12 August 2014

By email

Basel Committee for Banking Supervision
c/o Bank for International Settlements
CH-4002
Basel, Switzerland
Attn: Mr. Amrit Sekhon
    Chairman, Securitisation Working Group
    Email: amrit.sekhon@occ.treas.gov

Further data and analysis relating to the proposed Revisions to the Basel securitisation framework

The undersigned associations (together the Joint Associations)\(^1\) are writing to provide further information and observations for the Basel Committee on Banking Supervision (BCBS or Committee) to consider as they move toward completing their work on the proposals set out in the second consultative document "Revisions to the Basel securitisation framework" published by the Committee on 21 December 2013 (BCBS 269).

First, we wish to thank the Committee and its staff for its constructive dialog with us to date on this important subject. We are especially grateful for the very useful meetings we had with Committee staff in Washington on 9 April. Our members also appreciate having had the opportunity to provide input through the related quantitative impact study (QIS).

Our remaining concerns

However, we remain concerned that the current proposals will not meet the Committee's stated objective of comparability, resulting instead in capital requirements that are neither comparable among calculation methods nor proportionate to risks.

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\(^1\) See attached Annex 1 for a description of each of the Joint Associations.
It is essential that the timetable for finalisation of the proposed framework is extended to address those shortcomings. Additional work should be undertaken to refine the calibration of the proposed framework and especially to improve the consistency of results between the internal ratings-based approach (IRBA), the external ratings-based approach (ERBA) and the standardised approach (SA). This should include gathering additional, more granular data and undertaking further analysis beyond what was provided in the QIS. In particular, we would recommend conducting analysis of data grouped by the market-defined asset classes of the underlying exposures (rather than according to the regulatory exposure categories).

Further consideration should also be given to additional analytical work provided by the industry and referred to in the Joint Associations' comment letter dated 24 March 2014 (Comment Letter).²

We provide further detail below and in the attached report (Report) commissioned by the Global Financial Markets Association (GFMA) and prepared by Professor William Perraudin, Adjunct Professor of Imperial College, London and a Director of Risk Control Limited (RCL).

The Report

RCL has conducted an analytical study of certain data provided by a number of GFMA's member banks. These data are limited as explained in the Report, and the Report should be read and understood in that context. It is especially important to note that the Report does not advocate or support a particular calibration method or outcome, and in particular we do not intend that any of the implied p-values set out in the report should be used to calibrate the revised framework. Rather, the Report reveals a number of results that we respectfully ask the Committee to consider as they continue to work on the proposed revisions.

In our view, the Report demonstrates that more work is needed to refine the calibration of the proposed framework and especially to improve the consistency of results between the IRBA, the ERBA and the SA. Key points are as follows.

- For each asset class, when one compares the average risk weights calculated using the IRBA, ERBA and SA, the capital requirements under the three approaches are very different and lack consistency.

- Even when average risk weights look comparable across the three approaches, the rank order correlations of individual tranche risk weights are often low, especially for "most senior" tranches and when excluding RMBS backed by non-recourse mortgages. In particular, the IRBA and ERBA yield very different rank orderings for regulatory capital. In some cases the risk weights under IRBA are higher than under ERBA, contrary to their order in the hierarchy.

- To compare the risk weights implied by the three approaches, RCL extracted the parameter p that, within either the IRBA or the SA, yields the same risk weight as the ERBA. The average asset-class and seniority-class p-parameters show much variation across the different approaches.

- The degree of dislocation between ERBA and the other two approaches is somewhat less striking when observations are based only on exposures issued from and after

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² Available at [http://www.bis.org/publ/bcbs269/jtagceiiisas.pdf](http://www.bis.org/publ/bcbs269/jtagceiiisas.pdf)
2010 and not on exposures issued before or during the financial crisis. We believe this is because current credit ratings of pre-crisis exposures (especially for non-recourse RMBS but more generally for some other asset classes) reflect the numerous downgrades of exposures during the crisis but may not yet reflect warranted upgrades on some exposures. In general, rating agency ratings are updated much less frequently than IRBA calculations would be.

