



afme/

asifma

sifma



5 February 2016

Basel Committee on Banking Supervision

Submitted via [www.bis.org/bcbs/commentupload.htm](http://www.bis.org/bcbs/commentupload.htm)

**Re: Response to BCBS Consultative Document on Capital treatment for "simple, transparent and comparable" securitisations**

The Global Financial Markets Association<sup>1</sup> (GFMA) and the International Association of Credit Portfolio Managers<sup>2</sup> (IACPM) (together, the "**Joint Associations**") welcome the opportunity to respond to the Consultation Document (the "**CD**") entitled "Capital treatment for 'simple, transparent and comparable' securitisations" published by the Basel Committee on Banking Supervision (the "**BCBS**") in November 2015.

The Joint Associations and their members would like to thank the BCBS for continuing to progress the concept of simple, transparent and comparable ("**STC**") securitisations by issuing this CD. We strongly support the incorporation by the BCBS of the STC criteria into its bank capital framework. We believe that doing so will help to achieve more appropriate and risk-sensitive allocations of regulatory capital for STC securitisations and mitigate the current regulatory capital impediments to functioning securitisation markets, as well as continuing to help eliminate the stigma attached to such markets.

Our substantive response consists of overall comments, followed by our answers to the 4 specific questions posed by the CD.

---

<sup>1</sup> The Global Financial Markets Association (GFMA) brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, please visit <http://www.gfma.org>.

<sup>2</sup> The IACPM is an industry association established in 2001 to further the practice of credit exposure management by providing an active forum for its member institutions to exchange ideas on topics of common interest. Membership of the IACPM is open to all financial institutions that manage portfolios of corporate loans, bonds or similar credit-sensitive financial instruments. The IACPM represents its members before regulatory and administrative bodies around the world, holds conferences and regional meetings, conducts research on the credit portfolio management field, and works with other organizations on issues of mutual interest relating to the measurement and management of portfolio risk. Currently there are 98 financial institutions worldwide that are members of the IACPM. These institutions are based in 19 countries and include many of the world's largest commercial wholesale banks, investment banks and insurance companies, as well as a number of asset managers. More information about the IACPM may be found on our website: [www.iapcm.org](http://www.iapcm.org).

## A. Overall Comments

1. *It is crucial to ensure that the criteria in general are principles-based so as to work for securitisation markets in different jurisdictions and asset classes*

There are a number of criteria (either additional language or wholly new criteria) articulated in such a way as to be specific to particular jurisdictions, investors or asset classes. Such an approach will make it harder to apply those criteria to jurisdictions, market participants or asset classes that are materially different to those contemplated. Inevitably, the result of these difficulties will be that transactions are excluded which, in principle, should qualify for STC treatment, and that the same criteria will be applied in very different ways, and with different effects, in different markets. This undermines the central purpose of having criteria set out at a global level by the BCBS. It is therefore important that all criteria be articulated in a principles-based manner so as to be sensibly applicable to a variety of jurisdictions, market participants and asset classes. If this is not achieved, it may result in a fragmentation of the securitisation markets and encourage 'home country bias', which discourages diversification of banks' fixed income portfolios and does not enhance the prudential safety of the banking sector.

For example:

- Criterion D15, which imposes maximum credit risk weightings for underlying assets in a securitisation, is a good example. Quite apart from the fact that we disagree in principle with the application of this criterion (see our response to question 2 below), criterion D15 automatically excludes securitisations of assets originated by non-bank lenders from qualification as STC, or at the very least renders that qualification impracticable. There are a wide range of non-bank lenders with appropriate experience and business volume who regularly securitise their assets. However, because they are not banks, they do not regularly calculate and are not generally in a position to calculate the risk weights of those assets according to the standardised approach. Nor is it sensible to ask these originators to begin calculating such risk weights purely for the purposes of complying with the STC framework. For the reasons set out below in our response to question 2, we believe criterion D15 should be omitted entirely, but if it is retained it must be re-articulated in a way that does not automatically exclude assets on the basis that they were originated by non-bank lenders. Similarly, all U.S. residential mortgages carry at least a 50% risk weight and would therefore be excluded effectively on the basis that they are U.S. mortgages. If retained at all, criterion D15 must also be amended such that the ceiling for residential mortgages does not exclude the entire U.S. market.
- A similar consideration exists with respect to the "additional requirement for capital purposes" in respect of criterion B8, this time because of a differential effect based on asset classes. This additional requirement that non-derivative hedges be "specifically created and used for the purpose of hedging an individual and specific risk, and not multiple risks at the same time" is unduly restrictive for certain asset classes and does not have a clear rationale justified by a proportionate mischief or concern. One example of an asset class that may be adversely affected is credit card receivables. Credit card receivable

securitisations are often hedged mostly or solely through the excess spread in the securitised book. That hedge has been effective with almost zero losses over the years 2000-2013<sup>3</sup> on credit card receivable securitisations throughout the financial crisis. While it would be possible to purchase swaps, the commercial parties to these transactions have concluded that it is more desirable to manage the risk by structuring transactions with a required minimum excess spread. There seems to be no compelling regulatory rationale for restricting this freedom. Provided that there is appropriate disclosure of this approach such that investors are capable of analysing and assessing its adequacy for themselves we can see no objection to permitting this approach to continue.

These examples merely illustrate our broader view that care must be taken to ensure that any criteria articulated as part of the STC framework must be appropriate across jurisdictions, market participants and asset classes.

It is equally important that implementation dates in various jurisdictions are as closely aligned as possible, since a lack of certainty about implementation dates, or widely varying implementation dates for a given measure, leads to significant difficulties for global institutions and unlevel playing fields between institutions established in different jurisdictions – the avoidance of which is a central aim of having a global framework.

2. *We strongly believe that a level playing field must be established and, in particular, that the implementation of STC criteria should not prohibit STC treatment for a securitisation solely on the basis that one or more of the parties involved in the securitisation is an overseas entity with respect to the jurisdiction implementing the STC framework*

One of the principal purposes of the Basel framework is to help ensure a level playing field for banks competing in what is an increasingly global financial market. Moreover, the integration of various markets and the reciprocal ability to tap pools of liquidity around the world helps to promote overall stability of each market, reduce volatility and encourage the efficient allocation of capital for both investors and issuers. This is as true for securitisation markets as it is for any other markets. Consequently, it is important to ensure that local implementations of the STC regime do not run counter to this general policy by taking a narrow and inward-looking approach to implementing the STC framework, raising barriers to cross-border flows of capital.

Already, and unhelpfully, in the EU Council's version of the implementing legislation, it has been proposed that only securitisations where the originator, sponsor and issuer are European can qualify as simple, transparent and standardised ("STS") (the EU's implementation of the STC framework); we see this as an unnecessary and retrograde step. Such a requirement would limit EU investors' and companies' access to third-country issued securitisations, and reduce activity in the EU by non-EU originators and non-EU securitisations by requiring issuances via an EU branch or subsidiary. Excluding non-EU securitisation from STS recognition (and consequent reduced

---

<sup>3</sup> See Annex I and also the EBA report on Qualifying Securitisation, July 2015, Section 1.1.1 and in particular Figure 6, quoting Fitch data.

capital requirements) would also result in securitisation exposures with similar levels of credit risk - which could otherwise be STS-compliant - being treated differently for regulatory capital purposes. Such a restriction did not appear in the European Commission's original proposal, and in order to maximize the potential of the STS as intended we believe there should be an open approach to third-country securitisation.

