December 17, 2002

Comments on the "Second Working Paper on Securitisation"

Japanese Bankers Association

The Japanese Bankers Association (JBA) is delighted to have this opportunity to comment on the "Second Working Paper on Securitisation" published by the Basel Committee on October 28, 2002. We hope our comments below will prove to be useful to the Committee in building up appropriate framework for securitisation.

General Remarks

In light of the fact that the development of securitisation markets differs from country to country, we requested in our "Opinion Paper on the New Basel Capital Accord" dated May 31, 2001 that particular attention should be paid not to harm the ongoing development of asset securitisation markets. We also raised issues for which further consideration should be required, in our comments on the "First Working Paper on Securitisation" in November 2001.

We are pleased that the Second Working Paper published in advance of the Third Consultative Document reflects some of the views we have expressed in the past, including 1) clarification of "Obligor by obligor" type of securitisation arrangements through clearer definitions of securitisation and 2) the adoption of regulatory capital requirement caps for originating banks.

However, from the viewpoint of practicality and logical consistency, we believe there is still room for improvement in the following two areas.

Firstly, in Japan, securitisation of corporate receivables is extremely important financing tool for large and medium-sized enterprises. Banks usually provide liquidity support or credit enhancements to those programs as sponsors, and in calculating the associated regulatory capital requirements, the question of whether a "top-down approach" is permitted or not is extremely important from the viewpoint of the economic substance of the transaction and the practicality of the calculation procedures. We would like to request that sufficient consideration to be given not to interfere in this type of transactions by setting excessively strict requirements for the application of the top-down approach.

Secondly, since the scope of the New Basel Capital Accord extends as far as investing banks, it should be understood that the new Accord will have a particularly strong impact in countries such as Japan, where banks themselves play a notable role as investors and the securitisation market is still on its developing stage. Imposing too much conservative capital treatment on investing banks may not only erode their willingness to purchase, but also eliminate the originating banks' incentive to use securitisation to control credit risk, and impede the healthy development of the securitisation market. We would like proper consideration to be given not to impose excessively conservative risk weightings to securitised products.

In line with the objectives of the revision of the Basel Capital Accord, we stand ready to continue proposing constructive suggestions through repeated discussions with supervisors in order to build more sophisticated regulatory framework that is also consistent with the banks' internal control systems.

(In the following sections, "TG" is used for "Technical Guidance," and "WP" for "Working Paper.")

Detailed Discussions

1. Clarification of definition of "Securitisation" (WP: paragraph 5; TG: paragraph 486)

TG paragraph 486 lists the conditions that "securitisation transactions" should satisfy, but depending on the nature of the transaction, there must be cases where it will be difficult to make a classification judgment as to whether a certain transaction should be treated as a securitisation or some other kind of portfolio exposures (corporate such as finance companies that primarily hold credit exposures as their assets, specialized lending, purchased receivable, so on). Prior to the actual implementation of the New Accord, we would like to request that the clearer guidelines concerning portfolio classifications to be provided, using a Q&A format with concrete examples, as well as clearer definitions of terminology such as "credit exposures" and/or "stratified positions or tranches."

2. Requirements for Applying the "Top-down" Approach to Purchased Receivables under the Internal Ratings-Based Approach

(1) *Consideration for individual countries' legal systems and business practices* (TG paragraphs 201-205 and 438-447)

We understand that it is necessary to satisfy the requirements stated in these paragraphs in order to adopt the top-down approach for securitised purchased receivables. We would like to request first of all that on actual application, the legal systems and business practices of each country should be taken consideration.

(2) *Purchased retail receivables* (WP: paragraph 10; TG: paragraph 202)

These paragraphs permit a top-down approach for purchased retail receivables while the retail exposures referred to in the third bullet point of paragraph 192 include credit exposures to small businesses that satisfy conditions of 1 million euros limit. For this reason, we understand it possible to apply the top-down approach to securitisations of purchased receivable pools as far as underlying credit exposures are less than 1 million euros for each obligor.

In this case, according to the proposed rule, it is necessary for each of the individual exposures included in purchased receivables to be aggregated with any other credit exposures held by the bank on obligor base, which would be practically impossible. We would like to request that the ceiling to be set on the amount within the purchased pool.

