not be ignored. In our view, the IAA combines the use of external expertise with banks’ internal risk management. Especially the application of the IAA is accompanied by a comprehensive credit analysis process within banks meaning that the external rating method goes hand in hand with an internal assessment that is comparable to an IRB rating. Furthermore, the IAA is subject to an approval and an audit process (similar to the IRB ratings / internal market risk models). Thus, the supervisor has the possibility of verifying the appropriateness of this approach.

Furthermore, above and beyond ABCP programmes, the Basel Committee should consider extending the IAA’s scope of application also to other securitisation positions. In our mind, this would be justified particularly given the Basel Committee's intention of making the use of the MSFA subject to the mandatory complete inclusion of the securitised portfolio in the IRBA. Last but not least, this proposal is in line with the provisions of the new EU Rating Regulation which also calls for a review of action aimed at reducing the reliance on external ratings.

At the last stage of the hierarchy, the BCRA would serve as a backstop approach. At this juncture, on the one hand it should be ensured that an approach is in place for use of the SSFA or RRBA which is predicated on regulatory capital. Our own calculations demonstrate that, at present, this is often not the case. Hence, in this context also a recalibration of the SSFA and the RRBA should be considered (cf. also Q6 and Q10 answer). Furthermore, on the other hand, there should be no excessively conservative BCRA calibration. We would like to reiterate our above reservations: Since the criteria for using the MSFA and the RRBA are very stringent, this will frequently mean that this approach will be used in order to calculate the capital charges for securitisations.

2. Revised Ratings Based Approach (RRBA)

Q5. 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.

One of the preconditions for using the RRBA should be that the respective securitisation position will have to have been rated by at least two rating agencies. We hold the view that this is inacceptable. Whilst the association with at least two external ratings might reduce the dangers deriving from potential modelling errors committed by rating agencies, we feel that the relative merits of this approach fail to live up to the principle of proportionality. It is already doubtful whether using two ratings provided any genuine benefit in the past. This appears spurious. More likely than not, any relative merit will – at best - have been limited to exceptional cases. In the meantime, all rating agencies will have adjusted their model assumptions. As a result, the extent of modelling errors is bound to have gone down. Furthermore, the compulsory use of two ratings is inconsistent with the overall rationale behind theconsultation paper, i.e. reducing dependence on external ratings. Last but not least it is worth bearing in mind that the costs for

a rating are generally rolled over to the originator meaning that particularly small and medium-sized enterprises securitising exposures in order to release liquidity could face considerable additional costs. Hence, we have come to the conclusion that the RRBA should always be applicable if one rating exists which can be used. This policy should at least be adopted for the existing positions. After all, any subsequent assessment might call the economic viability of the transaction into question.

Last but not least we like to point out that Footnote 22 (on page 12) is not clear. The question is whether both ratings (the direct and the inferred) can be given by the same rating agency.

Q6. Is the RBA appropriately calibrated and formulated? Should other risk drivers be incorporated?

In our opinion, the RRBA leads to excessively high risk weights. We have particularly strong reservations over the investment grade area. The envisaged huge increase of risk weights pertaining to categories that used to have a low weight is completely divorced from historical default rates. The introduction of a risk weight cap offsets the negative effects of this new calibration to but a moderate extent. It is entirely unclear whether the achievement of the regulatory objective “reduction of the cliff effects between the rating levels” would justify the macroeconomic costs. The high risk weights would above all affect investors in ABS who, more likely than not, will frequently not be able to use one of the other approaches.

Furthermore we would like to point out that the additional risk drivers “thickness” and “maturity” incorporated in the RRBA are already accounted for in most methodologies applied by the rating agencies and in IAA ratings. They would be double-counted when applying the rating tables relevant for Alternative A. Banks should be able to demonstrate that the rating used by them addresses one or all of these risk factors and they ought to apply the formulas for the capital requirement “K” (c.f. page 14) accordingly.

Besides, we feel it is inappropriate that under the RRBA, the maturity will have a linear impact on the level of the risk weights and thus on capital charges. We suggest an initial sub-proportional increase of risk weights in cases where the maturity is in excess of one year. At this juncture, however, it should be borne in mind that – in cases where the maturity is longer than five years - the maximum adjustment is below the current proposal. Under the Basel Committee’s present proposals, the RRBA envisages a 58 percent floor for “AAA” rated items with a 5 year maturity. Given that the RRBA calibration is based on the MSFA, even the optional introduction of a 20 percent floor for such positions in the RRBA with minimum maturities of one year would be possible.