While there is a legitimate interest in ensuring an adequate regulatory nexus between regional/national regulators and particular transactions, this can be achieved without excluding non-local transactions. For example, the regional/national framework could apply to investors or other parties established within the home jurisdiction and could include a regime for determining equivalency of relevant regulation in other jurisdictions – either based on that other jurisdiction's legislative implementation of the global STC or other equivalent framework. Wherever possible, this should be the aim and the final BCBS guidance on the STC framework should reflect this goal.

In order to complement this approach to encouraging open markets, it is also important to include a system of mutual recognition among local implementations of the STC framework. In this way, issuers, originators and sponsors will be encouraged to make use of the STC framework secure in the knowledge that complying with their local implementation of the STC concept will provide benefits to investors regardless of the jurisdiction in which the investor's capital regulation takes place.

Finally, it is important to remember in this context that the level playing field sought by market participants is a broad concept. It applies not only to implementations of the STC framework, but also to capital charges for securitisation investments generally. In this context, the varying approaches taken by local regulators and legislators to the implementation of the Basel Securitisation Framework thus far are relevant. In particular, the ability of banks to use proxy data and therefore make wide use of the SEC-IRBA in the United States but not in Europe creates significant differences in the capital charges associated with an otherwise identical securitisation investment. Ideally this difference would be remedied by allowing the use of proxy data for SEC-IRBA purposes by European banks, thereby making it possible for them to use the SEC-IRBA, rather than the SEC-ERBA (which, European banks have found, tends to result in far higher capital charges, often higher than those under the SEC-SA). In order to facilitate this, the BCBS should amend the framework to allow the wider use of proxy data to determine IRBA inputs. It should also revisit the conditions for application of the purchased receivables top-down approach and relax them to make application more practical and certain in a securitisation context.

3. *We believe it is important to pursue the work already begun on ABCP programmes and ensure that STC capital weighting is available for these as well*

The multi-seller ABCP conduit market (“**ABCP**”) is a very important – although sometimes unjustifiably neglected - part of the overall securitisation market as well as being a critical tool in funding the real economy.

ABCP:

- has a more than 30-year operating history,
- has exhibited strong liquidity performance even during times of stress,

- funds the real economy, being the principal way certain asset classes (e.g. trade receivables) are securitised, predominantly for corporates, making it a significant contributor to working capital supporting trade and business,
- is supported by sponsor banks, and
- is relied on by bank customers as a significant source of working capital.

We refer to Annex II, AFME's "Data submission to the European Commission: historic funding for multi-seller ABCP conduits" which demonstrates that, historically, liquidity provided to ABCP has not been susceptible to "runs", even at the most stressful times through the financial crisis when, for example, liquidity supporting utilised portions of ABCP programmes never funded more than 5.45% of the utilised portion of total commitments. In other words, through the financial crisis, ABCP continued to fund 94.55% of the utilised portion of their total commitments by issuing and selling commercial paper, as they were designed to do.

Although ABCP securitisation is structured differently from term securitisation markets, so that the criteria set out in the STC framework are not necessarily appropriate for ABCP, we believe that ABCP and conduit liquidity lines should be subject to a similar regime to the existing STC framework, but with criteria adapted to suit the specific characteristics of this form of securitisation financing. In this way, ABCP that is STC can continue to support corporate borrowers with a very direct link to the real economy. It is also very much the case that due to lower set up costs and without the need for secondary liquidity ABCP conduits can provide permanent finance to SME clients who would otherwise be too small to access this type of secured and efficient funding.

More specifically, cash securitisation using ABCP conduits is a simple tool for banks to provide financing for a wide range of clients and assets. Using conservative credit enhancement, and programmes that dynamically reflect both risk and supporting asset pools ABCP programmes enable banks to extend low-risk secured financing to their corporate clients, thereby enabling these clients to monetise their assets rather than depending solely on their individual, stand-alone credit status to raise financing in the unsecured markets. Indeed, depending on the credit quality of the corporate borrower, ABCP is sometimes the only cost-effective way for banks to extend credit at all to these customers. Thus, the tranching used in the securitisation process enables banks to fund real economy clients while leaving most of the credit risk with the originator of the assets. The nature and extent of the credit enhancement is always dependent on a thorough analysis of the underlying assets.

Assets financed in ABCP conduits are generally of good quality and consist largely of trade receivables, auto receivables and SME receivables which tend to be granular and extremely predictable in their performance. Despite the fact that the underlying assets are of good quality, transactions are nonetheless structured to include conservative levels of credit enhancement (designed to meet the credit criteria of both the sponsor banks and the credit rating agencies') in order to ensure that the conduit sponsor bank is not exposed to significant levels of risk via the liquidity facility. Factoring companies also very often rely on securitisation through ABCP conduits to fund their activity with clients.

Mainly for those reasons, the Joint Associations would submit that the level of regulatory capital required to be held against investments in these transactions already exceeds that warranted by their level of risk. We are therefore deeply concerned that the STC framework does not cater for ABCP and might therefore worsen an already onerous regulatory capital burden associated with these highly beneficial transactions. For these reasons we would urge the BCBS to move forward urgently with the work it has already begun on developing an STC regime appropriate for ABCP.

The Joint Associations would be pleased to work with the Committee to help further develop the STC framework for ABCP programmes and the kinds of transactions typically funded by such programmes. Pending further discussions or consultation, such work would need to address the following important points:

- (a) The framework needs to address separately the two levels of the ABCP programme structure. In typical multi-seller programmes, the sponsor provides full credit and liquidity support for payment of the ABCP at maturity, so that investors look primarily to the sponsor bank, rather than the underlying assets or transactions, for repayment. The sponsor bank, as liquidity provider, together with any third party liquidity or credit enhancement providers and swap counterparties, takes full exposure to the underlying transactions funded by the programme. Different criteria therefore need to apply to each level.
- (b) Many banks provide funding to their customers under transactions and facilities identical to those typically funded by ABCP programmes, but fund such transactions directly from their own balance sheets. These private securitisation transactions should be subject to the same STC criteria that apply to ABCP transactions, and not to the more extensive transparency and other requirements that apply to widely-offered asset-backed securities in the term market.
- (c) In addition, as we have explained in our comments on the consultations leading to the revised securitisation framework<sup>4</sup>, the Committee should adapt the internal assessments approach (IAA) to apply to such bank-funded transactions as well as to transactions funded by ABCP conduits.
- (d) Criteria for exposures to ABCP should be focussed on the quality of support provided by the sponsor, without extensive criteria or information requirements relating to the underlying transactions or assets. The criteria for ABCP programmes should not require that every underlying securitisation transaction meets the transaction-level criteria.
- (e) ABCP programmes may be used to fund not only securitisation transactions but also transactions which do not fall within the definition of securitisation (such as receivables purchase facilities without credit risk tranching and secured or unsecured advances to corporates or institutions where payments do not depend on the performance of underlying exposures). STC criteria would not apply to such transactions, but an STC programme should be able to fund those transactions as well as securitisation transactions.

