Irish Securitisation Industry WG comments on the BCBS Consultative Document on capital treatment for "simple, transparent and comparable" securitisations

This paper has been compiled by the Irish Securitisation Industry Working Group comprised of investment professionals who are members and representatives of the Banking & Payments Federation Ireland, the Irish Debt Securities Association and representatives of the Irish Stock Exchange. The group welcomes the opportunity to reflect the views of experienced professionals that work in Ireland across the broad range of activities associated with securitisation. These activities cover all of the elements of the value chain from listing securities, managing special purpose vehicles, arranging and issuing securitisation and covered bond programmes, acquiring, managing and trading portfolios of asset backed securities from Ireland.

General comments:

Overall the BCBS is to be complemented on the suggested treatment it proposes for the risk weightings for STC qualifying securitisations. It is very positive that these proposals build upon the substantial work done to date by the EBA and the BCSBS-IOSCO and this is to be welcomed.

We agree with the BCBS that a more risk-sensitive regulatory capital regime is required to revive investment/issuance and we welcome the re-calibration of risk weightings proposed by the BCBS for STC securitisations.

The one major area of concern is in relation to emerging differences between different geographic regions specifically with regard to divergences between the European Commission's draft proposal for Simple, Transparent and Standard (STS) and those proposed under the STC criteria.

One major difference is that the STS criteria are wider than the proposed STC criteria as they include not only securitisation, but also short-term ABCP. The STC proposal are clear about the need for two types of STS requirements: one for long-term securitisations and one for short-term securitisations (ABCP), which would be subject to a large extent to similar requirements with specific adjustments to reflect the structural features of these two market segments. In addition, the STS criteria highlights the need to reflect the specific role of the sponsor providing liquidity support to the ABCP conduits. ABCP should be included in the BCSBS proposals and should align with the European Commission's proposals for ABCP adjusting the capital charges proposed in the 2014 Basel securitisation framework to recognise the relative lower riskiness of STS securitisation, while keeping regulatory capital within the perimeter of a prudential surcharge.

Another major difference between STS and STC is the approach adopted in applying the criteria to specific asset classes. STC has adopted a general-principles approach whereas STS proposes an asset-specific approach.

We believe that the BCBS should consider incorporating these differences with regard to the STS proposals to ensure a greater level of geographic harmonisation and ensure a level playing field for both investors and issuers in different countries. The securitisation market is a global market and we feel that a greater degree of consistency of regulation across different counties is critical to ensure an efficient functioning market.

While we welcome the re-calibration of risk weightings for STC securitisations we note that the potential floor at 10% to 12% could be in excess of the STS floor of 10% and that the BCBS scaling factor of 0.6-0.8 is higher than the equivalent EU 0.5 scaling factor. Again we have a concern of different standards being applied in different geographic jurisdictions.

We also remain concerned at the more preferential liquidity treatment of other financial instruments such as LCR haircuts. At present securitisations instruments have a much less favourable treatment under the liquidity regulations in terms of the requirements to be satisfied and the weighting in the liquidity ratios relative to other instruments. We believe that the negative treatment of ABS, in terms of liquidity, ensures that securitisation will continue to be seen as a less attractive investment proposal for regulated investors.

Although a primary aim of the implementation of the STC criteria is to reinvigorate the securitisation, we believe that implementation of these criteria without any alteration to the LCR haircuts will not be sufficient to restart the market.

Specific comments:

Q1. Do respondents agree with the rationale for introducing STC criteria into the capital framework? Are there any other aspects that the Committee should consider before introducing STC criteria into the capital framework that are not already reflected in the rationale above?

While we support introducing STC criteria into the capital framework, we do not believe it is necessary or appropriate to include additional criteria, especially not criteria related to credit risk. The STC criteria should refer solely to structural issues. We believe that before any additional criteria are added it should be clearly explained by the BCBS what purpose the original set of criteria would be used for.

