Basel Committee of Banking Supervision

Division Bank and Insurance
Austrian Federal Economic Chamber
Wiedner Hauptstraße 63 | P.O. Box 320
1045 Vienna
T +43 (0)5 90 900-ext | F +43 (0)5 90 900-272
E bsbv@wko.at
W http://wko.at/bsbv

Your reference, Your message of	Our reference, contact person	Extension	Date
	BSBV 189/Dr.Egger/We	3137	13 February 2015

Consultative Document on criteria for identifying simple, transparent and comparable securitisations

The Division Bank and Insurance of the Austrian Federal Economic Chamber, as representative of the entire Austrian banking industry, appreciates the possibility to comment on the Consultative Document on criteria for identifying simple, transparent and comparable securitisations and would like to submit the following position:

The document does, in contrast to the detailed EBA discussion paper (EBA/DP/2014/02 on simple standard and transparent securitisations), not (yet) include any recommendation on a preferred regulatory treatment for transactions fulfilling the criteria and leaves the door open for additional and/or more detailed criteria including those related to credit risk. The criteria for minimum credit quality are proposed in the EBA paper.

The criteria in the Basel Committee Consultative Document as well as in the EBA discussion paper capture and reduce the major non-credit related risks. All the proposed Basel criteria are mirrored in the EBA paper, except one difference - the Payment Status. BCBS proposes non-defaulted or delinquent credit claims or receivables to be allowed whereas the EBA only excludes those that are defaulted. We agree with the BCBS proposal which also has the advantage not to be in need to define a defaulted exposure

In our view, synthetic securitisations should not be excluded from the framework of simple, transparent and comparable securitisations. Synthetic securitisations can be structured in a way to fulfil all mentioned criteria for qualifying securitisations. The non-compliance of legal true sale can be eliminated with funded trustee accounts from investors and the originator. The investors pay the notes notional on a trustee account to cover losses of the underlying assets. The originator pays the interest on the notes on a trustee account for fulfilment of its payment obligations until maturity. A legal transfer for recourse is therefore not necessary. Moreover, not including synthetic transactions would be a differentiation from the CRR in which the same capital requirement calculations apply for both traditional and synthetic transactions.

On question Nr 1: In our point of view, the criteria could be much more detailed.

On question Nr 2: The STC criteria are not yet clear enough and we would appreciate more specifications. Based on the lack of detailed specifications we could hardly define if securitisations could be classified as simple, transparent and comparable.

Moreover, please let us convey a few thoughts and remarks with regards to the BCBS Revisions to the Securitisation Framework published on the 11th of December 2014:

We believe that the final revisions to the securitisation framework still unfairly and unjustifiably punish asset classes that have performed well during the last fifteen years. We would have welcomed if the BCBS had introduced a more specified approach based on the observed performance and based on treating the asset classes differently. We feel that this is a severe conceptual shortcoming. Our view is backed by the empirical evidence of a wide divergence in performance of different securitised asset classes. Practically all of the European cash securitisation sub-sectors, with the exception of CMBS transactions, have performed extremely well throughout the financial crisis.

The final risk weights are still too conservative due to the lack of differentiation between asset classes which is considered to be a conceptual - and the most determining - shortcoming identified in the paper.

In summary, the risk weights required for senior AAA 5-year securitisation exposures have decreased to 20%, instead of 25% as proposed in the 2nd Consultation Paper in December 2013. The floor risk weights remained unchanged at 15% (table 2 on page 21 and point 70 on page 22), representing an 8% increase from the current regulations under Basel III. As a result, even the revised risk weighting proposals render new investment essentially uneconomic for a bank. In our view, the implementation of the proposed risk weights for securitisation exposures would lead to a situation where ABS transactions would no longer be attractive for credit institutions originating and retaining ABS tranches as well as credit institutions investing in ABS.

In contrast to these ideas, the ECB through its ABS purchase programme from October 2014 has underlined the significant importance of securitisations promoting credit lending for business and supporting economic growth in the Eurozone. As well, several European institutions such as the European Commission and the European Banking Authority (EBA), the Bank of England and several finance ministers have emphasised the important role of securitisations for the real economy in various papers and statements.

Holders of legacy asset backed securities will find the risk weight of their portfolio increase by orders of magnitude – even where those portfolios may have already suffered from such a cliff effect by virtue of downgrades that were exercised in light of tightened rating agency rationales and in many cases notwithstanding strong performance.

