

15 March 2013

UniCredit reply to the BCBS consultation on “Revisions to the Basel Securitisation Framework”

UniCredit is a major international financial institution with strong roots in 22 European countries, active in approximately 50 markets, with about 9.500 branches and more than 155.000 employees. UniCredit is among the top market players in Italy, Austria, Poland and Germany. In the CEE region, UniCredit operates the largest international banking network with around 4.000 branches and outlets, and is a market leader.

Introduction – A few highlights on UniCredit experience

UniCredit utilizes securitisation for multiple purposes:

- Group funding and liquidity purposes;
- efficient funding of customer-driven transactions;
- direct investment in ABS securities and;
- hedging certain risk and optimizing capital consumption.

Within UniCredit true sale securitizations represent an important diversification of the funding sources. The availability of this tool for banks provides clear benefits for the real economy.

In addition, European initiatives such as a) the PCS label (“Prime Collateralised Securities”), b) the ECB loan by loan template (intended to ensure greater market transparency) and c) the Basel III revised Liquidity Coverage Ratio (“LCR”) which now incorporates some RMBS notes within the computation further contribute to the overall effectiveness of securitization and its contribution to the funding needs of the real economy.

Finally, UniCredit operates through the synthetic securitizations framework to optimize capital allocation both on existing/originated loans and on loans to be granted. For existing loans, synthetic securitizations allow to optimize the capital absorption to be deployed for new loans. Synthetic securitizations on loans to be granted provide the further benefit to improve borrowing costs for new small and medium enterprise (SME) customers. Such synthetic securitization structures involving new loans have recently been used by Sovereign European Funds (EU/EIF CIP Program, Jeremie Program) and Local Government Funds (e.g. the Italian “Fondo Centrale di Garanzia” - the Public Offer for Patents by the Ministry Of Economic Development) as a supporting facility for SMEs, with the ultimate scope of supporting new lending activity also in difficult market’s conditions.

A general overview on the “Revisions to the Basel Securitisation Framework”

In UniCredit’s opinion the proposed securitisation framework revisions will **significantly** and unnecessarily **increase the costs related to securitizations (both synthetic and true sale), reducing the economic viability and effectiveness** of these instruments with potential detrimental consequences in terms of lending to the real economy. The following points summarise the primary areas of concerns for UniCredit:

- 1) The premise that securitisations did not perform well during the financial crisis is inaccurate. In fact, the BCBS should consider the fact that senior tranches of securitisations involving well-established “real economy” asset classes in the EU incurred minimal defaults/losses since 2008. In addition, modifications in ratings requirements and regulatory changes relating to continuing disclosure and retention (“skin in the game”) have addressed many fundamental risk concerns arising from the financial crisis. Finally, BCBS must differentiate between asset classes so that well performing asset classes, such as retail receivables and conventional residential mortgages.
- 2) The revised framework, as currently proposed, would severely limit the use of securitisation as a means of funding for banks as a result of increased borrowing costs brought about by the increased capital requirements. It is conducive to significant distortions in the market among debt instruments. Furthermore, this outcome could occur

immediately in anticipation of the final modifications with banks (as investors) already exiting the market and selling existing securitisation assets. The combination of a reduced investor base with potentially sizeable bank disposals would unquestionably negatively influence ABS spread levels.

- 3) In principle, UniCredit is supportive of the proposed framework's concept of using the risk weights of the underlying assets as a basis of determining the risk weights of resulting securitisation tranches when retained by the originating bank. That said, however, the proposed framework clearly discourages securitization as an efficient funding and risk transfer tool, because of the resulting capital treatment. In fact, the proposed framework would result in the same pool of assets attracting significantly more bank capital (in aggregate) when securitised and sold to other banks.
- 4) The proposed framework is contrary to the efforts of the regulatory community to encourage retail and SME lending since it effectively would restrict an existing form of efficient financing for such lending activities.
- 5) The proposed ability of local supervisors to determine certain hierarchical paths could exacerbate jurisdictional discrepancies in required approaches to calculating capital utilisation.
- 6) The proposed frameworks raises the possibility (subject to local supervisory discretion) to discontinue the use of the Internal Assessment Approach (IAA) for calculating capital attributable to securitisation exposures within ABCP conduits. IAA models have been widely utilised and applied mainly to purchased receivables exposures. The credibility with supervisory authorities of IAA is well established as a means of effectively assessing risks relating to such exposures. The discontinuation of IAA would, not only penalize already existing securitisation exposures, but would eliminate ABCP conduit financing as an effective and efficient means of funding SME and retail lending.
- 7) The stated aim of the proposed framework to align more closely the resulting capital requirements derived from the Standardised to the Internal Ratings-Based Approaches is questionable since it would create a relative disincentive for banks to utilise IRB. In fact, IRB arguably requires banks to more completely assess transactions in a more disciplined manner than SA.
- 8) An additional stated aim of the BCBS is to reduce reliance on external ratings for capital calculation. In the view of UniCredit, this is not accomplished within the proposed alternative hierarchies, particularly within Alternative B in which the ability for banks to utilise the revised ratings-based approach or MSFA/SSFA is entirely dependent upon tranche seniority and "quality" (as defined by ratings).
- 9) Similarly, the BCBS's admirable goal of minimising "cliff effects" is not accomplished within the proposed framework. In particular, the hierarchy in Alternative B would require senior securitisation exposures which have experienced downgrades to below the "high-quality" level to utilise Concentration Ratio KIRB. This would inherently result in a significant increase in capital utilisation and, similarly, a "cliff effect." It should also be noted that the BCBS approach to the expressed goal of minimising "cliff effects" within RRBA is to increase risk-weights for higher rated securities while lowering risk-weights for lower rated securities which, on the surface, appears illogical and contrary to conventional supervisory thinking.
- 10) The revised ratings-based approaches (RRBAs) included in both proposed hierarchies incorporate maturity and tranche thickness (for non-senior securitisation tranches) as additional risk-weight determinants. While the rationale behind these proposed factors is sensible, it is important to highlight several key points. First, both maturity and tranche thickness are already factors considered by the rating agencies in their analyses so any add-on attributable to these factors would appear to be duplicative. Second, the definition of maturity must reflect the expected average life of securitisation exposures rather than the stated contractual term otherwise, particularly for asset classes such as trade receivables, the maturity and resulting risk-weights would be overstated and could