Q2. Do respondents agree that, for the purpose of alternative capital treatment, additional criteria are required? What are respondents' views regarding the additional criteria presented in Annex 1?

With regards to the requirement of additional criteria to those included in STC definition to deserve a preferential prudential treatment, we consider that their necessity should be further assessed as outlined above.

It should be taken into account that they are redundant to a large extent, given the fact that the capital framework already considers them in order to assess the amount of capital required. This is the case of the additional criterion D15 (Credit risk of underlying portfolio: Maximum Risk Weights) that is already considered in the capital framework for securitisation, which is risk sensitive to the credit risk of the underlying portfolio (it gives rise to higher capital requirements when the Risk Weights of the pool are higher). Moreover, in the case of the additional criterion D16 (Granularity of the pool), the SEC-IRBA already considers the granularity of the underlying pool as a risk factor in the case of wholesale portfolios, making the 1% maximum concentration criterion unnecessary and overly restrictive. Concerning the criterion D17 (Relationship between the originator and the servicer of the securitised assets), we do not see its rationale in terms of producing any structural or credit benefit, particularly given the existing requirement of criterion C3(Fiduciary and contractual responsibilities) in relation to services. Moreover, it should also be considered that risk retention is already included (criterion B12) to make sure that the originator has skin in the game. Accordingly, we consider that no additional criteria should be required to grant a preferential treatment to STC securitisation as it would unnecessarily fragment the STC market between qualifying and non-qualifying STC transactions.

In the case of D17 the only asset carved out is Residential Mortgage, we would also welcome the inclusion of other granular consumer asset types like , Cards , Autos , Leases and SME where there is clear evidence in a local market that a robust 3rd party servicing infrastructure exists. The general risk regarding the criterion outlined in D17 at present is that is makes the role of Standby servicers pointless, in essence investors would face a scenario whereby the mitigant put in place to address operational risk – discontinuity of servicing would also be the one (if replacement servicer trigger event occurred) that results in loss of STC and therefore result in a higher capital charge. We would like to avoid this potential unintended consequence.

With reference to some of the specific criteria outlined;

Criterion A1. Nature of assets

Criterion A1 requires "periodic payment streams". For real economy purposes. In the case of auto loans, it is current practice in many loans that contractually agreed payment streams include a final payment that is higher than the monthly payments and that is secured by an asset. For clarification purposes this important kind of financing should not be excluded. Additionally, the last sentence of this criterion states that "Any referenced interest payments or discount rates should be based on commonly encountered market interest rates…" The restriction to those "based on commonly encountered market interest rates" is problematic as it may be interpreted in a way that excludes banks' standard variable rates, which are very common in mortgage lending, which we do not believe is the legislative intent. This criterion should therefore also include an option for sectoral rates reflective of a lender's cost of capital, impact of asset impairment and operating environment in addition to cost of funds.

The current proposed collateral mix rules are too restrictive, for example issuers should be allowed to have a mixed pool of business loans, ie unsecured term loans and asset finance, otherwise smaller banks would struggle to create single pools of sufficient size that meet the requirements

Criterion A2. Asset performance history

Criterion A2 requires that the performance history should ideally cover at least one complete economic cycle. In our opinion, it can be very difficult to assess the length of a complete economic business cycle and different parties may have different opinions about the length of the complete economic business cycle. To avoid uncertainty about this requirement, the additional requirement should provide a clear statement about the period of history performance, including a specific maximum period. Therefore, the part of "ideally cover at least one complete economic cycle" should be deleted. An additional important consideration here is that it is not clear what the source of comparable historical data could be. In the case of Ireland and non-mortgage assets there is none , so is there a dependency on agencies creating one or reliance on the banks internal data?

Criterion A3. Payment status

In criterion A3, the credit-impairment of borrowers' definition could prove problematic. It is current market practice to exclude defaulted or delinquent receivables. However, the proposed non-credit-impairment requirements do not consider commonly well-established ABS. Accordingly this criterion should be narrowed down to reflect the current market practice.