---

<sup>4</sup> The Joint Associations (including GFMA) response to the second Consultative Document on Revisions to the Basel securitisation framework (24 March 2014), pages 16-17 and Annex 10.

- (f) In addition to fully supported programmes, ABCP programmes with liquidity support covering 100% of outstanding CP, but subject to asset quality tests, should also be able to qualify as STC, subject to appropriate requirements as to the coverage of non-credit risks and the credit quality of the programme's exposures to the underlying transactions.
- (g) Disclosure requirements for private transactions (whether funded by ABCP programmes or by banks directly) should be principles-based rather than detailed and prescriptive, and should focus on the quality and extent of sponsor support and pool level data regarding the underlying assets, and not require loan level data regarding the underlying assets or the preparation of a formal information memorandum.

4. *We continue to believe that STC or equivalent treatment should be available for appropriate synthetic securitisations*

We continue to believe that it would be both appropriate and desirable for appropriately designed synthetic securitisations to be included in either the STC framework or an equivalent, specifically-designed framework. This would help to contribute funding to the real economy by easing the execution of securitisations of more challenging asset classes such as SME loans and trade credit, thereby transferring risk and freeing up bank capital to make additional loans. This is especially true for SME loans which carry relatively high capital requirements when held on balance sheet and which can be difficult to securitise in an exclusively cash "true sale" format.

At the European level, the European Banking Authority issued a report on 18 December 2015 supporting the limited extension of the prudential treatment granted to STS securitisations to banks that originate and retain certain SME balance sheet synthetic securitisation positions. We support this positive development but believe it should have gone further and is therefore unduly restrictive. It nonetheless correctly acknowledges that synthetic securitisation as a technique does not in itself make a transaction inappropriate for more benign capital treatment. We would urge the BCBS to further investigate the inclusion of synthetic securitisations in the STC framework in accordance with the recommendations we made in our February 2015 response to the BCBS-IOSCO consultation on the STC framework.

**B. Answers to Specific Questions**

- 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?*

The Joint Associations broadly agree with the rationale for introducing STC criteria into the capital framework. It is clear based on the available historical data that only certain discrete portions of the global securitisation markets performed poorly through the financial crisis, with many other sectors, in both Europe and the United States,

exhibiting extremely low default rates throughout<sup>5</sup>. It is therefore appropriate to introduce a set of criteria designed to distinguish the predictable and transparent securitisations from those whose performance is more difficult to assess in advance. We believe that the STC framework is a sensible approach for achieving this objective and we support its inclusion in the capital framework.

Subject to our comments on the criteria set out in our response to the consultation of December 2014, we believe that STC securitisations are, overall, likely to have reduced model risk, reduced structural risk, increased transparency and increased predictability as compared to transactions that do not fulfil the criteria. Note, however, our view expressed above that ABCP and synthetics should also be able to qualify under appropriate circumstances.

Based on the above, we believe that exposures to STC securitisations therefore justify a more benign capital treatment than exposure to non-STC securitisation (as to which see our more detailed views in response to question 4 below).

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 I?*

We do not believe that a case has been made for additional criteria. Additional criteria should only be required if they are clearly and rationally linked to the objectives of the STC framework (reduced model risk, reduced structural risk, increased transparency, increased predictability) as it specifically applies to bank capital. Instead, many of the changes proposed in Annex I to the CD are not related to bank capital but are, in substance, amendments to the final STC criteria published in July 2015. For example, none of the guidance on the meaning of homogeneity in criterion A1, the requirement for a legal opinion to support the true sale and nature of the transfer in criterion A5 or the additional guidance on currency and interest rate risk mitigation in criterion B8 is obviously and specifically connected to bank capital analysis in any way. Instead, these all appear to be additional points of detail added to the existing framework, in many cases such that those criteria are more difficult to comply with or more specifically articulated for a particular jurisdiction, type of market participant or asset class (as to which see our general point A.1 above).

The result of this approach is confusing and removes the benefit of the "modular" approach proposed originally by BCBS-IOSCO, because it effectively creates parallel regimes where there are two different versions of the "base" STC criteria.

To the extent that it is proposed to amend the July 2015 criteria, or provide additional guidance (e.g. as set out in the CD), we would respectfully request an additional and separate consultation process to enable us to provide detailed feedback on the proposed changes and/or guidance, many elements of which are unhelpful as currently proposed.

For example, of the three specific additional criteria for capital purposes, two are not required (D15 on credit risk of underlying exposures and D16 on granularity of the

---

<sup>5</sup> See Appendix I and also the EBA report on Qualifying Securitisation, July 2015, Section 1.1.1 and in particular Figure 6, quoting Fitch data.



pool) because the underlying concerns are already dealt with separately in the capital framework. We also struggle to understand the concern underlying criterion D17.

- The concern underlying criterion D15 is dealt with by the capital weighting of the individual tranches. The risk weights assigned to individual tranches already take into account, among other things, the level of risk inherent in the underlying assets. To add a separate criterion creating a cut-off for the risk weights of underlying assets on top of these calculations seems redundant and unhelpful. In addition, the maximum risk weights proposed would exclude many securitisations, for example, of trade receivables and SME credits.
- Likewise, regarding granularity of the underlying pool of exposures (criterion D16), first this is already dealt with in the revised securitisation capital framework: in the SEC-IRBA it is measured by the effective number of exposures (N) used in calculating the p-factor for wholesale exposures; in the SEC-ERBA it is taken into account in rating agency rating criteria; and in the SEC-SA it is covered by the higher level of capital generally required under that approach. Second, comparing the criterion proposed to the final standard in the Basel “supervisory framework for measuring and controlling large exposures”<sup>6</sup>, the proposed 1% limit seems to correspond to the threshold of 0.25% of a bank's eligible capital base below which a bank is not required to look through to underlying exposures. We do not agree that the granularity standard applied here is an appropriate threshold for STC capital treatment. Third, the criterion proposed, like the maximum risk weights, would exclude many securitisations of trade receivables and SME credits. If the Committee adopts any granularity requirement, it should use the measure of effective number of exposures (N) equal to 25 or higher, which is already used in the SEC-IRBA.
- We struggle to understand the rationale for criterion D17 on the relationship between the originator and the servicer of the securitised assets. Whilst this criterion would often be fulfilled as a matter of fact, it does not produce any clear structural or credit benefit, particularly given the existing requirements of criterion C13 in relation to servicers. What is more, it undermines some of the benefits of the true sale that is central to cash securitisations. An obvious example is the ability to replace the servicer in the case of default or insolvency of the originator allowing the transaction to carry on to maturity – the very essence of the “insolvency remote” nature of securitisation. Further, it is important to recognise that the functions of origination and servicing are sometimes, for perfectly sensible reasons (e.g. economies of scale in the context of effective and established systems for ensuring collection, transmission and appropriate protection of data), carried out by different legal entities, often within one corporate group.

3. *What are respondents' views on the compliance mechanism and the supervision of compliance presented in this consultative document?*

---

<sup>6</sup> BCBS 283 (April 2014), para. 73.