result in inaccurately representing fundamental risk differentials between securitisation and unsecured corporate lending exposures. Third, using the maturity as a parameter to assign RWA risks introduces regulatory inconsistencies. It is in fact not clear the rationale for having the underlying assets assessed from an RWA viewpoint, regardless of their maturity; while, if the same assets are securitized, the related RWA depends on the maturity of the resulting ABS.

- 11) Under both proposed alternative hierarchies, it is likely that the Backstop Concentration Ratio Approach (BCRA) would be more broadly applicable for certain asset classes in which IRB parameters can not be determined. This would inherently result in significantly increased risk-weights for exposures to such asset classes, particularly non-senior exposures, without substantive changes in risk and, conceivably, in situations in which external ratings are available.
- 12) The newly proposed risk-weight floor of 20% would increase dramatically the capital requirement attributable to the most senior tranches of securitizations and would, as noted earlier have a detrimental impact on the securitisation market and would be inconsistent with the treatment of other asset classes such as covered bonds. Our proposal is to leave the floor at 7% or to align it to the 10% risk weight envisaged by the regulator for the AAA covered bond.

Answers to specific questions

II. Considerations around the hierarchy of approaches

Question 1 - *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?*

Answer 1

Additional Costs and Benefits of the Two Hierarchies – In general, neither hierarchy A nor hierarchy B provide tangible benefits to the financial system (both from the perspectives of an investor and an originator) and above all on the real economy. Both approaches entail significant additional costs directly related to higher capital charges. Correspondingly, these additional costs would likely restrict the viable resurgence of the securitisation market (and, correspondingly, lending capacity) at a time of critical economic uncertainty within the EU and throughout the global economy.

Specific concerns or costs to be considered for both hierarchies include:

- **Capital Requirements:** Significantly greater divergence within average RW of the underlying assets and of the collective securitisation tranches of the same underlying assets if varying tranches are held by several banks. In fact, the requirements proposed in the Framework are unjustifiably high to allow any resulting economic rationale for banks to transfer risk through inter-bank securitisation. For example the risk-weighting of a AAA tranche, for certain types of underlying assets, could be higher than the capital that would be required without the asset securitisation. In short, the transfer of risks between banks would require significantly more capital if done in a tranchised securitization format. This further creates a disincentive for banks to transfer risk and diversify the character and nature of the risks retained within the banking community.
- **Borrowing Costs:** Because of the increased costs of holding securitisation exposures, bank investment activity in the securitisation market will drop significantly resulting in a restricted investor universe. This, when combined with increased incentive for banks to dispose of existing holdings, will fundamentally likely result in increasing spreads for securitisation issuances.
- **Regulatory Call Exercise:** It is likely that existing securitisation exposures would be no longer viable under the proposed hierarchies resulting in a large number of regulatory calls which would then negatively impact bank liquidity and require additional capital.

- *Operational Costs:* The analytical infrastructure required for banks under both hierarchies would be substantial in order to calculate RW for all approaches with the exception of RRBA and BCRA. Therefore, without the ability to utilise RRBA (either because of seniority or supervisor discretion), banks would be required to create the ability to calculate KIRB for any exposure or must utilise BCRA which would be prohibitively capital intensive. This additional IT requirement, when added to the already substantial IT needs required to comply with the myriad of parallel regulatory initiatives, would likely simply result in less bank investment in securitisation exposures, while MSFA is only available in Alternative B for Senior High-Quality exposures.

Note: For IRB banks investing in securitisation exposures for which they are not the originator, access to a central data warehouse would be required in order to calculate KIRB under MSFA, SSFA and CRKIRB. While on-going disclosure regarding underlying portfolios is now required by Art. 122a CRD, an IT infrastructure to capture the necessary information from the data warehouse relating to underlying pool performance and to calculate Expected Loss (EL) and RW would likely be very expensive, particularly considering that many underlying pools would not have an approved IRB approach rating requiring mapping to existing customers, new rating with existing rating models or the development of new rating models. The development of internal models will increase the potential for arbitrage where banks consider differently macro-economic factors, country risks, etc. These different model approaches will lead to varying RW between banks for similar or identical exposures.

With regard to Alternative B, the following issues should also be considered:

- 1) Alternative B favors senior high-quality tranches and penalizes subordinated tranches for no defined reason.
- 2) "Cliff effects" would be caused by 1 notch downgrade from AA- to A+, since the definition of "high-quality" could be based on external ratings, i.e. [AAA to AA-]. Any other definitional approach would unavoidably result in ambiguity and create potential arbitrage opportunities.