The RRBA risk weight table 4 for short-term credit exposures applies to both options Alternative A and Alternative B. The statement on page 10 (pursuant to which “high quality” securitisations include only those transactions to which a short-term rating of “A-1/P-1” has been assigned) seems to contradict the table (at least as far as Alternative B is concerned).

The proposed adjustment to “high-risk underlying pools” is to be rejected. The quality of the pool is accounted for in the rating methodology and should not result in irrational adjustments (i.e. adjustments made just in order to be on the “safe side”). At least clear guidance is required on what constitutes “high risk” and what is considered as an appropriate upwards adjustment. The Committee’s proposal to give national supervisors the explicit discretion to adjust the capital requirements for these securitisation exposures is a further concern and is incompatible with the idea of a single rule book for the EU.

Comments “Revisions to the Basel Securitisation Framework”

3. Modified Supervisory Formula Approach (MSFA)

Q7. Is it appropriate to require that in order for the MSFA to be used the IRB approach should be applied for all underlying assets?

The MSFA should only have to be used if the bank can draw upon an IRBA approach for each and any securitised exposures, provided said approach has been officially endorsed by the competent supervisor and if above and beyond this, the bank is also capable of calculating the capital charges for the entire securitised portfolio using the IRBA (K_{IRB}). In our view, this constitutes an inappropriately high obstacle for using this approach. IRBA banks, too, may treat exposures using the Standardised Approach either on a transitional or on a permanent basis. This means that more often than not, they are incapable of drawing upon rating approaches that have been officially approved by the supervisor for all of their securitised exposures. Sponsors providing liquidity lines for ABCP programmes frequently lack all of the necessary information concerning the securitised customer exposures. Hence, they are incapable of generating an internal rating. In general, it is also unlikely for investors to obtain the necessary data from the originator or from the asset manager that will enable them to rate their securitised exposures. What is more, partly this would even be in breach of data privacy.

For banks lacking an officially authorised rating approach for parts of the underlying portfolio, the development of a new separate IRBA approach and obtaining the official approval by the competent supervisor only in order to be able to apply the MSFA will generally not be economically viable. Furthermore, more often than not, the necessary data will be unavailable for non-financial corporates. In terms of the overall system, the proposal is bound to lead to a concentration of certain exposures with but a limited number of counterparties. From a supervisory point of view, this appears to be counterproductive.

At present, the supervisory formula approach can be applied in cases where the securitised portfolio is mainly comprised of IRBA items. This rule should also be maintained for the MSFA. Otherwise, if individual securitised exposures are no longer eligible for treatment under the IRBA approach, banks would be forced to choose a different approach. In turn, this might lead to a situation where, in hindsight, the securitisation transaction turns out to lack economic viability. Lasting exemptions from the IRBA’s scope of application also exist for directly held counterparty risk positions. Hence, even in cases where an IRBA bank only treats insignificant parts of its credit portfolio under the Standardised Approach it would still be conceivable that individual items in the securitised portfolio are not IRBA eligible. It appears inappropriate to classify a securitisation position as non-MFSA eligible based on a single or a limited amount of exposures. Hence, we strongly suggest introducing a materiality threshold for not internally rated positions within the securitised portfolio up to which the application of the MSFA shall be permissible.

Under footnote 28, the Basel Committee points out that “As in the current framework, the top-down approach to estimate internal PD and/or LGDs would still be allowed for purchased receivables.” We welcome this statement. It should be incorporated into the text of the proposed rules.

In line with the calculation of the residual maturity, also for the risk parameters PD and LGD it should be possible to use portfolio sizes as an input. Despite the comprehensive data material made available to investors by servicer / originators already today, in the case of granular securitisation positions, generally only originators possess sufficient information in order to calculate PD and LGD. The fact that banks possess different rating systems which partly take into account other borrowers or transaction specific data renders uniform investor reporting not only difficult (if not impossible) but also invariably involves

higher costs. Generally, the servicer / originator will possess reliable information on the average exposure and default rate for the asset pool which can be used *in lieu* of the risk parameters determined at the level of the single contract.