The appropriateness of third party involvement in certifying the STC status of a particular securitisation is a matter on which there is a diversity of views among the Joint Associations' members and accordingly we believe that this question should be left to national/regional discretion, provided that a regime of mutual recognition and substituted compliance is in place to preserve an open approach to cross-border securitisation and in turn global access to markets and liquidity for issuers and investors.

Whatever the mechanism for, or method of supervision of, compliance we believe that clarity, consistency, and speed of obtaining the STC designation, along with stability of the STC designation once obtained, are key. Any regime for assigning this designation can only work effectively if that regime includes (1) unambiguous and objectively-verifiable criteria set out at the national level, (2) safeguards to protect issuers and investors where attestations are made using a third party certification regime or made in good faith if there is no such regime, and (3) provisions to ensure consistency of interpretation among regulators (where there are multiple regulators within a jurisdiction) and treatment is maintained at least during the life of the instrument.

Without these safeguards, investors and issuers may be reluctant to utilise the STC framework because of the adverse consequences of increased capital treatment and resultant reduced liquidity of the securitisation exposures if there is a change in regulatory interpretation. This would introduce an element of regulatory risk into purchasing STC exposures which previously did not exist. Without safeguards, such concerns around regulatory risk may (perversely) undermine the intent of the STC framework which is after all to provide reassurance to investors to assist their due diligence and increase securitisation issuance.

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

We do not seek reduction of regulatory capital requirements for its own sake; rather we seek sensible calibrations that reflect the real economic risk as demonstrated by the strong historic performance of most securitisation asset classes in both Europe and the US. The STC framework will further reinforce and support this strong historic track record because STC securitisations are, overall, likely to have reduced model risk, reduced structural risk, increased transparency and increased predictability as compared to transactions that do not fulfil the criteria.

It is generally accepted by policymakers globally that securitisation, prudently deployed and sensibly regulated, has an important role in delivering direct funding to the real economy and enhancing the stability of banks by enabling them to transfer risk to capital markets investors. Securitisation issuance in Europe is moribund, with placed issuance of less than EUR100 billion a year since 2010. In the US, while some market sectors have recovered better than this, others (such as private label RMBS) remain subdued.

In our view a large part of the reason for this is that the current proposals for regulatory capital to be held by bank investors in securitisation remain much too high. They are far in excess of the real economic risk as demonstrated by the strong historic performance of most other securitisation asset classes in both Europe and the US, and

instead have been calibrated to the admittedly extremely poor performance of US sub-prime mortgages and related highly leveraged products such as CDOs. These discredited products no longer exist, and regulations have sensibly been enacted to prevent their return. If securitisation markets are to recover it is essential that both absolute levels and the capital surcharge<sup>7</sup> are reduced. We therefore argue that transactions meeting STC criteria should benefit from a larger reduction in capital requirements than that proposed in the CD. We would note that under the SEC-ERBA, STC senior securitisation exposures will attract substantially more capital under Basel's proposed changes than they do under the current Basel approach. Even with the reduction in risk weighting offered by the STC proposal, securitisation exposures will be relatively less attractive to hold going forward than they are currently.

In addition to reducing the risk weight floor for senior positions in STC transactions from 15% to a lower value within the range of 10% to 12%, the CD proposes, for STC transactions, in the SEC-IRBA, to multiply the sum used to calculate the p-value (which primarily determines the level of the capital surcharge) by a factor within the range of 0.6 to 0.8, in the SEC-SA, to change the p-value from 1.0 to a factor within the range of 0.6 to 0.8, and, in the SEC-ERBA, to reduce certain of the specified risk weights. The overall effect of these changes would be to reduce the capital surcharge for STC securitisations under SEC-IRBA and SEC-SA to 60% to 80% of the capital surcharge that would apply to non-STC securitisation. (The reduction in capital surcharge under SEC-ERBA would appear to be considerably less.)<sup>8</sup> The BCBS's rationale for a substantial (and, we believe, excessive) capital surcharge for securitisations generally is to compensate for agency, structural and model risks that add uncertainty and complicate the evaluation of credit risk of securitised positions. Compliance with the STC criteria substantially mitigates these additional risks and so enables better evaluation of securitisation credit risk. Based on that rationale, we believe the capital surcharge for STC securitisations should be much lower, so that the capital requirements for those securitisations would be much closer to those that would apply to investments in the underlying exposures.

The CD does not explain how the BCBS arrived at the proposed range of 0.6 to 0.8 (for the ratio of STC vs. non-STC capital surcharge), or how it proposes to determine the final value within that range. We note that in its proposed amendments to the Capital Requirements Regulation (CRR), the European Commission (EC) has proposed (in addition to reducing the risk weight floor) to reduce the capital surcharge for STS securitisation by half (by making changes comparable to those proposed by

---

<sup>7</sup> By "capital surcharge" we mean the amount by which aggregate capital required for all tranches in a securitisation transaction would exceed the aggregate capital required for all the underlying exposures when held on the originator's balance sheet. In other words, the extent of departure from the concept of "capital neutrality" i.e. that the capital required post-securitisation should be the same as that required pre-securitisation, as the assets are the same.

<sup>8</sup> See Duponchee, Linden & Perraudin, Comments on the Commission's Proposals for Reviving the European Securitisation Market (15 October 2015), pages 9-10. This paper refers to the European Commission's proposed changes to capital requirements for European banks, which, as to the calculation of SEC-ERBA for STS securitisation positions, would provide risk weights corresponding to, or in some cases lower than, the corresponding risk weights for STC securitisation positions in the CD.

the BCBS, but with a factor of 0.5 rather than a range of 0.6 to 0.8).<sup>9</sup> In our view, even that larger reduction would not be sufficient to bring about a revival of the securitisation markets and note that the European Banking Authority (EBA), in its earlier proposal to the EC and referring to tests on a sample portfolio, found such a change would produce only modest reductions in capital requirements.<sup>10</sup> While we think the EC's proposal is also inadequate, we ask for an explanation of why the BCBS's proposed range does not go at least as far as the EC proposal.

The formulation of the p-value in SEC-IRBA has several aspects that lead to anomalous effects and unwarranted discrimination between jurisdictions. Among other things, the formula seems to reward poor asset performance by giving lower levels of capital surcharge at higher levels of  $K_{irb}$ , so that, for example, pools of high-quality retail exposures may have much higher p-values than pools of wholesale exposures.<sup>11</sup> In addition, by incorporating tranche maturity (which is based in part on expected time needed to liquidate collateral for underlying exposures under the relevant legal framework), the formula gives different capital requirements depending in part on the legal frameworks of different jurisdictions.

In order to eliminate these anomalies at least in the case of STC securitisations, we propose that the p-value in SEC-IRBA should be fixed. Data based on independent research (on European securitisations for which data is publicly available) would justify a p-value of 0.3 for wholesale exposures (equal to the floor p-value in SEC-IRBA) and a p-value in a range between 0.3 and 0.5 for retail exposures.<sup>12</sup>

The SEC-SA already has a fixed p-value that does not vary according to tranche maturity, so it avoids some of the anomalies that appear in applying the SEC-IRBA. For non-STC securitisations the p-value is fixed at 1.0. This is double the p-value applied in the corresponding approach under current United States rules. We would propose to reduce the p-value for STC securitisations under SEC-SA to 0.4 or, if higher, the value which is chosen for retail exposures under SEC-IRBA, and not higher than 0.5.

