



Verband der
Automobilindustrie



AKA

ARBEITSKREIS
AUTOBANKEN

Comments

**on the Basel Committee's Consultative Document
"Capital Treatment for simple, transparent and comparable
securitisations"**

Introduction

The Comité des Constructeurs Français d'Automobiles (CCFA) and the Verband der Automobilindustrie (VDA) represent the leading companies of the automotive industry in France and Germany, and the AKA represents the automotive captives in Germany.

We welcome the opportunity to comment on the consultative document on “Capital treatment for simple, transparent and comparable securitisations” issued by the Basel Committee (BCBS) on 10 November 2015. We agree with BCBS that the December 2014 framework does not capture some of the features (especially the qualitative ones) of securitisation structures found in the marketplace and that STC criteria are better able to capture the nuances and qualitative elements of such securitisation structures.

With our comments we would like to contribute to the development of a securitisation framework promoting a sustainable securitisation market while considering well-established market practices based on simple, transparent and comparable securitisations.

To achieve these goals we would prefer a principle-based-approach as proposed in the BCBS/IOSCO consultative document published in December 2014. The proposed criteria in that consultative document were rather generic and more principle-oriented. We stay with our position explained in our paper from 11 February 2015. Given the fact that the framework will be a worldwide global standard and taking into account the partial major differences between the European and the US securitisation market, we believe that this was the right level of detail for a global standard. Further rule based clarifications should be given by the European or national legislator. Thus, detailed examples should be deleted.

A further specification could be conceived at a later time with the aim to foster harmonisation of the standards for high quality securitisation between Europe and the USA. However a detailed one-size-fits-all approach would not be reasonable at this point in time, because it would not sufficiently consider specifics of these markets. Thus, for the time being, we advise against further specifications at a global level.

We would like to point out that we have already supported former works by the Basel Committee and IOSCO in the past to support the above described aims.¹

Question 1 – 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?

In principle, we agree.

¹ Position Paper on BCBS and IOSCO consultative document on criteria for identifying simple, transparent and comparable securitisations, 11th February 2015

Reply to Questionnaire to market participants on developments in securitisation markets, 9th June 2014

Question 2 – 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?

A1. Nature of the assets

Contractually identified periodic payment streams

Criterion A1. requires “contractually identified periodic payment streams”. The major part of securitised auto loans comprises contracts with so called balloon payments, though. Such payments are made at the end of the contract and are typically significantly higher than the other monthly instalments. Hence, in order not to exclude most Auto-ABS from STC-eligibility, the term “periodic” should be deleted. Alternatively it should be clarified in a footnote that “contractually identified periodic payment streams” encompass balloon payments.

Homogeneity

The homogeneity is in principal a reasonable criterion to reduce the complexity of securitisations. However the examples under “Additional guidance” should be deleted, because they do not sufficiently consider well established market practice.

This notably relates to the example, that only *“loans that have level monthly payments that fully amortise the amount financed over its original term”* are accepted as homogenous, *“except that the payment in the first or last month during the life of the loan may be minimally different from the level payment”*. It is well-established practice over the last decade that both classic amortising annuity loans and the prevailing annuity loans with a balloon payment at the end of the contract are securitised. As described above the latter are typically significantly higher than the other monthly instalments and would hence be excluded from the scope of the criterion.

Also we understand that a securitisation of auto leasing exposures from corporate lessees such as corporate SME's and retail lessees in one transaction would no longer be eligible for STC-ABS. However such transactions are well established market practice as well and showed an outstanding performance since the 1990's.

Eventually we are of the view that a further subdivision of one asset type would make it necessary to split these current securitised portfolios into several portfolios. Each of these split portfolios would have to be securitised separately. This would mean that all regulatory and market driven requirements would have to be fulfilled for each transaction. For example the assessments of rating agencies would be necessary for each transaction. Each transaction would need derivative counterparties to hedge interest rate risks. For each transaction a prospectus would have to be prepared and a cash flow model to be delivered etc. In addition the portfolio size would shrink significantly which would impede the marketability due to decreasing liquidity of small securitisations.

As a result if the criterion of homogeneity is interpreted too strict by supervisory authorities it will make Auto-ABS as the best performing securitisation segment uneconomically.

A3. Payment status

We are convinced that it is important that investors are able to assess the quality of the underlying assets adequately. We also do think that the requirements for such assessment shall not be too complicated and challenging in terms of the level of uncertainty that is inherent to such assessment. The criterion of “simplicity” should thus also refer to the simplicity of such assessments. An assessment is in our opinion simple if the following prerequisites are met:

- the credit and business processes, especially the acceptance policy and underwriting standards, but also the collection and dunning process as well as the internal controls and internal audits are the same for the non-securitised and securitised portfolio,
- underwriting standards have been stable over time in substance and transparent information including vintage curves exist about the historical performance and the development of the non-securitised portfolio and former securitised portfolios.