Relative Cost - For an IRB bank, Hierarchy B would appear to entail higher potential costs than Hierarchy A resulting from the "cliff effect" of comparing the RW of a Senior High Quality Exposure with the RW of a Non-Senior High Quality Exposure. Furthermore, Alternative A allows an IRB bank to use the Modified Supervisory Formula Approach (MSFA) as the initial starting point for assessing RWA on all positions regardless of seniority while Alternative B allows MSFA to be applied only to "high-quality" senior positions with "high quality" left undefined. In fact UniCredit would suggest that "high quality" should consider market standards as defined with the Prime Collateralised Securities (PCS) initiative (www.pcsmarket.org).

Addressing Shortcomings: The hierarchies that would best address the shortcomings are described below:

- Mechanistic reliance on external ratings → Alternative A (although both approaches still rely on ratings under the RRBA and the definition of "high-quality" (under Alternative B) is still based upon external ratings).
- Too low risk weights for highly-rated securitisation exposure → Both Alternatives A and B, although the credit rating agencies have adjusted ratings criteria in response to the lessons learned from the financial crisis and, therefore, this premise is questionable.
- Too high risk weights for low-rated senior securitisation exposure → Alternative A
- Cliff-effects in capital requirements following deterioration in credit quality of the underlying pool → Alternative A
- Misalignment of the Standardised Approach (SA) and IRB approaches → Both Alternatives A and B, but the misalignment creates disincentive for banks to utilize IRB since results are similar. Arguably, IRB implies a more complete understanding of the exposures and less reliance on external ratings which is inherently preferable and should be encouraged. Additionally, without a clear economic rationale for developing IRB capabilities, it is difficult to expect banks to develop IRB capability which, in the case of both Alternative A (subject to Supervisor discretion) and Alternative B (for Senior tranches and subject to Supervisor discretion) implies the use of RRBA and, therefore, external ratings.

Question 2 - *As regards Alternative A, could both the revised RBA and the SSFA be accommodated without raising concerns about regulatory arbitrage or level playing field?*

Answer 2 – No. The decision to leave the choice at the discretion of supervisors would inevitably create a discrepancy between approaches within different jurisdictions and would, therefore, fail to guarantee a level playing field. Additionally, such jurisdictional discretion would increase internal discrepancy between different foreign legal entities of the same banking group. In fact, UniCredit recommends the application of the RRBA following MSFA rather than SSFA in Alternative A which, as noted above, is the preferred hierarchy of the two (albeit with reservations). Alternatively, if SSFA were utilised instead of RRBA, the use of external rating as a means of standardisation and consistency would be no longer available.

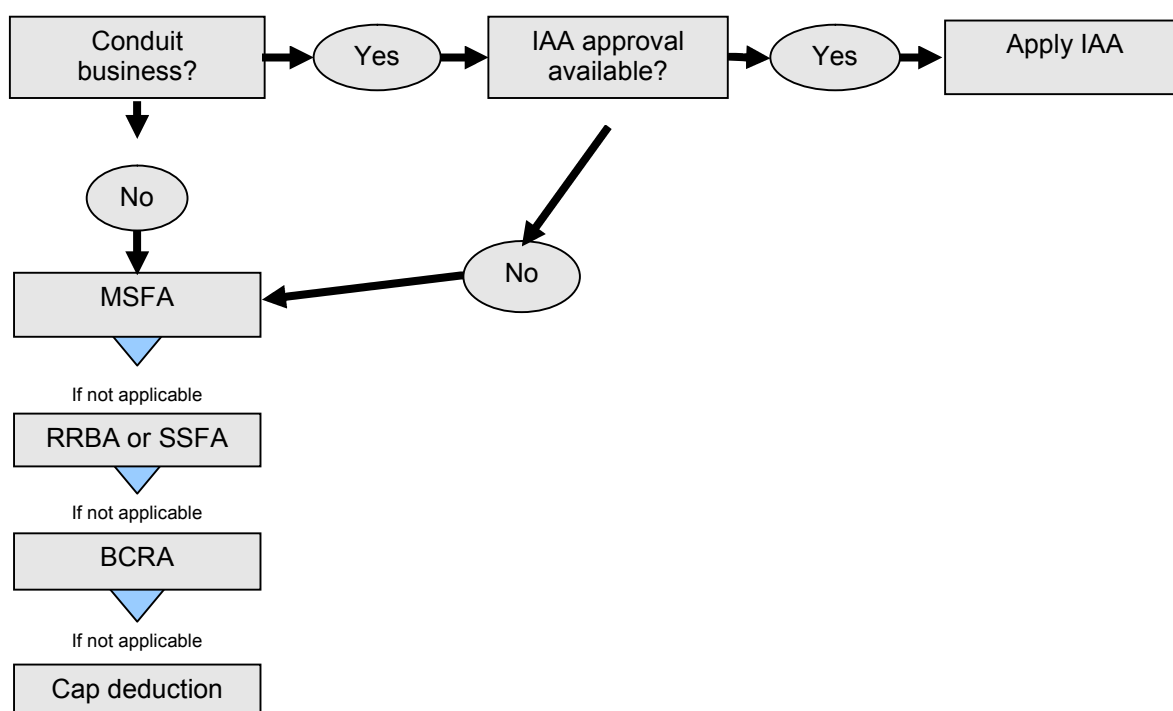
Similarly, in conjunction with RRBA, the Internal Assessment Approach (IAA) should be retained for conduit exposures. IAA is well established with regulators and a change from IAA to MSFA/SSFA (under Alternative B) or SSFA (under Alternative A) would increase capital and costs associated with conduit financing which would be passed through to debtors within the programs. Note: This assumes that IAA would no longer be available to the extent MSFA or SSFA were selected as the relevant approaches under Alternatives A and B.