- The Report also shows that ERBA risk weights are often higher than SA risk weights both on average and for individual exposures. This suggests that the calibration of ERBA is too conservative.

Because banks in some jurisdictions will not be permitted to use the ERBA, while banks in other jurisdictions will more often have to use the ERBA rather than IRBA when acting as investors, the dislocation between ERBA and other approaches will lead to lack of comparability of capital requirements between different banks holding similar exposures. In addition, the poor rank ordering will lead to inappropriately high capital requirements for senior tranches, which form the largest portion of the market. Capital requirements that are not proportionate to risk and lack consistency between banks using different approaches will lead to inappropriate incentives and feed market distortions.

**Our recommendations**

In light of these findings, we respectfully recommend that:

- The Committee should adjust the timetable for finalisation of the proposed framework to allow sufficient additional work to be undertaken to refine the calibration of the proposed framework and especially to improve the consistency of results between the three approaches (IRBA, ERBA and SA). Given the importance of securitization to global economic growth, it is critical that capital requirements are calibrated appropriately. If more time is needed to do so, it should be taken.

- This further work should include gathering additional, more granular, data and undertaking further analysis beyond what was provided in the QIS. In particular, it should include analysis of data grouped by the market-defined asset classes of the underlying exposures (rather than according to the regulatory exposure categories).

- The Committee should also consider further the analytical work done by the Conservative Monotone Approach (CMA) quant group and referred to in the Comment Letter, as explained in the papers published by Prof. Perraudin and others and available on the RCL website (http://www.riskcontrollimited.com/afa_capital.html). The CMA, being a securitisation risk model, can be used either directly to calculate capital requirements or indirectly to calibrate the simplified supervisory formula approach (SSFA). However:

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3 As stated in our Comment Letter, we believe the levels of capital implied by the proposed revised framework unfairly penalise securitisation across all three approaches, making it less likely that the asset-backed market will recover its ability to provide funding for the real economy.

4 Comment Letter pages 12-13.
As the IRBA calibration work that was published\(^5\) was based on data from banks using IRBA only as originators, further work must be done to include data provided by (mainly US) banks that use proxy values to calculate IRBA risk-weights when acting as investors. (Including these data would lead to a different calibration because banks using proxy values are required to add conservatism to the capital requirements calculations.) The industry would, of course, be happy to assist the Committee in this effort.

In addition, as we said in the Comment Letter,\(^6\) we believe that calibration should be done according to the market-defined asset classes of the underlying exposures (like those referred to in the Report), rather than the regulatory exposure categories, in order to take proper account of differences between asset classes within, for example, the wide wholesale and retail categories and to use data on the same asset classes from both large and small banks to get the largest possible sample.

By itself, the CMA would not solve the problem of lack of comparability between approaches, but it should be considered together with other improvements to the framework.

- If a more comprehensive adjustment of the approaches is not feasible, the Committee should at least adopt the Joint Associations’ proposals, also set out in the Comment Letter,\(^7\) to reduce the floor \(p\)-value and introduce caps on \(p\)-values for senior and non-senior exposures, in order to mitigate the effects of the dislocation between approaches shown in the report. However, while we recognise the benefits of capping the \(p\)-values, this mutes rather than resolves the underlying dislocation and therefore does not remove the need for an underlying sound risk-sensitive model.

**Conclusion**

We stand by our Comment Letter which discusses these and other changes we believe would improve the formulation and calibration of the proposed framework. We believe that if the Working Group takes the appropriate time to analyze and adjust the calibration of the various approaches, and makes adjustments as proposed, the Committee will be able to achieve a framework which delivers its stated objective of comparability and is better calibrated, more consistent, logical and proportionate. Of course the Joint Associations stand ready to assist the Committee and actively and constructively to engage in this further work should our recommendations be acceptable.

We would be very pleased to discuss these results and our recommendations further with the Committee staff, either in person or by conference call.

We thank the Committee and staff once again for their thoughtful consideration and for the opportunity for our constructive engagement with them over the last several months.


\(^6\) Comment Letter page 13.

\(^7\) Comment Letter pages 13-14.
Should you have any questions or desire additional information regarding this letter or the enclosed report, please contact in the first instance Richard Hopkin or Chris Killian of GFMA (at his e-mail address or telephone number set out below).