For STC securitisations under SEC-ERBA, we propose that the BCBS adopt the calibration proposed by the EC in its CRR amendments, with the additional changes that (1) for senior tranches with high ratings (down to single-A equivalent), the risk weights for tranches with tranche maturities of five years would be the same as for those with tranche maturities of one year, and (2) to maintain coherence, for senior tranches with ratings of AA+ or equivalent, regardless of tranche maturity, the risk weight would be 12% (see the table at Annex III hereto). These changes would

---

<sup>9</sup> EC, Proposal for a Regulation of the European Parliament and of the Council amending Regulation EU No 575/2013 on prudential requirements for credit institutions and investment firms (30 September 2015), proposing to amend the CRR to include, among others, new Articles 260 (Treatment of STS securitisations under the SEC-IRBA), 262 (Treatment of STS securitisations under SEC-ERBA) and 264 Treatment of STS securitisations under SEC-SA.

<sup>10</sup> EBA Report on Qualifying Securitisation (7 July 2015), page 106.

<sup>11</sup> Duponcheele, et al. (15 October 2015), page 22. This paper refers to the proposed CRR provisions, which, as to the calculation of SEC-IRBA, follow the corresponding provisions in BCBS 303.

<sup>12</sup> Duponcheele, et al. (October 2015), page 24.

neutralise the effect of tranche maturity in the higher rated tranches, thus avoiding incentives for regulatory arbitrage at a senior level.

In closing, we wish to emphasise that the engagement of the BCBS with market participants on the introduction of the STC criteria into the Basel framework, and on the revival of global securitisation markets more generally, is greatly appreciated. We hope this response is helpful and are grateful for the opportunity to comment on the CD. Should the BCBS wish to discuss any aspect of our response in further detail, we would be pleased to make ourselves available. Please contact in the first instance Richard Hopkin ([richard.hopkin@afme.eu](mailto:richard.hopkin@afme.eu)) or Anna Bak ([anna.bak@afme.eu](mailto:anna.bak@afme.eu)) of AFME or Chris Killian ([ckillian@sifma.org](mailto:ckillian@sifma.org)) of SIFMA.

Yours faithfully



David Strongin, Executive Director  
Global Financial Markets Association



Som-lok Leung, Executive Director  
International Association of Credit Portfolio Managers

## **ANNEX I**

### **Historical Default Rates for Securitisation**

# Historical Default Rates for Securitisation: Mid-2007 to End Q2 2014

	Original Issuance (EUR billion)	Default Rate (%)
<b>Europe</b>		
<b>Total PCS eligible asset classes</b>	<b>960.2</b>	<b>0.18</b>
Credit Cards	33.2	0.00
RMBS	756.0	0.14
Other consumer ABS	68.0	0.18
SMEs	103.0	0.55
<i>Only senior tranches to be PCS labelled, the default rate for which is zero, like Covered Bonds</i>		
<b>Total Non-PCS eligible asset classes</b>	<b>711.5</b>	<b>5.88</b>
Leveraged loan CLOs	70.6	0.10
Other ABS	68.8	0.00
Corporate Securitisations	47.9	0.17
Synthetic Corporate CDOs	254.4	2.88
CMBS	163.3	10.66
Other CDOs	77.8	6.54
CDOs of ABS	28.9	41.08
<b>Total European securitisation issuances</b>	<b>1,671.7</b>	<b>2.60</b>
<b>Covered Bonds</b>	<b>1,085.0</b>	<b>0.00</b>
<b>Total European issuances</b>	<b>2,756.7</b>	<b>1.58</b>
<b>Select US asset classes</b>		
Credit cards	295.4	0.14
Autos	198.2	0.04
Student loans	266.9	0.35
RMBS	3,254.9	22.97

Source: Standard and Poor's

## **ANNEX II**

### **AFME Submission to European Commission: Historic Liquidity Funding for Multi-seller ABCP Conduits**



Data submission to European Commission:  
historic liquidity funding for multi-seller ABCP  
Conduits

12<sup>th</sup> December 2012

- The strong liquidity performance of multi-seller asset-backed commercial paper conduits (“ABCP Conduits”), supported by the data in this document, warrants consideration for relief in the form of an adjusted calibration under Article 412 on:
  - undrawn liquidity supporting the **utilised portion** of total commitments funded by commercial paper (the “Utilised Portion”); and
  - undrawn liquidity supporting the **unutilised portion** of total commitments (the “Unutilised Portion”).
- In this paper, we refer to the sum of the Utilised Portion and the Unutilised Portion as “Total Commitments”.
- The currently proposed calibrations have the unwarranted consequence of severely penalising ABCP Conduits which:
  - have a 30 year operating history
  - have exhibited strong liquidity performance even during times of stress
  - fund the real economy: trade receivables, auto and consumer loans with good performance
  - are supported by sponsor banks, and
  - are relied upon by customers as a significant source of working capital.
- The data we present in this paper show that, historically, neither type of liquidity has been susceptible to “runs”, even at the most stressful times through the crisis when, for example, liquidity supporting the Utilised Portion never funded more than 5.45% of the Utilised Portion of Total Commitments.
- In other words, through the crisis, ABCP Conduits continued to fund at least 94.55% of the Utilised Portion of their Total Commitments by issuing and selling commercial paper, as they were designed to do.

- The Basel Committee’s proposed calibrations for Higher Outflows under Basel 3 for liquidity lines provided to SSPEs were designed to penalise discredited structures such as Structured Investment Vehicles (“SIVs”) and “arbitrage conduits”, which experienced severe liquidity stress during the financial crisis.
- If the proposed calibrations are not adjusted to take into account the very different nature, and very strong – performance, of multi-seller ABCP Conduits, then they will:
  - reduce access to capital markets financing for customers, when financial conditions call for precisely the opposite policy objective
  - make remaining capital markets financing more expensive by forcing customers to pay twice: both on the yield demanded by the investor and on the cost of redundant liquidity required by sponsor banks to meet the Higher Outflow in the LCR framework
  - encourage these “real economy” assets to weigh on alternative bank financing sources at a time of significant de-leveraging pressure on banks

## **Section 1**

# **KEY FEATURES OF ABCP CONDUITS**

# Funding of corporate receivables by ABCP Conduits is key for the real economy

- Multi-seller ABCP Conduits provide European corporates\* with a sustainable and resilient funding alternative to borrowing directly from banks.
- At the end of 2011, the global market for multi-seller ABCP Conduits was just over €238 billion, of which a significant portion provided working capital funding to real economy assets in Europe.
- An incorrect calibration of the treatment under the LCR of liquidity lines to multi-seller ABCP Conduits will therefore have a material and adverse effect on funding of the real economy and cause these “real economy” assets to weigh on alternative bank financing sources at a time of significant de-leveraging pressure on banks.