As a general rule, UniCredit would suggest that the IAA be moved within the hierarchies such that, for all ABCP conduit positions, IAA would be the preferred approach. As specified in the below flow chart, this would require that IAA be effectively positioned prior to MSFA within the Alternative A hierarchy. If a conduit exposure, for whatever reason failed to qualify for IAA, it would then be subject to remaining hierarchy beginning with the MSFA.

The BCBS must consider the broad acceptance by supervisors of IAA, the investments already made by banks in their IAA infrastructure and the amount of existing exposures currently covered by IAA. **If the use of IAA were discontinued** it would not only penalize existing but, more importantly, would also eliminate **a meaningful tool to finance SME, auto loans and trade receivables.**

Chart 1: Graphic representation of Internal Bank process, based on UniCredit elaboration

The below chart provides an illustrated overview of UniCredit's suggested changes to Alternative A intended to ensure the continuing applicability of IAA.



Question 3 - 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?

Answer 3 – It is fundamentally contradictory to the stated intention of the revised framework to explicitly rely on external ratings as the sole determinant of “high quality.” In contrast, a bank could use a portfolio model to rate exposures so that the “high quality” level could be set by the Basel Committee in order to be equal for all intermediaries. This should be done through the use of uniform (across jurisdictions) criteria including (at a minimum) a) type of underlying, b) attachment points/overcollateralisation per asset class and c) diversification. Such parameters should also recognize the relative historical performance of varying asset classes and be calibrated against the capital requirements of non-securitisation exposures accordingly. Once established, these parameters would also minimize the possibility of cross-jurisdictional regulatory arbitrage.

It should be noted that the standardization process described above is consistent with on-going PCS initiative which

establishes similar standardized criteria for well-established asset classes to ensure consistently high quality issuances under the "PCS label."

That said, as currently proposed by BCBS, Alternative B would produce material "cliff effects" to the extent exposures deteriorate to levels where they no longer qualify as "high-quality." As an example, a senior "high-quality" senior note with an initial RW equal to 20% would, after a downgrade to below the threshold ratings level, then become subject to the RW applicable using the Concentration Ratio Kirb (CRKIRB) approach. This approach would generate a capital charge 3-times higher than the current approach. This potential cliff effect could be mitigated by calibrating the Backstop Concentration Ratio Approach (BCRA), MSFA/SSFA and revised RBA such that credit-driven transitions between the various approaches result in more gradual RWA changes similar to the RRBA. This fact can be seen as an incentive to perform securitisation on underlying assets of low quality using many mezzanine tranches.

It should be noted that, the likelihood of "cliff effects" inherent within Alternative B are exacerbated by changes in sovereign ratings (country ceiling), changes in counterparty ratings or diverging rating methodologies among Credit Rating Agencies (e.g. rating approach to multinational entities like UniCredit). These rating factors are difficult to anticipate and manage.

UniCredit strongly contends that the "cliff effects" currently embedded in the proposed Framework would inevitably lead to "RWA" shocks due to downgrades which would, correspondingly lead to "fire sales."

Question 4 - *Are there alternative hierarchies or revisions to the two proposed (or a combination of both) that the Committee should consider?*

Answer 4 – **As noted above, supervisor discretion in selecting hierarchical paths is inappropriate and can lead to potential cross-jurisdictional inconsistencies and regulatory arbitrage.** Moreover, with regard to Alternative A, UniCredit believes that the Basel Committee should clarify the cases when banks may not be allowed to use the MSFA.

As also noted above, the IAA should be positioned as a direct alternative to MSFA for qualifying conduit exposures. This would ensure that conduit exposures currently covered by IAA would continue to be treated similarly and maintain an important tool for assessing RW for a range of receivable financings.

Tranche thickness requires more specific definition within the RRBA and it is meaningful only in the context of specific asset classes. Arbitrarily defined tranche thickness categories may lead to potential inconsistencies, risk inaccuracies and arbitrage opportunities. In addition, tranche thickness is already considered in the ratings' analyses so further adjustment seems redundant.

Similarly, maturity definition must accommodate the concept of expected life rather than contractual cashflow for securitisation exposures. The use of the latter within the definition would unnecessarily penalise securitisations with long legal terms but relatively short expected lives.

The BCBS should consider maintaining an RWA differential between the SA and IRB approaches to encourage banks to use the IRB. The IRB, particularly under the proposed Framework, would generally require a more complete understanding of risk than the SA. With a relative lack of incentive to use IRB, the banking system would most likely just revert to reliance upon external ratings whenever possible.

Regarding an alternative approach, please refer also to answer 2.