An example: A tranche with 5% thickness originally rated “A” that has been downgraded to “BBB” due to changes in the rating agency rationale although the underlying assets are still performing strongly would now have its risk weight increased from the original 20% to 304%. One potential upshot from this would be a forced selling of otherwise creditworthy bonds, which would lead to losses for banks that could otherwise be avoided. It would also lead to an erosion of their capital base. We doubt that this is an intended consequence.

Specific Comments:

Senior – non senior tranches differentiation
Rating agencies already take the seniority into account in their models and the resulting ratings. The Basel Committee overrules the model results with the separation in senior and non-senior tranches and implicitly assumes better performance of senior tranches compared to non-senior tranches from other transactions with the same rating. For example, a CCC senior Greek RMBS would receive a 505% RW (and possibly lower when applying the risk-weight cap for senior securitization exposures) compared to a 5 years UK RMBS CCC non-senior 5% tranche with a more than twice risk weight of 1,187.5%! For BB to B rated tranches the difference between senior and non-senior tranches is even roughly threefold.

Therefore, we strongly propose to eliminate the differentiation between senior and non-senior tranches especially for retail ABS.

The application of the proposed senior risk weight for non-senior tranches would, for example, result in a 105% risk weight for a 5 year BBB rated tranche or 8,4% capital. It would also lead to a coverage of 38 times the European ABS and European RMBS loss rates of 0,22% and 0,25% respectively, according to a Fitch study of 2000-2011 losses for ABS.

For maturity and thickness the Basel Committee uses the external ratings as basis for RW calculation but alters the model results with double counting and differentiation between senior and non-senior tranches which is already accounted for in the rating agency's models.

Tranche maturity
We believe that the introduction of legal final maturity for measuring tranche maturity for pass-through ABS is concerning.

A vast portion of pass-through ABS will pay off fully or very significantly before five years. The maturity is however already taken into account by the external rating. Longer legal maturities result in higher loss rates and thus higher required credit enhancement in rating agency's models. Still, the Basel Committee uses the maturity and its definition to increase the risk weight with a kind of double counting. In contrast to other asset classes a time horizon over one year is used.

Therefore, we propose again to use weighted average life (WAL) as the measure for tranche maturity.

Hierarchy approaches
Generally, we agree with a single simpler hierarchy for determining risk weights introduced in the 2nd Consultation Paper which was confirmed in this Consultation Paper (only three primary approaches in place).

Internal Ratings Based Approach (SEC-IRBA)
Although the SEC-IRBA is more senior in the hierarchy than the SEC-ERBA most banks will be unable to use the most senior approach.

The IRBA model requires bank investors to have sufficient performance data and inputs for the formula to be used. However, most bank investors are unlikely to have these inputs. For example, an Austrian bank is unlikely to have loan level data for Portuguese mortgages. Even where a bank does have some data on Portuguese mortgages, it is unclear whether the supervisory authority will permit the bank to use the IRBA.

Consequently, using IRBA is hardly possible where the bank is not the originator of the underlying pool or where the securitisation consists of collateral from another country.

As a result, we expect that risk weights on securitisation will be largely driven by the external ratings based approach (ERBA).

External Ratings Based Approach (SEC-ERBA)
We welcome the decision that the pool granularity aspect is no longer included in the securitisation framework when ratings are used based on the fact that credit rating agencies already take granularity into account when assessing a rating to a tranche.

We disagree with the Basel Committee's position that ratings do not fully reflect the effects of tranche thickness and maturity in a capital adequacy context. For example in the case of Moody's ratings, the tranche thickness is fully taken into consideration. Furthermore, as all ratings from credit rating agencies are ratings of the maturity of the exposure, maturity is also taken into consideration.

High quality ABS – reduction of RW
We support the initiative of the EBA and the Basel/IOSCO Consultation Paper on simple, standard and comparable securitisation to differentiate high quality ABS from broader ABS according to specific criteria if preferential RW treatment (below the current proposed RW) is given to high quality ABS.

Summary:

Loss rates given in certain sub-sectors (US HEL, Alt-A, re-securitisation) and rating migration were used by the regulators to apply disproportionate risk weight levels for the overall market ignoring the strong performance of sectors serving the real economy as important long-term financing instruments. Moreover, the sub sectors used as basis for the risk weight recalibration have been virtually non-existent since the start of the crisis whereas the sectors contributing to the lending to the economy such as high quality RMBS and consumer ABS that have started to recover from their post-crisis issuance lows are still heavily penalized in the latest Consultation Paper although slightly improved compared to the 2nd Consultation Paper. This issue will hinder the revival of this important funding and risk transfer instrument.

We ask you to give our concerns due consideration.

Yours sincerely,

Dr. Franz Rudorfer
Managing Director
Division Bank and Insurance