

20 August 2020

Secretariat of the Basel Committee on Banking Supervision
c/o Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Submitted electronically

Dear Sir/Madam

Comments on the “Technical amendment: Capital treatment of securitisations of non-performing loans” dated 23 June 2020

The Securitization Forum of Japan (SFJ) welcomes the opportunity to comment on the “Technical amendment: Capital treatment of securitisations of non-performing loans” issued for comments by 23 August 2020, dated 23 June 2020 (d504).

We provide our comments below, which are based on our discussion among members of our International Regulatory Affairs Committee and feedback and comments from our members.

I General Background:

1. Securitisation of Non-performing Loans in Japan

Between 1999 and 2005, several securitisations of non-performing loans originating in Japan were conducted. As far as we are aware, senior and mezzanine tranches in all such securitisations (10 transactions concluded between 1999 and 2005) obtained credit ratings from credit rating agencies. Sellers in such transactions were SPVs managed by NPL investors that acquired the underlying NPLs from banks at deep discount prices through bulk sales.

Credit ratings on the senior tranches in such transactions were typically Aaa/AAA. Senior tranches were often sold to banks while mezzanine and subordinate (equity) tranches were sold to non-bank investors.

2. Holdings of NPL securitisations by Japanese banks

Because more than 15 years have passed since the last securitisation of non-performing loans (NPLs) was observed in Japan, we are not aware of any holdings of NPL securitisations by Japanese banks in substantial amounts.

II Comments on the proposed paragraphs in d504:

1. Application of SEC-ERBA should be allowed for all securitisations, including “qualifying NPL securitisations” (CRE 45.3) and other NPL securitisations

With respect to the proposed CRE 45.3, we believe that (1) there is no evidence that justifies preclusion of SEC-ERBA (even if application of SEC-ERBA may produce risk weights of less than 100%) and that (2) the general principles for senior tranches as described in CRE 40.50 and CRE 40.51 should supersede in all cases.

We presume that the reason for the proposed preclusion of SEC-IRBA based on the foundation IRB (F-IRB) for all NPL securitisations is that the capital charge for the underlying pool (K_{IRB}) is calculated with a given LGD value and that the credit enhancement (protection) effect of specific provision or NRPPD, which is typically significant in NPL pools, is completely disregarded. In addition, SEC-SA may not be suitable for many NPL securitisations, because of how the parameter W (see the formula in CRE 41.8) works in determining the required capital for the underlying pool (K_A). Application of SEC-SA to NPL securitisations often results in excessively large capital charge which may not reflect represent the credit risk of NPL pools, as it requires euro-to-euro capital of 0.5 times the W (which is effectively similar to assuming 50% of 90-day delinquent receivables would become total loss).

We do not understand why the SEC-ERBA should be precluded (in CRE 45.3), because the external credit ratings assigned by ECAs have no such shortcomings when applied to NPL securitisations (i.e., securitisation exposures backed by a pool of $W \geq 0.9$, PD=100%, or/and that accompanies substantial provision or NRPPD). We do not have any evidence showing the credit ratings on NPL securitisations are any different, quantitatively, or qualitatively, from the credit ratings on non-NPL securitisation tranches. While the IAA is substantially similar to the SEC-ERBA, and we believe it should be treated equally as the SEC-ERBA, a situation where a bank might want to seek applying the IAA to NPL securitisations is inconceivable in our view.

With respect to CRE 45.3, we are of the view that the proposed language “A bank should assign a fixed 100% risk weight to the senior tranche of NPL securitisations” can be excessively conservative treatment in many cases and it contradicts with the general principles as described in CRE 40.50 and CRE 40.51. The risk weight applicable for senior tranches in securitisations should not exceed the weighted average risk weight of the underlying pool.

Instead of assigning a 100% risk weight for all “qualifying NPL securitisations”, we would like to propose: (1) allowing application of SEC-ERBA (CRE 42) (including the IAA) (or other approaches, including SEC-IRBA and SEC-SA), (2) explicitly stipulate that the CRE 40.50 and CRE 40.51 should supersede, and (3) replacing 100% with 50% as the fixed risk weight (and

explicitly provide that the second sentence in the proposed CRE 45.5 does not apply to senior tranches).

2. Look-through approach referred to in CRE40.50 should supersede in all NPL securitisations and if the floor needs to be introduced, it should be 50% rather than 100% (CRE 45.3 and 45.5)

Whether or not a fixed risk weight floor of 100% regardless of any approaches referred to in CRE 41 through CRE 44 is used is appropriate is doubtful because such a floor directly or indirectly conflicts with the general principals as described in CRE 40.50 and CRE 40.51.

For example, in jurisdictions where the regulator adopts the second sentence alternative in CRE 20.26 (3), risk weight for past due loans with specific provision of 50% or greater of the nominal value is 50% for non-residential mortgage exposures under the Standardised Approach for credit risk. For residential mortgages, CRE 20.29 provides that the applicable risk weight can be reduced, at national discretion, to 50% if the accompanying specific provision is 20% or greater of the outstanding amount.

Because of such provisions in the CRE 20 (Standardised Approach), the applicable SA risk weight for past due loans can often be below 100%. While noting that the CRE 20.26 (3) may not be interpreted to the effect that it also applies to delinquent exposures acquired at a NRPPD of 50% or greater, we are of the view that the requirement of NRPPD of 50% or greater is effectively equivalent to delinquent exposures with specific provision of no less than 50%. For this reason, if a risk weight floor needs to be introduced, 50% rather than 100% is more reasonable in our view.

We would like to propose: (1) changing the risk weight floor value for non-qualifying NPL securitisation from “100%” to “50%”, and/or (2) removing the risk weight floor (in which case the risk weight floor would be 15%, as stipulated in CRE 40).

We would like to express our gratitude for taking our comments into consideration. We consent to making this letter public. Should you have any questions, please do not hesitate to contact us.

Yours faithfully,

/s/

Masaru Ono
Managing Director,
Securitization Forum of Japan

About the Securitization Forum of Japan

The Securitization Forum of Japan (SFJ) was founded as a voluntary association in 2005 and established as a corporation in 2007.

The members of SFJ include banks and other market participants such as finance companies, insurance companies and securities firms, as well as major law firms, accounting firms, and credit rating agencies.

SFJ aims to contribute to the sound development of the asset securitisation market and carry out the following operations: (1) research and study associated with asset securitisation; (2) exchanges and cooperation with internal and external organisations concerned, etc. associated with asset securitisation; (3) diffusion and enlightenment of asset securitisation; (4) policy recommendations concerning asset securitisation; and (5) any other operations incidental or relevant to operations of the above items. SFJ operates Experts Committees on a steady basis to discuss issues on securitisation, share practical intelligence among members and make policy proposals based on the discussions.

Some of the committees run a Subcommittee or Working Group to further address crucial topics on securitisation such as Basel III securitisation framework. SFJ also deliver high-quality educational system to members, providing opportunities to attend seminars on securitisation or to take professional development programs.

Website: <http://www.sfj.gr.jp/>