However, using the top down approach should also be permissible without compelling the bank to treat the corresponding portfolio under the IRBA. It would also be conceivable to use K_{IRB} generated by an IAA tool. Especially in the real economy customer business involving retail exposures, calculating the capital requirements on the basis of the IRBA (K_{IRB}) using the normal IRBA rules (bottom up) will not be possible. As has already been pointed out above in the general remarks, we therefore strongly concur with the Basel Committee's objective explained under indent 77 of the paper “Foundations of the Proposed Modified Supervisory Formula Approach” i.e. simplifying the use of the MSFA and lowering the information requirements for banks. At this point, a pragmatic solution is indispensable. In the final analysis, also investors should be allowed to use this approach.

Last but not least, we would like to reiterate our support for a solution where banks are entitled to keep on using all three formulas which are currently being used in the framework of the SFA in order to calculate the parameter N. At this juncture, the Basel Committee has merely suggested one single formula.

Q8. 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?

Especially for long maturities the calibration seems excessively conservative. The tranches RWA amount to multiples of the pool RWA. This is in particular puzzling since the maturity of each loan is already taken into account via the maturity adjustment within the IRB-framework. One explanation provided for this conservative calibration is that the excess spread cannot cover the portfolio’s multi-year EL.[6] This is inconsistent with the general framework as well as with the performance of transactions during the crisis (see answer to question 21). To avoid a double counting of effects and a prohibitively conservative approach, the maturity add-on therefore should be excluded from the MSFA.

The following example shows the massive effect of the maturity add-on next to other add-ons on the capital requirement. It compares the pool RWA of the current non-securitisation framework (where maturity adjustments are already taken into account) and the resulting RWA under the MSFA approach[7] and of the current SFA. It can be seen, that the proposed calibration is inconsistent with the general framework because it requires far more capital than the current pool RWA (100 percent unsecuritised vs. 199 percent securitised). Furthermore it becomes clear that the no-excess-spread-assumption via the additional maturity add-on leads to significant additional capital charge. I.e. the moment assets are securitised they obtain a RWA add-on of 63 percent compared to their wholesale RWA only due to the incorporation of the maturity adjustment. For the majority of transactions this is by no means appropriate given the overall performance of excess spread during the crisis:

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[6] BCBS Working Paper No. 22, Foundations of the Proposed Modified Supervisory Formula Approach, Footnote 5.

[7] Assumed is a transaction which K_{IRB} of a 6.67%, structured in three tranches and with a maturity of 5 years. The resulting tranche risk weights are split up into the different effects: Model – i.e. the risk weights assigned by the beta distribution, Model-Risk – i.e. the tau-omega adjustment, K_{IRB}-Floor – i.e. deducting tranches below K_{IRB} and Maturity – i.e. the effect the additional maturity adjustment has. It is visible that incorporating the maturity adjustment leads to a 60% add-on on the pool RWA compared to the wholesale framework.

Comments "Revisions to the Basel Securitisation Framework"

Parameter	MSFA	SFA	impact
Model	100.0%	100.0%	unchanged
Maturity	63.6%	0%	new add-on
Model-Risk	6.0%	2.6%	increased add-on
K_{IRB}-Floor	30.3%	6.3%	increased add-on
Total	199.9%	108.9%	Highly increased add-on

Q9. 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)?

The Basel Committee considers allowing the use of the MSFA exclusively for banks which use the advanced IRBA because only they can draw upon internal estimates for LGD. We hold the view that this is inacceptable. The supervisory LGD requirements may indeed be less risk sensitive than the ones determined by banks themselves. However, they were calibrated in a way that, by and large, they yield comparable results. Also, it is not obvious why a counterparty risk position held directly by the bank should still be regarded as an IRBA position if the supervisory LGD is being used. Yet, in an asset pool the same position is supposed to disqualify banks from using the MSFA. This gives rise to unequal treatment. Furthermore, it is worth bearing in mind that this requirement would lead to a situation where the MSFA would be the prerogative of but a small circle of banks.

4. Simplified Supervisory Formula Approach (SSFA)

Q10. 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?

