

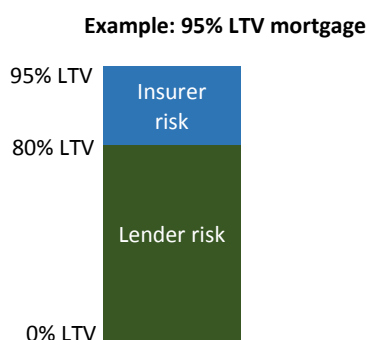
Context

Whilst our comments do not relate to any specific questions raised in the consultation, the securitisation framework, and in particular the STC, is extremely relevant to our clients, especially in the wake of the open Basel consultation “Revisions to the Standardised Approach for credit risk” of December 2015.

Whilst we will submit our response to the aforementioned consultation, it is important that we share our thoughts on the STC framework also.

About our product and relevance of the securitisation framework

We insure lenders (banks, building societies, insurance companies etc.) of residential mortgages against losses in the event of borrower default. We take the first loss position (‘top slice’) on individual mortgages, insuring high LTV loans down to a certain LTV threshold (80% to 70% LTV). The example below reflects our typical cover.



The insurance complies with the CRR requirement for an eligible credit risk mitigant and therefore can reduce the regulatory capital requirement for the lenders. However, the ‘tranching’ nature implies use of the ‘securitisation’ framework for calculating the capital requirements.

Whilst the protection is ‘tranching,’ it is still provided on individual loans where losses are not pooled for the portfolio, as is the case with typical securitisations (both ‘true sale’ and ‘synthetic’). This renders the calibration of the securitisation model unsuitable and overly conservative for such a plain vanilla insurance contract. The use of the securitisation model also raises other questions, discussed below. We would appreciate the Committee’s views on these points.

Challenges around the use of the securitisation framework

1. Calibration

As mentioned above, the securitisation model is calibrated for pooled transactions and not plain vanilla guarantees such as mortgage insurance. Therefore, at the very least, the STC calibration should be used for such contracts.

The current consultation excludes synthetic transactions from the scope of the STC framework, although this was not the case in the previous version. The consultation states that “The objective of the Committee and IOSCO when drafting the July 2015 STC criteria was to revitalise sustainable

securitisation markets, and this was seen as incompatible with allowing synthetics to qualify as STCs. Nevertheless, the Committee is of the view that synthetic securitisations should not be under the scope of the STC framework for regulatory capital purposes (proposed in this document). All synthetic securitisations will remain subject to capital requirements as determined by the December 2014 framework”.

Such a blanket treatment of all ‘synthetic’ transactions penalises plain vanilla risk transfer solutions such as mortgage insurance. Furthermore, in the absence of a global standard identifying a subset of high quality synthetic securitisations, the European Commission, based on EBA’s recommendations, is currently considering the application of STC risk weights to senior tranches of synthetic securitisations where the underlying exposure is to SMEs, in a proposed amendment to the CRR.

In this light, and given that residential mortgages are considered less riskier as an asset class than SME loans, we believe that the STC risk weights (at least for the senior tranches) should also be applicable to the former where risk transfer is via plain vanilla ‘loan by loan’ insurance contracts.

2. Choice of methodology

The securitisation framework suggests External Ratings Based Approach (ERBA) followed by Standardised Approach (SA) for Standardised lenders by order of hierarchy. This creates an issue for ‘loan by loan’ insurance or guarantee contracts where getting an external rating for every single retail mortgage will be impractical. Therefore, it would be best to allow such lenders to use a non-ratings based approach (i.e. the SA) as was deemed appropriate by the U.K. PRA on the Government’s ‘Help-to-Buy’ guarantee scheme¹.

The Standardised Approach assigns the floor of 15% RW for a 15 percentage point cover (e.g. where first loss down to 80% LTV threshold is insured for a 95% LTV loan). If the ERBA approach were to take precedence over SA in this case, could the Basel Committee confirm that such a depth of cover is sufficient to ensure an ‘AAA’ rating? Such a confirmation would circumvent the issue of getting individual loans tranching by an external rating agency whilst maintaining the ERBA risk weights.

Whilst this point is more relevant to the “Revisions to the Standardised Approach for credit risk” consultation, it is being raised here for completeness.

3. Retention requirements

Further clarity from the Basel Committee would be appreciated on whether the 5% retention requirement for the lender applicable on pooled securitisations would also apply to plain vanilla ‘loan-by-loan’ insurance contracts or whether the insurer can cover 100% of the first loss on individual loans.

4. Use of securitisation model

Finally, smaller lenders with no prior experience of securitisations may find using the securitisation model difficult. It would be helpful if the Basel Committee could propose a much simpler approach for assigning risk weight for the type of transactions in question.

¹ STATEMENT ON THE REGULATORY TREATMENT OF RETAIL RESIDENTIAL MORTGAGE LOANS UNDER THE HELP TO BUY GUARANTEE