In addition, it is worth noting that the "requirement" to apply the MSFA should not be overly restrictive – particularly for the non-originator/investor since the data management and analysis requirements could make it costly and impractical to collect the relevant data, run it through the systems in order to understand the risk weight and the economics of a potential trade prior to execution. Therefore, the BCBS needs to maintain a more pragmatic and balanced approach in which MSFA and RRBA are more interchangeable for RW calculation.

III. Proposed approaches in the securitisation framework

Revised Ratings Based Approach (RBA)

Question 5 - *The Committee recognizes 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.

Answer 5 – UniCredit does not foresee major difficulties or cost increases to have two ratings for each new transaction. The European Central Bank (ECB) currently requests at least two ratings for the eligibility of assets to be used as collateral for credit operations.

Even if the requirements for two ratings are not an obstacle for new transactions, the BCBS should consider that currently one rating agency is sufficient for RWA calculation. Hence, in some jurisdictions where a single rating is sufficient for RWA calculation, a requirement for a second rating on existing transactions would produce additional costs. As a result, UniCredit strongly advises that the BCBS considers a grandfathering provision to manage this issue.

Question 6 - Is the RBA appropriately calibrated and formulated? Should other risk drivers be incorporated?

Answer 6 - The RRBA fails to recognize that credit rating agencies have already made significant adjustment to their structured finance criteria in response to lessons learned during the financial crisis. As a result, the addition of more stringent capital requirements should be calibrated to reflect this adjustment rather than based upon past ratings performance. The credit rating agencies would have already considered the shortcomings of their ratings when changing existing ratings/ assigning new ratings, so that a blunt application of higher risk weights per given rating would lead to an effective double counting.

Additionally, it must be considered that, **apart from US transactions, senior tranches of various well established asset classes (outside of the US) have incurred only insignificant defaults/losses over the past six years.** In fact, historic performance and rating migrations for securitisation transactions involving "real economy" asset classes (such as trade receivables, car loans/leases, equipment leases) would indicate that that risks have remained relatively stable and that, therefore, an increase of RW is unjustified. In short, transactions secured by diversified/granular portfolios of real economy assets should not be penalised because of the performance of other securitisations involving non-traditional assets/less granular asset pools.

Furthermore, the inclusion of tranche thickness as a risk factor is logical but, as currently proposed, is arbitrary, unnecessary and should be reassessed. As currently proposed, tranche thickness is strictly defined by set levels regardless of the underlying asset class. In addition, the rating agencies already consider tranche thickness in their analysis so, therefore, the addition of a RW penalty for tranche thickness is duplicative. In any case, the overall calibration of the penalties should be reassessed given the results which appear not to reflect actual differences in risk profile. For example, under the proposed framework, a thick (.50) BBB tranche would attract a lower risk weight than a thin AA tranche for a five year transaction. In fact, in the same transaction structure, the BBB tranche would be wiped out before the AA tranche experiences any losses.

As discussed elsewhere in this response, maturity as a risk factor should also be reconsidered since it is a factor already considered in the external rating process. In addition, the definition of maturity must incorporate the concept of average life rather than legal maturity.

In summary, the net effect of the proposed regulations is to increase the cost of funding via securitisations for banks because of the increased capital required by banks to hold securitized risks. This is potentially highly detrimental to the securitisation market and for the whole European economy and, therefore, should be carefully considered. It should also be highlighted that even proposed rule changes that dramatically change capital treatment of securitisation holdings will be disruptive to the market.

It is worthwhile in considering the coherence of the proposed RRBA to compare the resulting RW of senior financial bonds, covered bonds and securitisation. The below table provides the RW for a hypothetical AAA-rated or AA-rated bank (S&P) seeking to fund a target residential mortgage portfolio (with an average RW=35%):

Case 1	Case 2	Case 3	Case 4
Simple senior bond issuance	Covered bonds issuance	Old Framework - Securitisation – senior notes AAA (maturity not relevant)	New Framework - Securitisation – senior notes AAA with maturity > 5 y
SA RW = 20%	RW = 10%	RW = 7%	RW = 58%

Considering that:

- in Case 1, the investor has only the guarantee of the issuing bank,
- in Case 2, the investor has the guarantee of issuer's covered bond and preferential recourse to specific collateral

(residential mortgage or government obligations) in an amount higher than the covered bond's face value (overcollateralization) and,

- in Case 3 and 4, the investor in senior notes has security provided through the segregated asset pool. Moreover, this security is further enhanced through the securitization tranching structure.

UniCredit conclusions include the following:

- Investor cost in terms of capital is unjustifiably high in Case 4 considering the security provided.
- The results highlight the irrational result that the senior securitisation notes require more RW than a plain senior unsecured bond issuance and the RW of the most senior securitisation note is higher than the average RW of the underlying portfolio itself.
- From the originating bank's point of view, the proposed framework causes the securitisation to be no longer efficient and economically viable for funding purposes given the relative capital costs and the resulting required investment return to bank investors.
- The investor's reduced appetite to purchase securitization assets due to the RWA increase, as reported under Case 4, will cause the originating bank to no longer be in a position to use this technique for well-established real economy assets because of a significant and unjustified increase in cost which makes securitization inefficient compared with other funding instruments. In addition, if securitization is utilised for risk transfer purposes and, therefore, the senior tranche is retained by the originator with the balance of the capital structure sold to investors, the retained tranche will absorb more capital than the underlying portfolio on a stand-alone basis. This is inconsistent with the principal of risk transfer because the originating bank is in a better risk position than before the securitization having transferred the first loss and mezzanine risk to third-parties. These considerations will produce negative consequences for borrowers since banks will no longer be able to use securitisation as an efficient vehicle for lending to the economy.
- Even in the event an RW cap for the senior securitization note is applied, the senior note in Case 4 would attract a RW equal to 35%, which fails to consider the credit enhancement provided by the subordinated notes and correspondingly, contradicts the primary business motivation for such a transaction.