In our view, the basic assumptions underlying the calibration of this approach are not presented in a sufficient manner and require further explanation. By way of example, we would like to mention the factor "p" which was initially set at 1.5. Apart from the explanation that this factor is supposed to ensure that the resulting capital charges should preferably be higher than the ones calculated under the MSFA, it remains unclear how exactly this factor was determined. Furthermore, it partially fails to meet its objective, i.e. achieving higher capital charges than under the MSFA (c.f. the graphical charts contained in the document). This gives rise to an unwelcome scope for regulatory arbitrage (cherry picking opportunities).

Under the current proposals, there is an excessively conservative calibration of SSFA risk weights particularly in the field of senior positions. During the practical application, the use of the cap would regularly mean that the pool's SA risk weight (complete neglect of the structuring) would become applicable.

The following example presents the interaction between the SSFA and the cap.[8] There is an illustration of the SSFA capital requirements for a securitisation of leasing exposures to unrated companies to which a

[8] This example is based on a real auto lease ABS transactions dating back as long ago as 1996. Always, even during the crisis, performance was good and satisfying high investor expectations. The transaction is a good example of how securitisation is used by the real economy in order to obtain access to capital at attractive price levels. Furthermore, it illustrates how the new proposal will affect these industries. The tranching is chosen in a way that (based on the methodology of external rating agencies), a AAA rating for senior and a A+ for the class B can be achieved. Given the good performance of the series during the crisis there is no reason to criticise this methodology.

low amount of retail exposures has been added. Under the SA, the pool has a relatively high risk weight of 99.98 percent.

	Attach-ment point	Detach-ment point	SSFA RW	SSFA RW Capped[9]
Class A	8.2%	100%	160.3%	99.9%
Class B	5.4%	8.2%	1249.2%	1249.2%
FLP	0.0%	5.4%	1250.0%	1250.0%

Applying the new SSFA proposed by the BCBS (with a factor of p = 1.5) the senior tranche receives a risk weight of 160 percent which a) is much higher than the pool RWA and would b) lead to a total capital consumption of the senior tranche that is higher than the current SA risk weight for the whole pool. The fact that a position with significant credit enhancement has to be capped to the pool risk weight in our view calls the calibration of the SSFA into question.

On the whole, we feel that “p” is excessively conservative. In the US, the current factor for “p” is 0.5. This would turn the SSFA into a simple instrument that could also be handled by investors and that would still lead higher capital requirements.

Q11. Is the SSFA properly formulated or should other risk drivers, such as maturity, be incorporated?

From our point of view the advantage of the the SSFA is that it is easy to use. Thus, it should not be complicated by the introduction of additional risk drivers.

Apart from the thickness of tranches, the SSFA requires as input parameters the capital requirements under the SA and the ratio of exposures that were 90 days past due. These two parameters are then used to calculate the adjusted capital requirements under the SA (K_A). On principle, we welcome the proposed adjustment for the part of the exposures past due for 90 days. However, the 90 days are not always consistent with the internally used default criteria. Hence, banks should be entitled to use a more stringent internal default definition, too. Furthermore, it is unlikely that the default definition can be adjusted as regards existing transactions. We would therefore advocate allowing banks to use the maturity laid down for these transactions in the documentation.

5. Concentration Ratio Based Approaches

Q12. Has the BCRA been appropriately calibrated and formulated?

In both hierarchies, the Basel Committee suggests the so-called backstop concentration ratio approach (BCRA). This approach does not appear to be the result of a review of existing approaches. Instead, it seems to have been added as a new approach. In our view, the basic assumptions underlying the calibration of this approach are not presented in a sufficient manner and require further explanation.

[9] In the current proposal the senior RW cap is not applicable for IRB institutes. This adds inconsistency between the IRB and the SA framework which is contrary to overall goal of the proposal.

Even if the BCRA should exclusively serve as a fallback solution, the calibration should still be economically appropriate. For instance, a securitised portfolio with an average risk weight of 100 percent exclusively yields the most senior securitisation tranche i.e. the tranche with a detachment point of 100 percent, a 100 percent risk weight. Accordingly, a potential credit enhancement would remain unconsidered. In our view, this would be economically unjustified.

We would like to recap that the Basel Committee proposals involve more stringent conditions that have to be met in order to use the MSFA. Also, two ratings are required for the RRBA. This would mean that the BCRA (which, under Alternative B is only subject to the CRA K_{IRB} for “Other Tranches”) would almost become the default application case for calculating capital charges applicable to securitisations. For the BCRA to actually fulfil its role as a backstop, the scope of application for the advanced approaches would have to be expanded in line with our earlier suggestions above; also, the entry thresholds should be lowered and they should particularly be applicable to mixed pools.