The criterion requires that credit claims or receivables being transferred to the securitisation may not, at the time of inclusion in the pool, include obligations that are in default. It should be noted that the impairment criteria can only be checked at the time of selection for inclusion in the securitisation. However, it takes some time until the selected exposures can be legally transferred and assigned, respectively. During this short period, it cannot be avoided that exposures get into default or become credit-impaired. Thus, the exclusion of defaulted exposures should refer to the time of selection if the underlying exposures will be transferred and assigned, respectively without undue delay. In practice, it is often required that the time between portfolio selection and the inclusion into securitisation does not need to exceed three months.

The additional critera that "Credit claims or receivables being transferred to the securitisation should not include obligations…(where)……the obligor has been the subject of an insolvency or debt restructuring process due to financial difficulties within three years prior to the date of origination;" will narrow the pool of available assets, in paticular for those jurisdictions which felt the greatest impact from the financial crisis. We would welcome the deletion of the additional payment status criteria including this specific criterion on the basis that a seasoned loan of say 5 years would require look-back of 8 years to check that the requirement is satisfied. We believe that an updated and calibrated credit assessment of the borrower at time of origination should be sufficient and this would widen the pool of quality assets available for issuance.

Q3. What are respondents' views on the compliance mechanism and the supervision of compliance presented in this consultative document?

We are concerned that the emphasis for verification remains with the Originator / Sponsor (self-certification), with very limited support from external sources. There appears to be no independent external verification prior to issuance, so the Originator / Sponsor will issue with a level of uncertainty. Moreover, in order to overcome the current stigma associated with securitisation, certainly in Europe, it is necessary that investors are able to rely on a binding certification issued by an independent third party. A binding nature of certification is crucial to ensure legal certainty for originators, sponsors, original lenders and SSPEs as well as to ensure the trust of investors. Thus the use of an external verification agent, or trade body, properly supervised, along the lines as proposed in the most recent EC Proposal for a Securitisation regulation, should be reconsidered if an active STC market is being sought.

If the originator, however, is subject to legal liability or regulatory action then, in return, originator should at least have the right to request and obtain a binding confirmation of conformity after the self-assessment of the criteria that certain requested criteria under A to C are met. We believe that this would be necessary from a prudent perspective of the originator and as part of his legal risk management to reduce his regulatory risk that can incur in case of a different interpretation as to whether a certain criterion is fulfilled in the special case. Different to a certification, such confirmation could not cause any moral hazard as indicated by the Committee, because the originator would have to provide a self-assessment and to give reasons why in his opinion a certain criterion is met. Furthermore, the possibility of obtaining such confirmation would have the advantage to reduce reputational risks both for originators but also for the STC-securitisation market because it would help avoid cases that "supervisor [will] not be satisfied with a bank's determination" which would make market participants insecure and which would adversely impact the further development of the STC-securitisation market.

We are also concerned that the criteria are subject to the interpretation of the various national supervisory authorities, leading to the risk of post-issuance changes in interpretation that could result in the loss of STC status and resulting liability on the part of investors and issuers, even where attestations were made in good faith at the time of issuance. Accordingly, a mechanism for assuring consistent interpretation of the criteria across Europe and/or grandfathering provisions which protect STC designations from future interpretation changes are essential.

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

We agree with the BCBS that a more risk-sensitive regulatory capital regime is required to revive investment/issuance and we welcome the re-calibration of risk weightings proposed by the BCBS for STC securitisations.

The one major area of concern is in relation to emerging differences between different geographic regions. One major difference is that the STS criteria are wider than the proposed STC criteria as they include not only securitisation, but also short-term ABCP. The STC proposal are clear about the need for two types of STS requirements: one for long-term securitisations and one for short-term securitisations (ABCP), which would be subject to a large extent to similar requirements with specific adjustments to reflect the structural features of these two market segments. Another difference between these approaches is in applying the criteria to specific asset classes. STC has adopted a general-principles approach whereas STS proposes an asset-specific approach.

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