

March 15, 2013

Comments on the Basel Committee on Banking Supervision's Consultative Document:  
Revisions to the Basel Securitisation Framework

Japanese Bankers Association

We, the Japanese Bankers Association ("JBA"), would like to express our gratitude for this opportunity to comment on the consultative document: *Revisions to the Basel Securitisation Framework*, released on December 18, 2012 by the Basel Committee on Banking Supervision (the "Committee").

We hope that our comments below will be of assistance and perhaps offer an additional point of reference as you work towards finalizing the rules proposed by the Committee.

General Comment

In response to lessons (e.g. identified issues for each type of products and reasons why such issues occurred) learned from the financial crisis, various regulations, including rating agencies rules, Basel 2.5 and risk retention requirements for securitisation markets, have already been implemented. The level of capitalisation under the proposed enhancements to the securitisation framework needs to be determined achieving a proper balance with these already introduced regulations.

The securitisation requirements, as an overall framework, should fundamentally be designed to facilitate sound development of the securitisation markets. If however the proposed enhancements to the securitisation framework were to be implemented without considering the impacts of the proposed enhancements on the overall framework, it may accelerate investors' exits from the markets, which may result in undermining the roles of these markets currently serving critical functions.

In particular, the securitisation markets are not only significant funding and liquidity tools for financial institutions, but have also provided capital for the users of financial institutions, including retail, as well as funding for business entities including sales financial companies. For example, the presence of the RMBS market made a significant contribution to promoting the housing policies in developed countries, as is evident in the increase in home ownership rates. While the ABS market provides capital to individuals and dealers and supports expansions in the automobile market, imposing restrictions on these markets would have a significant adverse impact on the benefits which users in each jurisdiction have enjoyed.

However, the proposed revisions overly emphasise capitalisation. In fact, the proposed level of capital charges for securitisation exposures is so high that it goes far beyond the level which is considered reasonable in comparison with the performance of each securitisation exposure for each region/underlying

asset. As an example, a 10-year accumulated loss rate<sup>1</sup> for a securitisation exposure rated AAA, such as ABSs, CMBSs and RMBSs, in the Asia-Pacific region is 0.01%, while the capital charge required under the proposed revisions is 4.64%. This is considered to lack sufficient reasonable grounds. Primary reasons are presumed to be that the BCBS excessively focused on modeling risk for particular securitisation exposures highlighted during the crisis (e.g. U.S. RMBS/HEL with AAA-rated, which demonstrated a 7.34 % of 10-year accumulated loss rate) without reflecting differences in the characteristics and performance of securitisation exposures among regions/underlying assets as well as that it ignores the post-crisis situation of the securitisation markets and other related initiatives, such as improvements in assessment/ rating methodologies and strengthened monitoring. Accordingly, the proposed framework has substantially deviated from the BCBS's original intention of striking a balance between reducing the investment risk associated with a securitisation exposure and developing the sound securitisation markets as an important tool for funding.

In order to ensure the balanced framework between the regulations for investors and originators, given that the regulations introduced to date have placed an excessive emphasis on the regulations to be imposed on investors, enhancements to the regulations addressing information disclosure and registration mandates for originators in the securitisation markets are preferable option. Should the information on tranches, including the nature, performance and repayment priority of underlying assets, be registered and disclosed in a manner widely available to market participants, such requirements would curb the issuance and distribution of low-quality instruments that could have a significant impact on the financial system. If, however, a securitisation exposure with insufficient information disclosure is retained, then, as an exceptional treatment, a capital charge that exceeds the general level should be imposed on the exposure. Such a regulatory regime is considered to promote the sound development of the securitisation markets.

Some securitisation exposures had caused market disruption due to various reasons and defects in products during the crisis. However, post-crisis efforts made by market participants, investors and regulatory authorities are considered to have remediated, or are remediating, such defects as paragraph 3, Page 35 of the Consultative Document also indicates the improved rating methodology of a rating agency as one of its assumptions. We believe the concept underpinning the proposed framework will deviate from such a perception and lack a balance.

In finalising the Revisions to the Basel Securitisation Framework, the BCBS's basic stance and analysis on the current securitisation markets applied in developing this revised framework should be explicitly disclosed. In particular, how the BCBS recognises the improvement initiatives for and regulatory effects on such market. Specific issues to be addressed are as follows; Has a securitisation exposure recognised as having a defect during the crisis still maintained its marketability in the post-crisis market, or has it exited from the market? Had any action been taken to remove the defect? How have the effects been evaluated? Is it reasonable to still consider it to have a high risk for a certain type of a product just because such a

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<sup>1</sup> Extracted from Figure 37 of Moody's "Default & Loss Rates of Structured Finance Securities: 1993-2011".

product has a similar nature to that which caused investors to incur losses in the past?

Q1: What additional costs and benefits of the two hierarchies should the Committee consider? Which hierarchy presents the greater benefits relative to its drawbacks? Which hierarchy would best address the shortcomings identified with the current framework, whilst meeting the Committee's objectives?