Considering the above outcome, UniCredit suggests that the RW attributable to certain senior securitisation issuance be recalibrated to be more consistent with the treatment of covered bonds.

Indeed, it is a matter of concern that, under the proposed securitisation framework that unsecured lending to corporates absorbs less capital than secured financing when retained by banks. This implicitly favors riskier types of lending techniques and restricts the ability of banks to transfer and manage risk through securitisation.

Modified Supervisory Formula Approach (MSFA)

Question 7 - *Is it appropriate to require that in order for the MSFA to be used the IRB approach should be applied for all underlying assets?*

Answer 7 - **From an investor standpoint, the application of the IRB approach for all underlying assets is nearly impossible.** Hence, a level of reasonableness should be applied to this. Otherwise, this requirement would result in an additional cliff effect which is unjustifiable and unnecessarily inflexible e.g. it would most likely render the MSFA inapplicable for most banks and therefore not generate any benefit in terms of accurate risk evaluation.

Considering that the Simplified Supervisory Formula Approach (SSFA) was deliberately constructed to be even more conservative than the MSFA, the question arises as to whether 1% SA assets within a portfolio would justify the extra conservatism of dropping back to a much more conservative approach. This requirement will limit the applicability of the MSFA.

Considering that mixed pools will be the standard, it should be analyzed how their risks can be assessed.

From a theoretical perspective, the proposed pro-rata approach can represent a solution. But on an operational side, this approach is almost impracticable considering that it would imply to divide each securitisation as it would be two distinct transactions and to assess the risk of the two sub-portfolios (and consequently on the notes) as if they were 2 different securitizations. Such a process would be highly cumbersome and involve intensive IT development requirements.

Against this background, UniCredit proposes to maintain the current approach of the "prevailing" portfolio also for the future. In this case the application of the MSFA would be allowed if the IRB portfolio is higher than 50%. On the remaining portfolio the average RW may be usable.

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?*

Answer 8 - In its current form the MSFA leads to a multiple factor increase when comparing the pre- and the post-securitisation RWA on the basis that all tranches remain within the banking industry. In fact the framework has to be adopted by investors and originators, this means that a loans portfolio that has a certain risk weight ante securitization could have a considerably higher risk weight once securitized and distributed - either entirely or partially (the notes average risk weight could be higher than the risk weight of the underlying loans).

As regards the risk drivers, the mere fact of securitising assets is considered to be driving both the risk and thus the required capital levels up for reasons which are difficult to understand. The attention is also drawn to the fact that the Asset Value Correlation (AVC) is again counted twice – both in the underlying pool and in addition for the tranches.

The diversification within the pool should be a vital component of the capital determination process, since e.g. for the conduit business it is needed to differentiate between a pool of very many obligors vis-à-vis a guarantor. The risk here is completely different.

One way to improve the calibration of MSFA would be to divide the capital requirement by the tranche thickness in order to receive the risk weight in question.

Question 9 – *Is it prudent to allow the use of the MSFA by banks making use of the foundation IRB approach (ie not calculating internal estimates of the underlying loans' LGD)?*

Answer 9 - Since the Supervisory formula approach (SFA) is already used by Foundation IRB (FIRB) banks, UniCredit considers appropriate to maintain the same approach.

In fact, considering that the FIRB calculations and the application of the supervisory Loss Given Defaults LGDs (e.g. 45% for senior unsecured corporates) is legitimate in the banking book, UniCredit argues that what is acceptable for the Banking Book should be applicable within the scope of the securitisation framework as well.

Simplified Supervisory Formula Approach (SSFA)

Question 10 - *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?*

Answer 10 - UniCredit has not completed an analysis of the impact of SSFA due to time and data constraints. From a qualitative perspective and according to the explanation of the BCBS, it is a matter of concern that the reason to choose a more conservative value for (p) than the US authorities have decided to use, is to simply make the SSFA more conservative than the MSFA. This is not deemed a relevant and appropriate factor to determine proper risk-weight.

As a consequence, the proposed Framework would exacerbate the unlevel playing field situation even further for reason not related to the underlying risk, but simply due to comparability reasons.

Question 11 - *Is the SSFA properly formulated or should other risk drivers, such as maturity, be incorporated?*

Answer 11 - As stated in answer 10, UniCredit is providing feedback on the SSFA only in qualitative terms. Considering that the BCBS has described that the SSFA is already more conservative than the MSFA, adding another risk factor (e.g. maturity) will widen the gap between the two approaches **without an economic rational and without improving accuracy in the calibration**

Concentration Ratio Based Approaches (Backstop Concentration Ratio Approach)

Question 12 - *Has the BCRA been appropriately calibrated and formulated?*

Answer 12 - In its current form the BCRA is very conservative. Assuming that the unsecuritised portfolios RW (%) can only be applied to the most senior tranche, it becomes obvious that the BCRA is heavily inflating the capital requirements after securitisation.

