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Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
4002 Basel
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Re: Consultative Document – Revisions to the Basel Securitisation Framework (the "Consultative Document")

Moody's Investors Service ("MIS") appreciates the opportunity to provide comments to the Basel Committee on Banking Supervision ("BCBS") on the Consultative Document.

BCBS seeks to address, among other things, the mechanistic reliance on external ratings. MIS supports discontinuing the mechanistic use of ratings in regulation. We believe that a single measurement system or a range of alternative measurement systems – whether ratings based or otherwise – should not be used to trigger a mandatory and mechanistic response, but rather as a tool used by prudential regulators to evaluate the most appropriate and tailored responses. We recognize, however, that in light of market conditions, eliminating or reducing ratings-based criteria may require a staggered approach with a view to mitigating any cliff risk that may arise following the recalibration of a model that eliminates one of the inputs.

We would like to take this opportunity to express our views with respect to some of the questions posed in the Consultative Document.

***Question 3:** As regards Alternative B, which methods could a bank use to conclude that a securitization 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 have refrained from commenting on any specific method because we believe other market participants, such as financial institutions, are in a better position to respond. MIS welcomes the introduction of additional factors in addition to external credit ratings such as market data, analyst reports and internal risk assessment ("the Additional Criteria") in the determination of what constitutes "high-quality" securitization exposures. However, based on our reading of Alternative B, it would appear that the actual determination of what constitutes "high-quality" securitization exposure remains ultimately based on external ratings, where "high-quality" would correspond to a long-term credit rating of "AAA" to "AA-", or short-term credit rating of at least "A-1/P-1/F-1".

The BCBS could consider alternative approaches to determine what constitutes "high-quality". For example, to qualify as a "high-quality" securitization exposure, (i) the exposure must meet two or more Additional Criteria or (ii) the determination is left in the purview of the financial institution subject to appropriate internal control mechanisms.

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

We recognize the important objectives of the BCBS in recalibrating the Basel Securitization Framework. We believe that this is therefore a good opportunity for the framework to capture a more comprehensive range of risk factors relevant to securitization exposures. Given the structural features of any securitization, risk factors which could have material negative impact on the cash flows could negatively affect investors, or the financial institutions. The performance of a securitization depends not only on the creditworthiness of the underlying assets (collateral risk), but also on other factors such as structural features and the effective performance of various transaction parties. A more comprehensive range of risk factors relevant to securitization exposures could include:

(i) *Unhedged interest rate or currency exposures between assets and liabilities of a securitization.* This could arise, for example, where the underlying assets pay a fixed rate of interest whilst the debt instruments issued by the securitization vehicle pay a floating interest rate. This mismatch could severely affect the issuer's ability to make payments to investors as promised even in a scenario in which the credit quality of the underlying assets remains at a very high standard. For transactions in which interest rate risks are not completely hedged, this increased risk could be captured through stressed assumptions regarding reduced cash flows or by conducting a sensitivity analysis of such cash flows.

(ii) *Structural features such as sequential versus pro-rata amortization, (but also for example: static or revolving pools, availability of cash reserves as well as potential, amortization or build-up of the reserve linked to transaction performance).*
Sequential amortization (i.e. the amortization of tranches starts with the most senior tranche and only once this tranches is completely repaid the second ranking tranche starts being repaid) is beneficial to senior tranches compared to pro-rata amortization (i.e. repayments are split between tranches) as over time, the relative subordination for senior tranches increases. Often amortization switches between sequential and pro-rata based on performance triggers. In transactions which allow *pro-rata* amortization in the case of strong performance, so-called "back-loaded losses" may arise (i.e. a scenario in which the transaction performs well directly after issuance, allowing for pro-rata amortization, but as the transaction matures, performance deteriorates). Senior notes are more vulnerable towards such late losses in case earlier pro-rata amortization of junior tranches has reduced the subordination.

(iii) *Operational risks and counterparty risks.*
In order to delink the credit quality of securitization tranches from counterparties' credit risk, the BCBS may also consider prescribing frameworks that define minimum criteria for counterparty credit quality.

(iv) Legal risks affecting for example the asset transfer.
Legal considerations, such as true sale, set-off risk and commingling risk, are very relevant for the assessment of the credit risk of securitization tranches as these risks can have a materially negative impact on the risk of securitization tranches.

Once again, we thank you for the opportunity to comment on the Consultative Document. We remain available for any questions you may have regarding this submission or more broadly on the role of rating agencies in the capital markets. Should you have any comments or questions, please do not hesitate to contact me or Neil Acres from our Regulatory Affairs team at +44 20 7772-5313.

Yours sincerely

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