Last but not least, we are of the opinion, that a kind of backstop already exists under the current regulatory framework. In the field of the standard approach for securitisations, in certain cases it will be possible to use the look-through method. The Basel Committee might consider using this approach as a backstop approach.

Q13. 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?

No comment.

6. Resecuritisations

The Basel Committe proposes an exclusive application of the BCRA to resecuritisations. We find this inacceptable. On the one hand, using this approach would be extremely onerous. This is due to the fact that, in the final analysis, under the SA the capital requirements would have to be calculated for the initially securitised portfolio. More likely than not, this will not always be possible for the existing positions. Apart from this, some banks have acquired structured risk protections for their securitisations and resecuritisaitons positions which, in turn, present a securitisation. Accordingly, the positions in these risk protections schemes constitute resecuritisations under the current proposals, these risk protections which are extremely important for financial market stability may potentially be jeopardised. Hence, as regards existing positions, we advocate in favour of a continuation of the current rules (especially given the extremely strict definition of the resecuritisation (Art. 541(i) Basel II Framework).

Partly, the risk weights calculated under the BCRA and under other approaches are fairly different. Hence, above and beyond this, we suggest introducing a threshold level for resecuritsations. Essentially, due to the partly lower transparency of resecuritisations, higher capital charges appear fit for purpose. However, already in transactions with but a few securitisation positions added to the portfolio mix, the categorisation as a resecuritisation would trigger clearly higher risk weights thus exaggerating the actual risk. Hence, we propose the introduction of a materiality threshold where the risk weights for normal securitisations shall apply up to three percent securitisation position ratio in the overall portfolio mix.

Q14. How prevalent and material are securitisation exposures backed by mixed pools?

As has already been pointed out, in practice, there are primarily mixed pools.

Q15. Is the proposed treatment for mixed pools appropriate, or should another approach be employed?

Please see our general remarks above as well as our answer to Q7.

7. Use of inferred ratings under the SA

We do support the extension of the use of inferred ratings to the SA. However, since this rating is inferred from a subordinated tranche (and more than one rating is available), it seems appropriate to use the rating, which maps into the lowest risk weight (instead of the second best rating). This seems to be appropriate, since the application of the second best rating would be overly conservative. This alleviation should be applied to SA and IRB exposures.

8. Definition of maturity (M)

Q16. Is the definition of maturity appropriate, in light of the Committee’s objectives?

As already mentioned with regard to question 6, the parameter ‘tranche maturity’ is generally accounted for in most methodologies applied by the rating agencies. To avoid double-counting we propose not to consider the ‘tranche maturity’ in the RRBA.

In the MSFA and in the RRBA the capital backing shall (*inter alia*) depend on the maturity. At this point, in the event of fixed interest and repayment plans for a tranche, the “weighted average term to maturity of the contractual cash flows” shall be used. According to the second paragraph, it is required that “the contractual payments must be unconditional and must not be dependent on the actual performance of the securitised assets”. In our view, this method will generally not be applicable to securitisation positions. This is due to the fact that it is an intrinsic characteristic of securitisations that the repayment and thus a tranche’s term to maturity will particularly be based on the level of the losses assigned to a given tranche. Due to the reasons mentioned above, banks would generally be forced to focus on the longest, contractually permissible maturity. In general, this would result in an exaggeration of the actual term to maturity. When determining the residual term to maturity, investors should therefore be allowed certain options for assumed default rates and expected disposal losses. Alternatively, the weighted-average life (WAL) should be used as an input parameter.

One typical factor influencing the economic maturity of securitisation positions is early repayment (prepayments). It should be allowed to use parameters derived from historical data as assumptions for calculating the maturity. Due to the fact that some transactions also envisage so-called performance triggers which are tied to default or late payment ratios and which may trigger changes to the interest waterfall and / or repayment waterfall, the respectively necessary exemptions should also be allowed when calculating the residual term to maturity. A failure to recognise such economic realities on the ground would be inconsistent with the characteristics of securitisations.

Frequently, the average maturity is being limited in the documents on securitisations. Potentially, this information, too, could be used as a basis for determining the term to maturity.