It is also noteworthy that the BCRA is actually – apart from the most senior tranche – doubling the capital requirements for all other tranches **without an economic rational and without improving accuracy in the**

Question 13 - *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?*

Answer 13 – In the event competent authorities also applied a factor of 2 to the most senior tranche, the RW (%) attributable to the most senior tranche's would be 2 times higher than the average RW(%) of the underlying pool, in an unsecured form. As a result this setting of the F parameter clearly produces neither the expected nor desired effects.

Having all the RW doubled does not represent in any way a chance to avoid arbitrage opportunities.

The way the BCRA works is that even if the most senior tranche had an attachment point of 0% and a detachment point 100%, it would result – at best – the same capital requirements as the underlying portfolio, had it not been securitised. This means that there is no arbitrage possibility at all.

Considering the arbitrage opportunities that might be opened by the adoption of the different approaches (e.g. MSFA, SSFA, revised RBA, BCRA) it seems there are no solutions to avoid potential arbitrage opportunities since these opportunities are linked to the different functional shapes used by the different approaches.

Question 14 - *How prevalent and material are securitisation exposures backed by mixed pools?*

Answer 14 - As originator, securitisation exposures backed by mixed pools could be material for UniCredit in the Central East European region, in which different European Incentive Programs are in place (i.e. Jeremie).

From an investor standpoint, it will be a normal course of business to have mixed pools to be assessed.

Question 15 - *Is the proposed treatment for mixed pools appropriate, or should another approach be employed?*

Answer 15 - As already indicated in question 7 and considering that mixed pools will be the standard, it should be analysed how their risks can be assessed.

From a theoretical perspective, the proposed pro-rata approach can represent a solution. But on an operational side, **this approach is almost impracticable** considering that it would imply to divide each securitisation as it would be two transactions and to assess the risk of the two sub-portfolios (and consequently on the notes) as for two different securitizations. Also from a process and IT perspective this is really cumbersome to execute.

Against this background, UniCredit suggests that the BCBS consider maintaining the current approach for the “prevailing” portfolio within mixed pools. In this case the application of the MSFA would be allowed if the IRB portfolio is higher than 50%. On the remaining portfolio the average RW may be usable.

IV Other proposed changes and clarifications

Question 16 - *Is the definition of maturity appropriate, in light of the Committee's objectives?*

Answer 16 - The weighted average maturity of the contractual cash-flows of the tranche is currently used under the wholesale IRB framework (Basel Framework, paragraph 320). UniCredit deem this approach suitable to achieve BCBS's objectives.

Nevertheless, the maturity definition needs to incorporate the concept of expected average life to consider prepayment speeds rather than simply contractual cash-flow obligations. UniCredit proposes to include the actual prepayment rate of each specific portfolio as reported in the public Investor Report in the computation of the weighted average maturity. The usage of an “official” prepayment rate, specific for each portfolio, would increase the accuracy of the Weighted Average Life (WAL) computation for securitization exposures and, at the same time, would ensure that banks utilize identical WALs in capital calculations.

In addition, the definition of the maturity needs to be clarified especially for typical customer-driven conduit transactions. Example:

- (a) the initial liquidity commitment (e.g. 3 years) is longer than the receivables WAL (e.g. 1 month);
- (b) the transaction includes performance linked to termination triggers (monthly surveillance of those triggers);
- (c) the breach of such a trigger would terminate the financing and initiate amortization, the amortization period being equal to the receivables WAL.

As a result, the loss horizon (the maturity of the assets to which the bank would be exposed to) is equal to the receivables WAL, regardless of the original contractual commitment term. Hence, in the conduit business, the term of the original liquidity commitment is not the appropriate risk factor.

Risk-weight floor

Question 17: *Is the proposed 20% risk-weight floor set at an appropriate level? Please provide justification and evidence, to the extent possible, for alternative levels for the risk-weight floor.*

Answer 17: The proposed risk-weight floor increases dramatically the IRB capital requirement attributable to the most senior tranches of securitizations, increasing the requirement to 1.6% from the current 0.56% level. This increase in capital will have a similarly significant impact on the securitisation market as a whole, through a reduction of the economic benefits arising from the securitisation of high quality assets (with a low risk weight). Conversely, such a floor could implicitly incentivise banks to securitise only low quality assets (with higher risk weight).

This could also result in a material downsizing of securitisation transactions involving certain asset classes, which could cause banks no longer to have enough capital available for new loans origination.

UniCredit would propose that BCBS consider retaining the floor at 7% (at least for certain high quality asset classes) or at the very least, aligning the floor to the 10% risk weight envisaged by the regulator for AAA-rated covered bonds.

Securitisation is also an efficient tool to provide secured funding to corporates via ABCP programs or on-balance sheet form of receivables backed financing. Any unjustified increase in RWA due to the introduction of a floor will result in an inefficient increase of the cost of funding for the banks' clients with negative impacts on the real economy.

As an example a AAA-rated tranche which attracted 7% risk weight so far will increase to 20% first and, then as a consequence of the implementation of the maturity factor, to a possible 58% risk weight. This represents an increase of a factor of more than 8 times. The magnitudes of such a change would have an enormous impact on current bank holdings of securitizations and, therefore, UniCredit suggests that the BCBS consider grandfathering all transactions and positions entered into before the revised Framework becomes effective.