The key messages of the proposed regulatory revisions are mitigating the mechanistic reliance on external credit ratings, revising risk weights, and reducing cliff effects of required capital. Under alternative A the Modified Supervisory Formula Approach (MSFA) that captures additional risk factors which securitisation exposures may involve, and that does not rely on external credit ratings, is at the top of the hierarchy of approaches. In addition, the Simplified Supervisory Formula Approach (SSFA) not relying on external credit ratings like the MSFA and the revised Ratings-based Approach (RRBA) requiring eligible external credit ratings are second in the hierarchy. Therefore, Alternative A is considered to address more issues because the risk-sensitive approach is used for wide-ranging tranches from senior to non-senior and extreme cliff effects can be reduced. However, Alternative A also has the issues as described below and it is considered necessary to review the excessive capital charges for senior tranches for the purpose of reducing cliff effects. The proposed level of capital charge has a merit of preventing the issuance and distribution of low-quality instruments causing disruptions during a crisis, but may drive out appropriate instruments from the markets.

Under Alternative B, requiring the "high-quality" criterion for external credit ratings is presumed to increase the "mechanistic reliance on external credit ratings" which is one of the purposes of the regulatory revisions. Furthermore, as described in detail in Q3, the definition of "high-quality" tranches is ambiguous, which makes it difficult for banks and national regulators to eliminate subjectivity. Thus, the treatment may vary among jurisdictions. In cases where the assessment is made based on the external credit ratings illustrated in the Consultative Document, a securitisation product originated in an Asian country is not likely to qualify as having "high-quality" tranches, depending on the country rating provided by rating agencies, since such a country rating will be a cap on the credit rating no matter how high credit quality the securitisation tranches have, which may result in hindering the expansion of the securitisation business. In the case of a bank employing the Standardised Approach (SA), the Backstop Concentration Ratio Approach (BCRA) is applied to a securitisation exposure not qualifying as having a "high-quality" tranche, which causes significant cliff effects in comparison with a bank applying the Internal ratings-based approach (IRB). As a result, under Alternative B, the motivation to invest in non-high quality tranches of a securitisation exposure may significantly be reduced since the application of a concentration ratio approach results in excessive higher capital charge.

Q2: As regards Alternative A, could both the revised RBA and the SSFA be accommodated without raising concerns about regulatory arbitrage or level playing field?

The calculation methodology under the RRBA which focuses on credit ratings is fundamentally different from that under the SSFA which builds on SA-based required capital for all underlying assets of a securitisation exposure. Such differences include the parameters incorporated in the respective formulas. As such, initiatives to align capital charges under both the RRBA and the SSFA at the same level for all securitisation exposures might be difficult, and hence fully addressing concerns about regulatory arbitrage or a level playing field might become challenging.

The proposed revisions permit each jurisdiction to select either the RRBA or the SSFA. Assuming that Jurisdictions A and B select the SSFA and the RRBA for cross-border transactions, respectively, the only available information on a securitisation transaction originated in Jurisdiction A might be information required under the SSFA. Such situation may prevent an investor located in Jurisdiction B from applying the RRBA. Taking into account the impact on these cross-border transactions, it is desirable to employ a uniform hierarchy, under which RRBA is applied to transactions which can obtain eligible external ratings while SSFA to other transactions, after making as much calibration as possible so that risk weights under the former have the same level of those under the latter, rather than to allow each jurisdiction to apply either approach, as described below in Q4, because such a treatment has the merit of extending the scope of applying a risk-sensitive approach and avoiding regulatory arbitrage and a level playing field.

On the other hand, we respectfully request BCBS to consider not requiring both RRBA-based and SSFA-based reports if an overseas branch / subsidiary of a bank employs an approach different from its home country.

Q3: As regards Alternative B, which methods could a bank use to conclude that a securitisation exposure is of high-quality? Would the use of these methods likely result in a capital charge consistently related to credit risk across banks and countries? Would Alternative B produce material cliff effects as exposures deteriorate below high-quality?

“High-quality” could not be an effective determinant for the following reasons:

An external credit rating of “AA-“ or better currently illustrated as the basis of “high-quality” is considered not reasonable. In cases where a securitisation product is originated in an Asian country, the country ceiling may limit the global credit rating to “A” or worse even when such a product has a domestic credit rating of “AAA”. The uniform introduction of an “AA-“ or better will lead to the application of risk-insensitive approach to a number of securitisation products, including senior tranches, in Asian countries, and may impede the expansion of the securitisation business in Asian countries.

On the other hand, with regard to the definition of “high-quality”, it is difficult to eliminate banks’ subjective judgment. The key factors for determining risks for a securitisation exposure are the nature and performance of an underlying asset as well as the nature of its credit enhancement. However the performance varies depending on the type of underlying asset, and so does the nature of required credit enhancement. As each underlying asset is unique, it is considered impossible to eliminate subjectivity in determining to what extent “high-quality” is specifically defined.