Apart from this, when determining M, the expected average maturity of the tranche should be used as an input parameter (and not the expected average maturity of the portfolio).

Additionally, it should be possible to offset a bank’s call rights against the tranche's maturity.

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We would like to reiterate our point made in the general comments, i.e. that we subscribe to the Basel Committee’s view concerning the fact that – as far as revolving securitisation transactions are concerned - the contractual maturity of a pool specific liquidity facility may potentially underestimate the actual period of time over which a bank is exposed to the risk that this facility will be drawn upon. However, the BCBS proposes determining the term to maturity for liquidity facilities in the case of revolving securitisation transactions by means of the “longest contractually possible remaining maturity of the asset that might be added during the revolving period”. We hold the view that this proposal is excessive. Instead, we suggest adding the average maturity of the securitised portfolio to the liquidity facility’s maturity.

Furthermore, 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.

Last but not least, if the method for calculating M proposed in the Consultative Document should be retained, we suggest a clarification that all banks are entitled to apply indent 320 of the Basel Capital Accord, regardless whether this bank is a KSA, IRBA or advanced IRBA bank.

9. Elimination of requirement to deduct below-investment grade exposures for originators under the SA

The elimination of this requirement is appreciated as it helps to align Basel and the draft European Capital Requirements Regulation. This deduction obligation was never included in the German Solvency Regulation.

10. Preferential CCF for eligible liquidity facilities under the SA

Under the current SA securitisation framework, eligible liquidity facilities are subject to a 50 percent CCF. The Committee proposes to eliminate this special treatment. We agree with this proposal as we see no reason for special treatment in the SA.

11. Risk-weight floor

Q17. Is the proposed 20% risk-weight floor set an appropriate level? Please provide justification and evidence, to the extent possible, for alternative levels for the risk-weight floor?

In the current securitisation framework, the lowest risk weight is 7 percent under the IRB and 20 percent under the SA. The revised framework proposes a risk weight floor of 20 percent.

It seems as if the risk-weight floor is set randomly without being based on any evidence. This proposed risk weight is too high. In addition, the risk-weight floor should consider the type of underlying assets and ought to differ depending on the approach used. This is supposed to set incentives for banks to develop and use IRBA rating systems, MSFA and IAA. An alternative would be to keep the floor of 7 percent and increase the floor in individual cases up to the minimum IRBA risk weight of 15 percent.

The risk weight floor of 20 percent is an appropriate level for re-securitisations.

Q18. Should the risk-weight floor for short-term exposures be the same as for long-term exposures?

No, the risk-weight floor for short-term exposures and for long-term exposures should not be the same. Short-term exposures have an original maturity that is less than one year. Since a maturity floor of 1 year is proposed, we need an adjustment factor for these short-term exposures. Therefore the risk-weight floor for short-term exposures should be lower than for long-term exposures.

12. Maximum capital charge (overall cap)

The Committee proposes to retain the provision under the IRB framework “that the capital charge is limited to the amount of capital the bank would hold if it held the underlying assets directly”. This is highly appreciated. However, the draft European Capital Requirements Regulation (CRR) translates this provision differently. Under the CRR, the maximum capital charge is the sum of 8 percent of the risk-weighted exposure amounts plus the expected loss of these exposures. According to paragraph 610 of the Basel capital framework, the expected loss as well as the provisions must be included in the calculation of this overall cap. In order to achieve a level playing field, the Basel Committee should clarify this paragraph. It ought to be made clear that provisions made for the underlying exposures can be included and therefore reduce the overall cap.

A similar limitation on the maximum capital charge under the SA securitisation framework is highly appreciated. However, we propose that this overall cap should also apply to investors that have sufficient information about the underlying assets. This proposal is further supported by the fact that investors must apply the MSFA if they fulfil the three mentioned requirements on page 8 (one of them is the ‘information requirement’).

Furthermore, we would like to reiterate our point already made in the general comments above, i.e. that the capital charges for all banks involved in a securitisation transaction should not exceed the capital charges for the securitised portfolio.