---

\* Some large European corporate groups, for example Volkswagen, choose to originate receivables through subsidiaries that are regulated banks. The arguments we made in this paper for “corporates” apply with the same force to them even though technically they are banks.

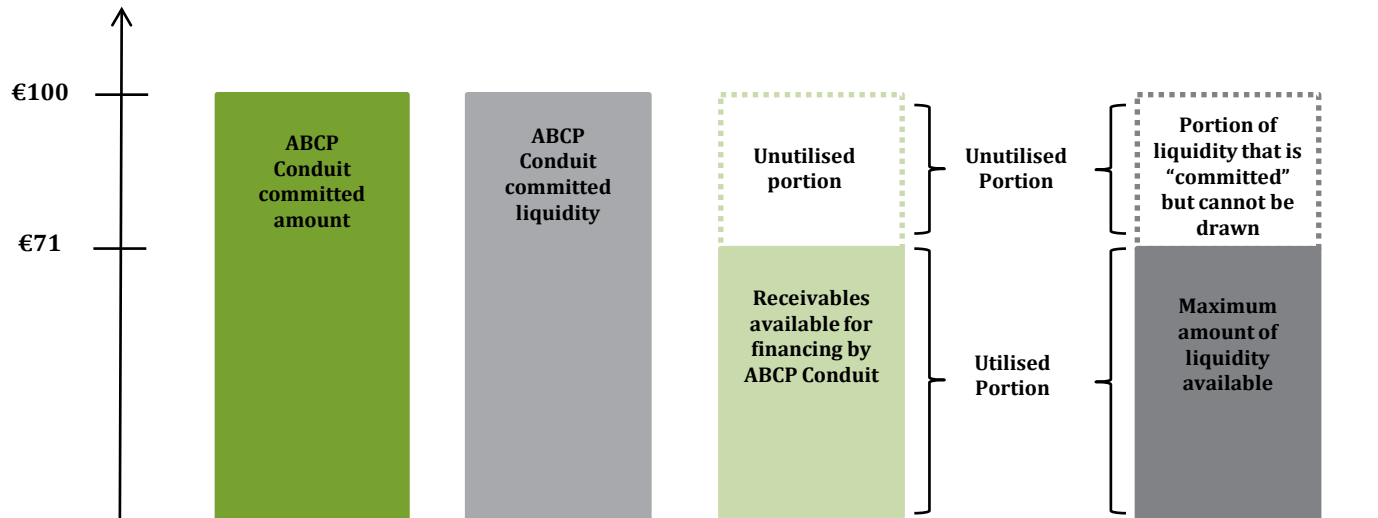
## While both SIVs / arbitrage conduits and ABCP Conduits sought their funding primarily from the short-term commercial paper markets, the similarities end there

### KEY DIFFERENCES BETWEEN SIVS / ARBITRAGE CONDUITS AND ABCP CONDUITS

SIVS AND ARBITRAGE CONDUITS	ABCP CONDUITS
Held long term financial assets, such as bonds	Fund short term trade receivables which are typically less than 90 days in tenor (with the vast majority shorter than 30 days), as well as other shorter term borrowing such as auto or consumer loans.
Funding need (and liquidity risk) at or close to maximum utilization as most SIVs were fully “ramped up”; they were highly dependent on financial market conditions	Funding need dependent on day-to-day financing needs of customers, namely whether business is good and a high volume of receivables is generated, or business is poor and a low volume of receivables is generated. Not systemic financial risk.
Proved to be illiquid under stress: short-term funding dried up, assets returned to banks’ balance sheets or liquidity drawn, no market for sale of the underlying long term financial assets	Proved to be relatively liquid under stress: short term funding was less affected, some limited liquidity drawings, underlying assets were “real economy”, short term and self-liquidating
Liquidity backup was dependent on financial market conditions: if there was no market for the assets, then liquidity was drawn	ABCP can be issued and liquidity put at risk of drawing only if good quality receivables are presented to the ABCP Conduit for funding. No receivables = No liquidity drawings or issuance of ABCP
Underlying assets performed poorly in credit and market terms: US sub-prime RMBS, US home equity loans, CDOs	Underlying assets were from the “real economy”; have performed and continue to perform well and within tolerances
Mis-used SSPE technology to exacerbate leverage and concentration of risk within the financial system	Well-established traditional use of SSPE technology to complement bank funding and share risk with capital markets investors
No longer active: no investor appetite and new regulations prevent re-emergence	Struggling to cope with new liquidity rules: some conduits have been closed because of the new liquidity rules

# Key structural features of ABCP Conduits

- ABCP Conduits are backed by liquidity provided by sponsor banks which are “committed”; however, the Total Commitments cannot be utilised, nor can liquidity be put at risk of drawing, unless specific conditions precedent are met.
- The first and most important condition – *which makes such liquidity very different from “ordinary” committed lines of credit provided to corporates* – is that sufficient receivables of good quality (there are “asset quality” tests) must be available for financing by the ABCP Conduit
- The amount of such receivables will depend on the needs of the day-to-day business of the corporate seeking funding from the conduit, for example:
  - whether business is good, and the corporate is selling high volumes of goods, or
  - whether business is poor, and the corporate is selling low volumes of goods
- Therefore, even if the “committed” amount of an ABCP Conduit and its supporting liquidity facility is €100, if only €71 of eligible good quality receivables are available for financing then no more than €71 of ABCP can be issued. The associated liquidity remains undrawn unless ABCP cannot be issued due, for example, to market disruption.