(3) *Purchased corporate receivables* (WP: paragraph 11; TG: paragraph 204)

In addition to legal requirements, these paragraphs stipulate two objective standards in the form of a "the remaining maturity being not greater than one year" and "concentration limits established by the national supervisors." However, if the latter is stipulated and put into operation, we do not believe there is a large logical necessity to impose maturity limits as well. We would like to request an additional clarification on the grounds for the limit on remaining maturity to "one year or less", and would request flexibility of the "maturity limit " in the practical operation, as in the case of the operational flexibility on retail claims (final bullet point of paragraph 192(a)).

3. Treatment of recognition of guarantees in purchases of receivables (TG paragraph 328)

In the case of the second bullet point, where seller or third party guarantees are provided for dilution risk, we would like to confirm that the "exposure" for which the guarantor's risk weight will be substituted/applied is not the nominal amount of the receivable, but the amount of the expected losses (or the maximum losses) that are associated with dilution.

4. Treatment of deductions of retained or purchased positions up to KIRB at banks adopting the IRB approach (WP paragraphs 14-15, TG paragraph 561)

We would like to request clarification of the reasons why "deductions from regulatory capital" were chosen as the most severe treatment in calculating the capital requirement, instead of 1250% risk-weighting. We believe that there is a lack of consistency in deducting a position from regulatory capital after securitisation, although amount of asset will be added as risk asset if it is not securitized.

The Committee proposes that positions up to KIRB should be deducted from regulatory capital, in order to create strong incentives for originating banks to shed the risk associated with highly-subordinated securitization positions whose levels are KIRB or less. However, we would like this to be reconsidered from the following viewpoints.

① If part of the positions below KRB has investment grade ratings, we believe that it would be too conservative to deduct this portion from regulatory capital, since correlation effects have already been reflected.

② Moreover, if the bank is an investing bank, it may adopt the Ratings Based Approach (RBA), but if it is an originating bank, it has to deduct positions from regulatory capital as far as the position is below KIRB, which gives rise to discrepancies between investing banks and originating banks.

5. Risk Weightings under the Ratings Based Approach and the Standardised Approach

(1) *Risk weightings under the RBA* (WP: paragraphs 27-29; TG: paragraph 570)

We believe the risk-weightings for the non-investment grade zone are too high under the RBA. While risk weights for corporate exposures rated BB+ and below are 150% maximum for corporate exposures, for securitisations they start from 250% and in the most severe cases, the position must be deducted from regulatory capital.

The Committee's view is that the risk associated with corporates is largely idiosyncratic and therefore differs from that associated with securitisation transactions, which tend to embody more systematic risk, and the marginal contribution to portfolio risk also differs between corporate exposure and securitisation. We would like to request more concrete explanation on this difference.

(2) *Reflecting granularity* (WP: paragraphs 23-24; TG: paragraph 570)

Under the proposed RBA, differences in LGD (loss given default) according to granularity and tranche are reflected in risk weight; however, we believe that they are already reflected in the ratings of rating agencies, and we take the view that the adjustment is duplicated. Please clarify the grounds for adopting this risk-weighting structure.

(3) *Treatment under the Standardised approach* (TG paragraph 518)

The treatment under the Standardised approach is much more severe than that of the RBA approach, since the risk weight for the non-investment grade zone (BB+ and below) ranges from a 350% to capital deductions. We would like to request clarification on this point, too.

6. Treatment of implicit support (WP paragraph 63, Annex 4 paragraphs 8-11)

We would like to request exemption rules to be established for certain transactions that do not fall into the category of "implicit support," e.g., transactions that satisfy certain conditions, such as repurchases of marketable products at market value, and for which rational can be demonstrated to the national supervisors.

7. Treatment of sponsor banks in the case of early amortisation provisions (WP: paragraph 51ff.; TG: paragraphs 493, 540)

We assume the rules of TG paragraph 540ff. concerning transactions that contain early amortisation features result from a concern on the liquidity risks of the seller (originating bank) for the undrawn portion in the event of early amortization. And TG paragraph 493(b) defines that "originating bank" includes sponsoring.

However, in securitisations of receivables (credit card claims, etc.) where the bank only plays the role of a sponsor, the above-mentioned risk associated with early amortisation is unlikely to arise. The risk should arise and/or recognized at the seller bank. Consequently, we would like to ask that paragraph 540 clarify that "this item applies only to originating banks, excluding sponsoring banks."

Once again, the JBA would like to express its gratitude for having this opportunity to make comments. We intend to continue our dialog with the regulatory authorities bearing necessity of the highly risk-sensitive framework in our mind and looking forward to the future development of the securitisation market.

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