13. Maximum risk weight for senior securitisation exposure under the SA framework

The RW cap for senior securitisation exposures under the standardised approach is appreciated. However, since the Committee intends to align the approaches used under the standardised approach and the internal ratings based approach, the RW cap should also be allowed for IRB banks that need to apply the SSFA (e.g. in Alternative A, jurisdiction’s choice for SSFA or in Alternative B, SSFA for senior high quality tranches). If an IRB bank needs to apply the SSFA, the pool RWA will be calculated with standardised approach inputs. This is identical to banks calculating the standardised approach. Hence, the RW cap should also be allowed for IRB banks applying the SSFA. We suggest clarifying this.

We do support the extension of the overall cap rule to the SA. However, we do not understand why this rule is limited to originator and sponsor. If the data are available and the investor can calculate the pool RWA, the investor should also be entitled to use the cap.

Comments “Revisions to the Basel Securitisation Framework”

14. Floors and caps

Q19. Are the proposed caps and their interactions with the proposed floor risk weight appropriate?

We appreciate the rule that the risk weight of the cap should be used if the cap generates a lower risk weight than the floor. However, as already said (see question 17), the risk-weight floor of 20 percent is too high.

15. Early amortisation provisions revisions

We disagree with the proposal of the Committee to preclude an originator or seller of assets into such a securitisation from applying the securitisation framework for the sold assets. This would be too punitive if a bank has, for example, only one senior tranche that incorporates an early amortisation provision.

16. Write-downs and purchase discounts

Q20. Are there other approaches that could provide a more risk-sensitive treatment while still being prudent and operationally straight-forward to implement?

The Committee proposes to use the carrying accounting value as exposure value whereas the EU Capital Requirements Regulation (CRR) requires the sum of the carrying accounting value plus credit risk adjustments. However, under the CRR, these credit risk adjustments can be used to reduce the RWA for these securitisations.

The Committee does not support this offset as i) the differentiation between credit related and non-credit related adjustment is complex and ii) this method would grant excessive capital benefit to write-downs and purchase price discounts. We disagree with this view and provide two different reasons for that:

1. This capital offset does make sense as these write-downs have already reduced the regulatory capital of the bank.
2. Under the wholesale IRB framework, a similar concept is used. The expected loss must be deducted from capital, but this amount can be reduced by the write-downs.

Furthermore, The Basel Committee’s proposal would promote a divergence of the Divergence between prudential supervision rules and accounting rules. Based on the foregoing, we endorse a proposal for a single rulebook. At present, IRBA securitisation positions are subject to the rule that ratings related writedowns may be deducted from the RWA. This rule should be extended to include all positions, namely regardless of the risk weight approach and regardless of the respective jurisdiction (provided that a breakdown of writedowns into ratings related elements and non-ratings related elements can be achieved in a reliable manner).

17. Revisions to the treatment of securitisation positions under the market risk framework

The risk driver maturity covers one aspect of the market risk. In our view, consideration of this risk driver also for items in the investment book translates into a convergence of the rules for the investment book and the trading book. In order to prevent any blurring of the boundary between the trading book and the investment account, the market risk relevant driver should not be used for positions in the investment

book. The reference to the “fundamental review of the trading book rules” is ineffective because securitisations are not being covered at this juncture.

18. Assumptions

Q21. 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.

The assumption that there is given no credit to excess spread is inconsistent to the general framework where the calibration of the maturity adjustment is chosen in a way that limited credit is given as well as not justified by the performance of many securitisations during the crisis. There are many example transactions.

Furthermore including maturity as an input in the MSFA and the RRBA leads to a double counting of this effect. As described to a certain extent the maturity of the underlying loans (which together with the tranching defines the maturity of the tranches) is already captured in K_{IRB} used as an input for the MSFA. In the RRBA on the other hand the stability of existing excess spread even under a stressed environment is key part of assigning a rating within the methodology of each of the big rating agencies. By that insufficient or unstable excess spread already leads to a lower rating grade which is a main input in the RRBA. Additionally adding this effect through a further maturity add-on would be double counting and lead to overly conservative capital charges.

When tranches are rated better than BB, the RRBA is based on a portfolio which is equivalent to a PD of 4.73 percent and an LGD of 60 percent. Given that this assumption is extremely conservative and since there is a strong delta to the performance of some portfolios, it should be permissible to prove to the competent supervisor that the performance of the underlying pool is better thus allowing for a reduction in the risk weight / the floor.