Considering the lack of a clear economic rationale and the significant resulting negating impact on banks, UniCredit suggests that the BCBS consider a less arbitrary and more flexible RW floor which distinguishes between various asset classes based upon relative historical performance. This is important to ensure a closer alignment of risk with required capital and to avoid unintended incentive structures in which bank investment (and, similarly, interbank risk transfer) in riskier securitized assets are implicitly encouraged by the floor.

Note: While not a preferable outcome, to the extent any changes in capital treatment were implemented, UniCredit would strongly suggest that BCBS consider grandfathering existing bank holdings of ABS.

*The multiplier effect is even greater for AA-rated and A-rated senior tranches

Question 18 - *Should the risk-weight floor for short-term exposures be the same as for long-term exposures?*

Answer 18

It is inconsistent to impose maturity as a determinant of RWA on ABS alone. Similarly and as stated elsewhere in this response, the imposition of an RWA floor has no rational basis and results in unjustifiable RWA differences between financing instruments.

Maximum risk weight for senior securitisation exposures (RW cap)

Question 19: *Are the proposed caps and their interactions with the proposed floor risk weight appropriate?*

Answer 19: UniCredit deems appropriate the proposed caps and their interaction with the proposed floor risk weight even if as mentioned in our answer to the question 17 UniCredit believes the 20% floor is likely to lead to economic non-viability of the securitization technique.

In addition, the forthcoming result of the Quantitative Impact Study (QIS) should be used to compare the values for floors and caps for real life trades.

Treatment of write-downs and purchase discounts

Question 20 - *Are there other approaches that could provide a more risk-sensitive treatment while still being prudent and operationally straight-forward to implement?*

Answer 20 - UniCredit agrees with the BCBS proposal to use the carrying value as the amount to be risk weighted, net of write-downs and discounts.

In fact, the write-downs and the amortization of purchase discounts are already recognised through Profit and Loss and, correspondingly, reflected directly in resulting capital. As a result, they should be not considered in RWA calculations in order to avoid double counting.

V. Key assumptions and theoretical underpinnings

Question 21: *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.*

Answer 21: UniCredit in principle warmly welcomes the BCBS's idea to use the risk weights of the underlying assets as a basis when determining the risk weights of the tranches after securitizing the assets. However, currently UniCredit fears that all suggested measures (MSFA, RRBA, SSFA, CR-KIRB, and BCRA) produce significantly more capital for the tranches compared to the underlying portfolio, had it not been securitized. This fact is against the concept itself of securitisation.

When looking at the factor increase for the different approaches - which can be substantial – UniCredit deems that the linkage of the capital required to support the underlying assets versus the tranches is not clearly evident. The main aim of any calibration should be to capture the inherent risk of the transaction rather than to inflate the amount of capital required after securitizing the assets, even if the caps apply.

Retail securitisations

Question 22 - *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?*

Answer 22 – Currently, retail exposures – residential mortgages in particular – seem excessively penalized. Assuming an average risk weight of 20% - 30% for an underlying pool of mortgages, and given that the legal final maturity for RMBS transactions is determined by the asset with the longest maturity in the pool (again values greater than 20 year are not infrequent) the triple-A most senior tranche would qualify for 58% risk weight.

UniCredit welcomes the proposed exemption granted by the BCBS to most senior positions (both SA and IRB). We understand a look-through approach into the underlying assets would be replaced by their average risk weight. This is the right step to avoid the aforementioned issue. However, UniCredit would like to point out that this still constitutes a burdensome data collection exercise, e.g. for an investor and in any case against the securitisation business sense (applying the same RW of the underlyings to the most senior tranche does not recognize in anyway the credit enhancement of the subordinated notes).



Since the risk weights used for the banking book SA are readily available for the competent authorities as well, and since the different assumption with regards to the risk of different asset classes is evident here as well, UniCredit deems that a differentiation between the assets classes could be made when determining the appropriate risk weight for a securitisation exposure. Ideally, there would be preferential risk weights in the regulatory look-up tables for e.g. RMBS tranches.

Question 23 - *How could concerns that securitised retail exposures have high default risk or high correlation be managed?*

Answer 23 – UniCredit fundamentally challenges the premise that securitized retail exposures entail high default and/or correlation risk. In fact, available default history for senior tranches of the most common asset classes (e.g. auto loans, credit cards, prime RMBS, etc.) would indicate that such concerns are unfounded with performance of such tranches relatively unaffected since the start of the financial crisis in 2008. Concerns may be justifiable in the case of certain asset classes (particularly subprime/non-conforming RMBS) but UniCredit would argue that such ill-conceived asset classes are no longer viable given their post-crises performance and, therefore, are not representative of the retail securitization market as a whole.

It should also be noted that ratings migration tables are not necessarily a sound indicator of overall securitization market performance because of distortion caused by country ratings ceilings. In addition, ratings migration also reflects tightening of rating criteria.

VI. Calibration of the proposals and planned QIS

Question 24 - *Is the relative calibration of the approaches appropriate? Please provide empirical data to support any conclusions.*

Answer 24 – Currently, UniCredit deems that the proposed regulatory framework will simply require banks to hold disproportionately more capital against securitization exposures than against non-securitised exposures without a viable rationale.

UniCredit is in the process of looking at empirical examples of such a misalignment and will revert in due course.

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Please find below the list of the key contact-people involved in this work, whose contribution made possible to coordinate and provide UniCredit answers to this Consultation. Some other experts have been involved alongside the UniCredit Group, but are not listed below.

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