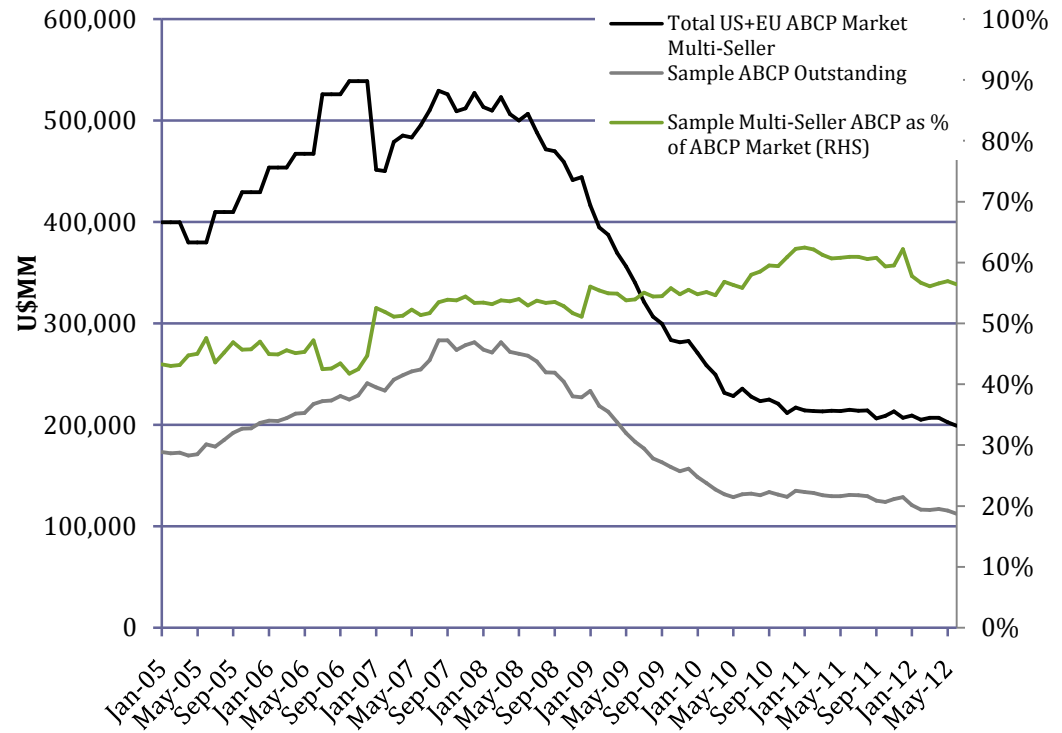


# AFME has gathered data from 2005 to date, showing historic utilisation across the industry and through the crisis

Jan-05 to Jun-12

- AFME received data from 12 sponsor members representing issuance from over 27 multi-seller, multi-asset ABCP Conduits issuing in the Euro, Sterling and USD ABCP markets.
- Members submitted program commitment amounts, amounts of direct bank funding, ABCP outstanding, liquidity draw amounts, ABCP retained amounts, and the amount placed with government facilities on a month-end basis from January 2005 to June 2012.
- The time line was chosen to incorporate different stages of the economic cycle.
- Our sample represents an average of 55% of the global ABCP market for the period, and since 2009 over 60%.

**Sample Size Versus Market 2005-2012**



Sources: Moody's, Member Data  
Note: Pre-2007 market data is shown quarterly



- Assuming a given size of the Utilised Portion in an ABCP Conduit, the first aspect consists in evaluating how much funding pressure can be created for the sponsoring bank when the market is no longer able to provide the funding in the form of ABCP. Our data demonstrates that funding pressure is limited – see Section 2.
- The second aspect consists in evaluating by how much the Utilised Portion can increase, which – potentially – could add further funding pressure on to the sponsoring bank at times of stress (as per Section 2). Again, our data demonstrates that such growth remains controlled – see Section 3.
- Therefore we have kept both analyses separate and sequential. Firstly, we evaluate the liquidity funding given a certain Utilised Portion; secondly, we go on to analyse the evolution of that Utilised Portion.

## **Section 2**

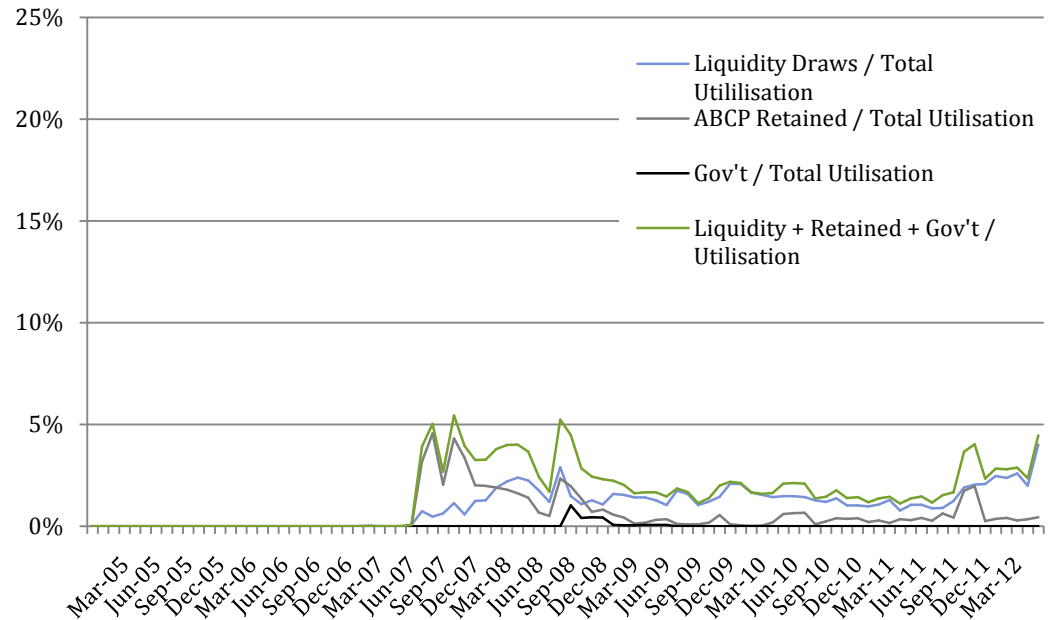
# **HISTORIC LIQUIDITY FUNDING SUPPORTING THE UTILISED PORTION OF TOTAL COMMITMENTS**

# Highest liquidity funding = 5.45%

Jan-05 to Jun-12

- We define “Liquidity Funding” to include (1) liquidity draws, (2) retaining ABCP on-balance sheet for non-investment purposes, and (3) accessing government funding relief programs.
- Liquidity Funding proved to be non-existent pre-July 2007.
- The majority of issuers experienced nil, or minor, Liquidity Funding in the post-2007 period.
- In total, Liquidity Funding peaked at c.\$16bn, accounting for only 5.45% of total program funding requirements.
- On average, Liquidity Funding accounted for only c.\$3.3bn of average funding requirements of over \$200bn (1.6%) during the sample period.

**Liquidity Funding / Total Commitments, 2005-2012**



*Note 1:* at least five ABCP conduits were or are in the process of being wound up during the sample period. This may skew the reported liquidity draw figure to the high side because at some point in the wind-up process, an issuer may not choose to, or may not be able to, market its ABCP.

*Note 2:* sponsors who are also dealers of ABCP will, as a matter of course, retain ABCP inventory for market-making purposes. Dealer members were asked to remove this inventory when reporting.

*Note 3:* liquidity draws primarily occur for two reasons:

1. a genuine market-disruption type event; or
2. as a funding preference where the cost of funding via LIBOR-based liquidity is more efficient than the current market price for ABCP.

## **Section 3**

# **LIQUIDITY SUPPORTING THE UNUTILISED PORTION OF TOTAL COMMITMENTS**

- ABCP issuance is constrained by the borrowing base of the assets of the seller; if good quality receivables are not available, ABCP cannot be issued and within a funding cycle there is no risk of the associated liquidity facilities being drawn.
- Of course, ABCP will vary from month to month as the volume of eligible receivables changes. Over time, therefore, and across funding cycles, liquidity could be at risk of being drawn as the Unutilised Portion becomes utilised.
- However, historical data shows that utilisation by sellers has averaged 68% for the sample period, with a standard deviation of 2.94%.
- The Utilised and Unutilised Portion has therefore remained relatively stable throughout the sample period.