We would like to reiterate a point made already in the general part of our comments, i.e. we hold the view that, on the whole, the RRBA risk weights appear excessively high, particularly when compared to the capital charges applicable to corporate lendings. Potentially, this may have as a consequence that banks would have to back unsecured corporate lendings with less regulatory capital than funding through the securitisation of corporate exposures. Hence, banks would have an incentive to accept higher risk financing.

The Asset Value Correlation (AVC) factor is based on the IRB wholesale framework and would require a classification of reference entities (especially whether they qualify as “financial sector entities” or not). The creation and validation of static data will become more complex and cumbersome. It will also have a knock-on effect on servicers that have to provide the data to investing banks in their servicer reports. Last but not least it will potentially limit the use of MSFA because of lacking loan-level information. The AVC factor should not be required especially as K_{IRB} already addresses correlation risk. Correlation risks are also addressed when applying pool rating systems (see paragraphs 491 et seq.). It should be clarified that the AVC factor will have to be taken into account exclusively for the calculation of K_{IRB}.

We object to a general switch from the risk parameter Value at Risk to the Expected Shortfall / the Conditional Value at Risk.

Comments “Revisions to the Basel Securitisation Framework”

19. Retail securitisations

Q22. 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?

We don’t believe that is appropriate to use the same approach for retail and corporate securitisations. The Committee determined under Basel II lower risk weights for retail exposures both under the standardized approach and the IRBA. The rationale behind is, that the unexpected loss in the retail portfolio is normally due to the high number of retail exposures (law of large numbers), a better diversification and a better distribution around the expected loss significant lower than in the corporate portfolio. Under the IRBA, this is substantially reflected in the formula of the correlation factor.

A lower unexpected loss means in terms of asset backed securities that it is less probable that protection instruments like cash reserves, overcollateralization or excess spreads are completely consumed and thus a loss could happen for the investor. Based on these general thoughts we deem an adaption of the formula for retail securitisations necessary.

Under Basel II the Committee distinguishes in the retail segment between residential mortgage exposures, qualifying revolving retail exposures and other retail exposures. Especially, the securitization of instalment loans and here in particular motorcar loans play an important role in the segment of traditional securitizations. Motorcar loans and leases are backed by cars. In case of defaults of such underlying retail exposures the loss is generally low due to the sale proceeds from the cars. Hence, such traditional asset backed securities are very popular with investors due to their low risk profile.

The calibration was based on an assumed underlying corporate portfolio with a 4.73 percent PD and a 60 percent LGD which was consistent with the average historical default rate for corporate bonds having an external rating of “B”. We assume that the high LGD is due to the fact that corporate bonds are generally not backed by any collateral. This means an assumed expected loss rate of 2.84 percent. This is compared to observed loss rates of motorcar loans and leases much too high. Even cumulated loss rates over lifetime for motorcar loans are much lower. In addition, due to the fast amortization of loans, the portion of protection for the investor increases in relation to the outstanding amount during the lifetime. Thus, most of the motorcar ABS had a strong track record and were upgraded by the rating agencies during their lifetime.

In the past, even in crisis times investors in securitized motorcar loans or leases have never experienced losses in Europe. Commonly, the financing and leasing companies originating motorcar loans and leases don’t use the IRBA. Instead, the senior and junior tranches are rated by one or two rating agencies. Thus, the revised rating based approach and a risk adequate capital requirement will remain further important for the investing institutions.

Therefore, we deem an adaption of the formula based on an impact study considering the net losses of the underlying assets on the one hand and the lower unexpected losses on the other hand necessary.

Because most of the transactions were rated by the big rating agencies and performance reports had to be provided to them during the lifetime of the transactions, these agencies should have analyses available on the performance and cumulated net losses of retail ABS, especially in the motorcar loan segment, which could be used for a calibration.

Comments “Revisions to the Basel Securitisation Framework”

Q23. How could concerns that securitised retail exposures have high default risk or high correlation be managed?

High default rates may be an issue of securitized revolving retail exposures from credit cards but are no issue for motorcar loans. The rationale is that an owner or the lessee of the car will do anything to hold the car because he/she needs the car to remain mobile. Hence, the willingness to pay is high.

Q24. Is the relative calibration of the approaches appropriate? Please provide empirical data to support any conclusions.

See above. We don’t think that the calibration is appropriate. Empirical data to support this conclusion would have to be delivered.

Yours faithfully,
On behalf of the German Banking Industry Committee

Silvio Andrae

Olaf Instinsky