Based on such information and conditions investors can easily compare the performance of securitised and non-securitised loans, so that it can be simply concluded from the quality and performance of such portfolios in the past – adjusted by macroeconomic forward-looking information, if necessary – to that of the securitised portfolio.

To simplify the assessment and to reduce uncertainty, it is reasonable to exclude loans that are in *default* according to Basel II as implemented into the CRR and that show *evidence of impairment according to the applicable accounting standard* with the need of specific allowances. Furthermore to provide investors more comfort and to exclude loans that could indicate a significant increase in credit risk, it is common practice of existing high quality ABS to exclude – as of the cut-off date – *delinquent* loans and to require that *at least one and partly even two payments* have been made before securitisation. In addition it is important that the loans to be securitised are *selected randomly* from a target portfolio to avoid assessment bias. Based on such random selection from target portfolio it can be warranted that the quality of the underlying securitised exposures is comparable to the non-securitised portfolio which is one main feature of “comparable” securitisations. An assessment and selection considering these requirements would be appropriate to classify securitisations as “simple” and “comparable”.

By empirical evidence this practice has proved to maintain low level of losses for the underlying securitised auto loan and auto leasing contracts in the past even under severe stress conditions. In contrast it was typical for originate-to-distribute model in

the US subprime RMBS segment that loan receivables were sold without any payment obtained by the debtor.

Based on the aforementioned deliberations as well as the current securitisation practice and in order to avoid a too complicated selection process, we advocate for the deletion of the additional proposed guidance for criterion A3. With regard to lit. a) to c).

Additionally we would like to take the opportunity of this consultation to once again give our view on the phrase “for which the transferor or parties to the securitisation are aware of evidence indicating a material increase in expected losses”. As stated in our Position Paper of 11th February 2015 we are of the view that this phrase should be deleted. It could be difficult to measure and determine a material increase in expected loss. The calculation of expected loss requires the parameter PD, LGD and EAD. However such parameters are typically calculated by IRB-banks and would exclude banks that use the credit standardised approach. Beyond such practical issues, we doubt whether an increase of the expected loss is an appropriate criterion at all. We understand such requirement if it is the aim to avoid that an originator mainly selects the receivables where he expects a significant increase of the expected losses. However, this should be better addressed, as explained above, by the requirement that the selection of the receivables has to be carried out randomly from a defined target portfolio and that no adverse selection of receivables is permitted which could hinder the comparison of the performance of the non-securitised portfolio with the expected performance of the securitised loans.

D15. Credit risk of underlying exposures

We understand criteria A3. (payment status) and A4. (consistency of underwriting) as safe-guard against higher-risk underlying exposure. Criterion A4 requires that the exposure are originated in the ordinary course of the originator's business pursuant to underwriting standards that are not less stringent than those the originator applies to origination of similar exposures not securitised. In addition according to criterion A3 at least one payment has to be made and defaulted and credit-impaired exposures shortly after origination are excluded. Thus we don't see the need to exclude further exposures. For these reasons we propose to delete criterion D15.

D16. Granularity of the pool

We believe that the 1 % threshold is appropriate for retail transactions. However the language with respect to the group of connected clients should be changed slightly so that this applies “according to the best knowledge” of the originator.

With respect to wholesale transactions such as the securitisation of receivables from car dealers, the 1% threshold is set too low and will prevent these types of securitisations from ever meeting the STS criteria. Therefore if dealer floorplan is not to be completely excluded from STS, a significantly higher threshold will be needed. In our view the threshold needs to be set at 5% to allow significant dealer groups to

obtain funding through ABS and this could be implemented as either a single threshold or in combination with other thresholds to further ensure the granularity of the overall pool of loans. This is something that the Captives have a great deal of experience with and we would urge further detailed discussion on this point.

Question 3 – What are respondents’ views on the compliance mechanism and the supervision of compliance presented in this consultative document?

We are of the opinion that the originator should have the possibility to obtain a “*confirmation of conformity*” on request by the competent authority. Such confirmation should refer to the originator’s self-assessment that certain or all of the criteria under A to D are met. We believe that this is necessary from a perspective of a prudent 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 or not.

Such regulatory risk can increase significantly particularly if many supervisory authorities are involved as it is envisaged by the European legislative proposal for a regulation laying down common rules on securitisation and creating a European framework for simple, transparent and standardised securitisation (COM(2015) 472).

We understand that BCBS apparently fears that a “*certification*” process may raise issues of moral hazard, as investors would have less incentive to perform rigorous due diligence. Our proposed solution differs from such certification process, though. To receive a “*confirmation of conformity*” the originator would have to provide a self-assessment and to substantiate why in his opinion a certain criterion is met. This allows the supervisory authority to comprehend the interpretation of the single case in terms of the fulfilment of the criteria requested to be confirmed. Thus different to a certification it is not possible that the supervisory authority could overlook problematic features in the securitisation. The request on confirmation only refers to specific criteria that have to be interpreted under consideration of the specific circumstances of the single case. While in case of a certification market participants could fully rely on the designation by the supervisory authority, such problems could not arise in case of a confirmation which relates to the substantiated self-assessment on certain criteria by the competent supervisory authority. As a result such confirmation cannot cause any moral hazard on the part of the investors.