**ABCP issued and placed / Total Commitments 2005-2012**

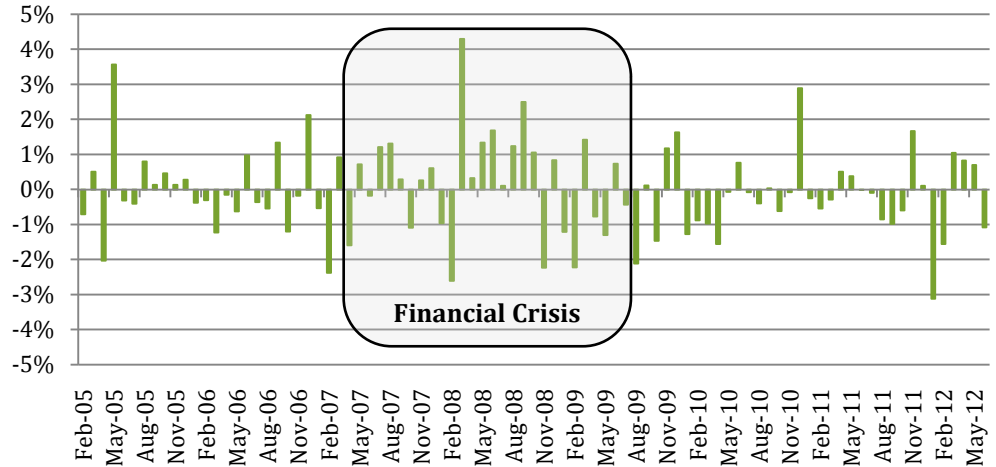


# Highest monthly change in Utilised Portion = 4.34%

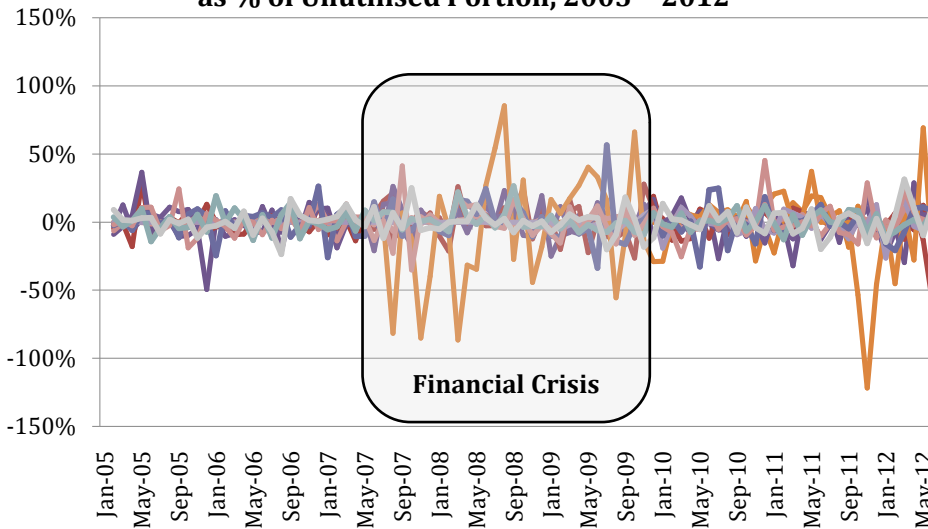
Jan-05 to Jun-12

- Number of observations: 2,403.
- Month over month variations in the Utilised Portion at an aggregate and sponsor level were tracked to assess the correlation between market stress during the financial crisis and increased utilisation of Total Commitments.

**Monthly change in Aggregate Utilised Portion as % of Total Commitments, 2005-2012**



**Change in Sponsor Level Utilised Portion as % of Unutilised Portion, 2005 - 2012**



- Low correlation was found during the sample period. This was because the borrowing base restricts increases to the underlying programs, and also because of reduced economic activity.
- Note that the graph on the left reflects not only underlying changes in the Utilised Portion but also an arithmetical feature which tends to exaggerate volatility.
- For example, assume Total Commitments of 100 of which 90 is utilised (and 10 unutilised) in Period 1. In Period 2 the Utilised Portion increases to 95. This is shown in the graph as a change of  $5 / 10 = 50\%$ . Yet the absolute amount of the extra Utilised Portion is relatively small.

## **Section 4**

# **SUMMARY OF DATA, CONCLUSIONS AND REQUEST**

- The strong liquidity performance of ABCP Conduits, supported by the data in this document, warrants consideration for relief in the form of an adjusted calibration under Article 412 on:
  - liquidity supporting the Utilised Portion; and
  - liquidity supporting the Unutilised Portion.
- For the Utilised Portion, Liquidity Funding was never more than 5.45% of the Utilised Portion of Total Commitments.
- For the Unutilised Portion:
  - at an aggregate level and as a percentage of Total Commitments, the monthly variation in the Utilised Portion never exceeded 4.34%;
  - expressed as a percentage of the Unutilised Portion, this monthly variation never exceeded 13.72%;
  - applying the same methodology but at the individual sponsor level, the data showed an average monthly variation in the Utilised Portion of 8.13%;
  - using a percentile analysis to focus on the more likely scenarios, the 95<sup>th</sup> percentile in the monthly variations is no more than 16.62%.
- Neither the Utilised nor Unutilised Portions are therefore susceptible to “runs”.
- Yet the currently proposed calibrations have the unwarranted consequence of severely penalising multi-seller asset-backed commercial paper conduits (“ABCP Conduits”) which:
  - have a 30 year operating history
  - have exhibited strong liquidity performance even during times of stress
  - fund the real economy: trade receivables, auto and consumer loans with good performance
  - are supported by sponsor banks, and
  - are relied upon by customers as a significant source of working capital



- Given that the current proposed LCR calibration exceeds these levels of historical drawings by many multiples, AFME respectfully requests:
  - further dialogue with the European Commission, the Basel Committee and other stakeholders to resolve these difficult technical issues; and
  - in any event, a commitment to a review to be undertaken by the EBA of the proposed calibration during an agreed observation period.

The Association for Financial Markets in Europe advocates stable, competitive and sustainable European financial markets that support economic growth and benefit society.

**London**

St Michael's House  
1 George Yard  
London EC3V 9DH  
United Kingdom

Tel: +44 (0) 20 7743 9300

**Brussels**

3rd Floor  
Square de Meeûs 38 -40  
1000 Brussels  
Belgium

Tel: +32 (0)2 401 8724

[www.afme.eu](http://www.afme.eu)

## **ANNEX III**

### **ERBA risk weights for long-term ratings**

### **ERBA risk weights for long-term ratings**

(Underscored figures are changed from those proposed by EC; others are as proposed by EC.)

Rating	Senior tranche		Non-senior (thin) tranche	
	Tranche maturity (Mt)		Tranche maturity (Mt)	
	1 year	5 years	1 year	5 years
AAA	10%	<u>10%</u>	15%	50%
AA+	<u>12%</u>	<u>12%</u>	15%	55%
AA	15%	<u>15%</u>	20%	75%
AA-	20%	<u>20%</u>	25%	90%
A+	25%	<u>25%</u>	40%	105%
A	35%	<u>35%</u>	55%	120%
A-	40%	45%	80%	140%
BBB+	55%	65%	120%	185%
BBB	65%	75%	155%	220%
BBB-	85%	100%	235%	300%
BB+	105%	120%	355%	440%
BB	120%	135%	470%	580%
BB-	150%	170%	570%	650%
B+	210%	235%	755%	800%
B	260%	285%	880%	880%
B-	320%	355%	950%	950%
CCC+ to CCC-	395%	430%	1,250%	1,250%
Below CCC-	1,250%	1,250%	1,250%	1,250%