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The Norinchukin Bank

Second Working Paper on Securitisation released by the Basel Committee on Banking Supervision (Comment)

1. Problem areas of the securitisation framework

As Paragraph 15 indicates, the purpose of the securitisation framework is to improve current regulations by switching to a more risk-sensitive regulatory system as risks associated with securitisation are not accurately complemented under the current system. As a result of this, an excessive risk burden is placed on originating banks.

From the viewpoint of securing sound banking business, this approach may be appropriate. It is, however, doubtful whether this framework proposal itself is the most favorable policy to realize its objective. We point out two major problem areas as follows:

(1) Lack of consistency with the entirety of the new regulations

The first problem area lies in the framework's inconsistency with the entirety of the new regulations. The new regulations' fundamental direction consists of three pillars to restructure the framework. The first pillar sets out minimum capital requirements that reflect more accurate risk characteristics. The second pillar indicates a bank's own assessment of its capital adequacy, taken in consideration of the overall risk profile, as well as supervision of this assessment from the authorities. The third pillar is to bolster market discipline through enhanced disclosure by banks. This proposed framework of securitisation, however, not only allows the targeted risk amount of capital requirements in post- securitisation to be larger than that of pre- securitisation, but also seeks punitive capital requirements. It deviates from the first pillar's spirit, which calls for appropriate capital requirements by more sensitive complementing of risk characteristics, and encroaches on the second pillar's area of regulation. In the second pillar, supervision from the authorities enables determination of whether originating banks have secured sufficient capital in the process of securitisation. This approach is in consistency with the entirety of the new regulations. However, the currently proposed framework is inconsistent with the basic framework of the new regulations.

(2) Lack of consistency in the first pillar

The second problem area is inconsistency with the regulations applied for other assets in the first pillar. The framework assigns a risk weight of 625% to the HVRE default case in Specialized Lending, which is placed in a high credit risk category among asset classes, that the Internal Rating-based (IRB) approach is applied for . On the other hand, this requires capital deduction for securitisation cases without any default. When external ratings are available, securitisation tranches, whose ratings are comparable to corporate bonds, require more capital requirements or capital allowance, as their ratings become lower. Moreover, the IRB approach for subordinated loans sets the LGD at 75% in giving credit to corporations, nations and banks. With a default probability of 75% in such subordinated loan its risk weight is 838.3%, on the contrast no-defaulted subordinated position in securitisation is applied a capital reduction. This fact also reveals an inconsistency. These problems come from the underlying formula that increases the amount of required capital after securitisation, aiming to prevent originating banks from excessive risk possession. The supervisor's intention to achieve this object seems reasonable, however, this proposal brings to investing banks a side effect that it imposes much heavier amounts of capital to the securitisation position with the same rating or at the same credit level as of another type of asset class.

These problems in the new regulations would be a seriously limiting and inhibiting factor for securitisation market, which is developing as a market for adjustment of financial assets. We must conclude, therefore, that the negative impact would outweigh the curbing effect against originators.

2. Problems and Solutions for individual items of securitisation

(1) Consistent utilization of external ratings

The framework should allow securitization positions to use all external ratings (all the rating grades) in risk weight calculation. Based on external ratings, it accepts an approach to map PD to internal ratings when giving credit to corporates, banks, sovereigns, but does not allow this for securitisation positions. Furthermore, the handling of capital deduction is required for ratings lower than a certain level. This ignores current business practices and market conditions.

This issue was pointed out in the "2.3. Rating Adherence System" contained in the letter of September 11, 2002, which the European Securitisation Forum submitted to the Securitisation Working Group of the Basel Committee. The Norinchukin Bank also gives its wholehearted

endorsement to this.

As discussed above, capital requirements for investors should be treated in the same way as other assets and requirements for originating banks (to secure sufficient capital) should be implemented in the second pillar.

(2) Use of internal ratings

The capital deduction for non-rated positions is an excessively heavy requirement. The framework should give another risk estimation scheme, one not using inferred ratings, to investors who actually have difficulties in utilizing the SFA. With the current business practices and conditions, ratings by external rating agencies play an important role in credit risk assessment for securitization positions. Taking this fact into consideration, a possible measure would be to use quasi-ratings based on marketability and risk analyses, which conform to rating standards released by rating agencies. Naturally, this measure requires verification and approval of use by the authorities in the second pillar to prove that the analysis level is indeed appropriate.

Retail securitization, even for non-rated positions, should also be treated accordingly in light of its higher distribution effect.

(3) Non-bank originators

The framework does not clearly describe the handling for securitization products with non-bank originators. Naturally, this regulation is not applicable to cases with non-bank originators, and it is foreseen that the necessary input data required for the SFA will not be able to be obtained. The framework lacks consideration for investors under these circumstances.

(4) Consideration for operation and data disclosure

Investing banks usually adopt the RBA and must have an accurate grasp of the effective number of underlying exposures (N) for risk weight application. The Second Working Paper introduces a "Safe Harbor" concept to originators in Paragraph 38, intending to limit their computation burden. Investors, however, must also bear this burden. Some type of consideration, comparable to originators, is necessary.

Meanwhile, if it is difficult to implement this type of scheme, securing equal measures for both originators and investors needs to be considered. More specifically, enhanced information disclosure from originators can be a way for investing banks to adopt the SFA with a burden comparable to originators. In this instance, however, the case indicated in (3) must be addressed

in conjunction with this.

(5) Handling in the second pillar

Investing banks assume that corporate bonds and ABS positions, whose ratings fall in the same grade, have the same risk level. They, therefore, treat these as having the same risk profile in Economic Capital management practices. (The above-mentioned European Securitization Forum's letter states that the BIS' securitization group has also confirmed this point.) As a result, the assessment of capital adequacy under the second pillar might be based upon a different risk recognition between regulatory and economic capital, and such discrepancy should be acceptable (in this case, the recognition as a lower risk amount might be acceptable for economic capital calculation purpose).