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Att.

Copy to: Mr. Stefan Ingves, Chairman, Basel Committee for Banking Supervision
Annex 1 – Joint Associations

The Commercial Real Estate Finance Council (CREFC) is the trade association for lenders, investors and servicers engaged in the $3.1 trillion commercial real estate finance industry. More than 250 companies and 5,500 individuals are members of CREFC. Member firms include commercial banks, insurance companies, private equity funds, mortgage REITs, investment grade and B-piece buyers, servicers and rating agencies, among others. CREFC promotes capital formation, encouraging commercial real estate finance market efficiency, transparency and liquidity. In addition to its member Forums, committees and working groups, CREFC acts as a legislative and regulatory advocate for the industry, plays a vital role in setting market standards and provides education for market participants in this key sector of the global economy. For further information, please visit www.crefc.org.

The Commercial Real Estate Finance Council Europe (CREFC Europe) is the voice of the commercial real estate finance industry in Europe. Our role is to promote transparency and liquidity in commercial real estate finance markets by developing and disseminating best practice and engaging with regulators, so our industry can flourish while playing its part in supporting the real estate industry and the wider economy. In addition we are the meeting place for lenders, capital providers, those seeking finance and others with an interest in the health of this market. We provide education and networking opportunities for market participants, and seek to ensure that the industry we champion has a bright and sustainable future. For further information, please visit www.crefceurope.org.

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.

The Institute of International Finance, Inc. (IIF) is a global association created in 1983 in response to the international debt crisis. The IIF has evolved to meet the changing needs of the international financial community. The IIF's purpose is to support the financial industry in prudently managing risks, including sovereign risk; in disseminating sound practices and standards; and in advocating regulatory, financial, and economic policies in the broad interest of members and foster global financial stability. Members include the world's largest commercial banks and investment banks, as well as a growing number of insurance companies and investment management firms. Among the IIF's Associate members are multinational corporations, consultancies and law firms, trading companies, export credit agencies, and multilateral agencies. All of the major markets are represented and participation from the leading financial institutions in emerging market countries is also increasing steadily. Today the IIF has more than 470 members headquartered in more than 70 countries. For more information, please visit www.iif.com.

The International Association of Credit Portfolio Managers (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 in 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 90 financial institutions worldwide that are members of the IACPM. These institutions are based in 17 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.iacpm.org.

Since its founding in 1985, the International Swaps and Derivatives Association (ISDA) has worked to make over-the-counter (OTC) derivatives markets safe and efficient. Today, ISDA has over 800 member institutions from 62 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. ISDA's work in three key areas – reducing counterparty credit risk, increasing transparency, and improving the industry's operational infrastructure – show the strong commitment of the Association toward its primary goals; to build robust, stable financial markets and a strong financial regulatory framework. For more information, please visit www2.isda.org.

The Securitization Forum of Japan (SFJ) was founded as a voluntary association in 2005 and established as a corporation in 2007. SFJ aims to contribute to the sound development of the asset securitization market and carry out the following operations: (1) research and study associated with asset securitization; (2) exchanges and cooperation with internal and external organizations concerned, etc. associated with asset securitization; (3) diffusion and enlightenment of asset securitization; (4) policy recommendations concerning asset securitization; and (5) any other operations incidental or relevant to operations of the above items. For more information, please see http://www.sfj.gr.jp/e/index.html.

The Structured Finance Industry Group (SFIG) was established in March 2013 for the purposes of: (1) educating members, legislators, regulators, and other constituencies about structured finance, securitization and related capital markets, (2) building the broadest possible consensus among members on policy, legal, regulatory and other matters affecting or potentially affecting the structured finance, securitization and related capital markets, (3) advocating on behalf of the structured finance and securitization industry with respect to policy, legal, regulatory and other matters affecting or potentially affecting the structured finance, securitization and related capital markets, (4) accomplishing all of the above while being dedicated to the core principles of governance, financial transparency, inclusion and respectful accommodation of divergent member views. For more information, please visit www.sfindustry.org.