Finally the possibility of obtaining such confirmation would have the advantage to reduce reputational risks both for originators but also for the STC-securitisation market. It helps to 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 believe that without such confirmation any additional rules in the securitisation framework on STC would not achieve the aims to foster a functioning securitisation

market which is essential to support economic development and growth by providing sufficient credit to the economy.

Question 4 - What are respondents' views on the alternative capital requirements for STC securitisation presented in this consultative document?

We explicitly welcome favourable capital treatment of "simple, transparent and comparable" securitisations. However we are convinced that the proposed reductions of risk weights for STC-securitisations are not approximately sufficient to revamp the securitisation market. The reason is that even the reduced risk weights for STC-securitisations are in most cases significantly higher than the current risk weights for securitisation positions that apply according to Basel II. We believe that the risk weights of Basel II are still appropriate for high quality prime securitisations. With regard to Auto-ABS the performance was at all times and even in the last financial crisis excellent. To our knowledge no investor has ever suffered a loss resulting from a default over the last 20 years when the first Auto-ABS has been placed. Over and above the structural risks of STC-securitisations are significantly reduced compared to non-STC-securitisations. Nevertheless the Basel Committee proposes a floor risk weight for STC-securitisations for IRBA-institutions that is significantly higher than today. Thus we see an urgent need to retain the current floor risk weight of 7% and to make it available both for the SEC-IRBA and the SEC-ERBA due to reduced structural risks of STC-securitisations. We propose that the data of the current QIS should be used to reduce the risk weights for STC-securitisations under the SEC-ERBA.

In addition the risk weights for STC-securitisations in the SEC-ERBA should not be higher than today for IRBA-institutions. This is necessary, because we believe that many IRBA-institutions will not be ready to develop specified IRB-models that would be necessary for the different securitisation segments, such as RMBS, Auto-ABS, CMBS, CDO etc. due to the high development and maintenance costs for such models on the one hand and the problem that the required data for such developments will not be sufficiently rich to reliably build and calibrate such models on a statistical basis. Thus only very few big credit institutions that have sufficient rich data will be able to develop such IRB-models and achieve the required economies of scale. All other credit institutions will mainly have to use the SEC-ERBA which warrants risk sensitive capital requirements. Because there is no reason to differentiate the risk weights for IRBA-institutions and CSA-institutions that both use the external ratings for the determination of risk weights, the current risk weights of Basel II under the rating based method for IRBA-institutions should also apply for CSA-credit institutions. Thus we see an urgent need to revise the proposed risk weights for STC-securitisation under the SEC-ERBA.

Finally we propose a segment specific calibration of risk weight for the segments that are currently analysed in the QIS, because we believe that these securitisation segments have specific risk characteristics and thus specific risk profiles that differ

from segment to segment and which can be empirically evidenced by the general different performance of certain securitisation segments.

Additional comment on the scope of STC securitisations (exclusion of ABCP)

A large part of the European automotive industry is dependent on the funding that multi-seller conduits provide and whose funding relies in turn on conduits being able to sell ABCP to investors. Thus short term transactions such as ABCP programs constitute an important instrument for the automotive industry.

Unfortunately with Annex 2 BCBS proposes to insert a recommendation into the STC framework which would exclude ABCP from the scope of STC securitisations by stating that only non-ABCP, traditional securitisations are within the scope of the framework (No. 109).

However ABCP conduits play an important role in the financing of businesses. In particular, many private and bi-lateral securitisation funding arrangements are financed in this way. If ABCP is not able to benefit from the lower capital charges proposed under the STC framework there will be a real and adverse cost impact on the automotive manufacturing industry in Europe and on SME's and consumers. At worst, it will cause Auto ABS issuers to have to look for alternative forms of financing if in a post "qualifying regime" Europe there is not a strong market outside of the qualifying sub set.

We would urgently request that the BCBS revisits the exclusion of ABCP from the scope of STC securitisations given its potential to exclude what is in our view one of the safest and best performing securitisation asset classes.

Paris, Berlin, Cologne – 04 February 2016

Comité des Constructeurs Français de l'Automobile (CCFA), 2, rue de Presbourg,
75008 Paris, France

Verband der Automobilindustrie (VDA), Behrenstrasse 35, 10117 Berlin, Germany

Arbeitskreis der Banken und Leasinggesellschaften der Automobilwirtschaft (AKA),
Gut Maarhausen, Eiler Straße 3 K1, 51107 Köln, Germany