Given that the objective of this proposed revision is to make appropriate risk measurements for mezzanine tranches, Even if Alternative B is selected, the condition of “AA-“ or better is not necessary and the classification based on whether senior tranches or not is sufficient.

Q4: Are there alternative hierarchies or revisions to the two proposed (or a combination of both) that the Committee should consider?

As described above in Q2, from the standpoint of regulatory arbitrage and a level playing field, it is not reasonable for the selection of the RRBA or the SSFA to be at the discretion of jurisdictions.

There are some securitisation transactions, such as short-term and small amount transactions, which do not obtain two or more ratings in Japan. Some products may not be able to estimate the probability of default (“PD”) and the loss given default (“LGD”) for each underlying asset under the IRB which is one of the requirements for the MSFA. In such a case, if the application of the SSFA is not allowed (the RRBA is employed), then the BCRA is employed as the MSFA and the RRBA cannot be applied, which may result in an excessive capital charge. Thus, with regards to the RRBA and the SSFA, the approaches which are used if the MSFA is not adopted, we believe that the SSFA and RRBA should be evenly positioned within the hierarchy, applying the RRBA to transactions which can obtain eligible external credit ratings, and SSFA to the others, rather than allowing national authorities to select either approach. The introduction of such an explicit hierarchy will resolve the concern about regulatory arbitrage.

If a hierarchy is established, unless merits pertaining to the risk-weighted assets are added to the calculation methodology for approaches at the higher end of the hierarchy, there may be no incentive for banks to choose an approach at the higher end. If the current proposal gives the impression to banks that the most advanced approach in the hierarchy merely increases the burden, and applying a simplified calculation method does not change the resultant risk weight due to the floor, it is likely that banks would employ a more simplified calculation method. As described below in Q8, the MSFA has an issue of being excessively conservative and hence calibration should be made so as to reduce risk weights. Accordingly, it should be noted that even if a hierarchy criteria is introduced, such criteria may not restrain banks from using a more simplified method.

Q5: The Committee recognises that in some instances and in some jurisdictions, the requirement for two external ratings could be difficult to implement or could impose additional costs on banks. The Committee requests feedback on the relative merits of reducing idiosyncratic, rating agencies' modelling risk with the costs of using two ratings and/or whether exceptions to this treatment should be permitted.

Exceptions to this treatment should be permitted for the reasons described below. Also, whether to apply such exceptions should be at the discretion of jurisdictions, considering the reliability of eligible rating agencies and the features of the securitisation market in each jurisdiction, on condition of stipulating specific principles, including small-amount and short-term transactions.

It is understood that acquiring two credit ratings is a common practice in the United States and EU countries. In Japan, there are a number of securitisation exposures with a size of 15 billion yen or less. While the credit rating acquisition costs varies according to the size and nature of the transaction, the need for two ratings is lead to an additional increase in the credit rating acquisition costs and likely to have a material impact on return mainly for highly-rated transactions. Furthermore, in certain Asian countries with a potential growth in their securitisation markets, there may be no major rating agencies. Accordingly, it is expected that credit rating acquisition will require a considerably longer period and a significant amount of costs for the time being.

For these reasons, we respectfully request the BCBS to permit an exception that securitisation exposures not exceeding a certain threshold (e.g. 15 billion yen) do not need to obtain multiple ratings.

On the other hand, most short-term exposures are intended for temporary funding needs. Unlike EU countries and the United States, the balance of securitised accounts and notes receivables exceed 5 trillion yen in Japan. A structure of such instruments has a simple with only senior and subordinated tranches. Major Japanese banks have not suffered from the default of such securitised products for the past 15 years. It is therefore considered unnecessary for such exposures to obtain multiple ratings, considering that the probability of default for short-term (less than one year) exposures is extremely low.

In addition, except for the above small-amount and short-term transactions, from a cliff effect reduction perspective, in the case where there is only one external credit rating, the application of the RRBA should not be prohibited but permitted by assigning a conservative risk rate (e.g. assigning a risk weight below one notch).

The proposal under this Consultative Document is intended to reduce rating agencies' modeling risk. We recognise that certain products, such as subprime RMBSs, ABSs - CDOs materialised such risk during the financial crisis. In Japan, the majority of securitisation products traded in the securitisation market are auto loan ABSs and prime RMBSs, where such modeling risk was limited (our understanding is that traditional securitised assets, such as auto loan ABSs and prime RMBSs, were not exposed to such risk even on a global basis). From such a standpoint, the treatment should be varied depending on asset types.

Furthermore, we respectfully request the BCBS to permit existing transactions to obtain only one external credit rating because, in many cases, it may be difficult to force initial originators to develop additional credit rating acquisition processes due to reasons that the initial originator no longer exists, or has changed; an approval for such additional acquisition needs to be obtained from the related parties; and issues associated with the cost burden for such additional acquisitions may arise.

Q6: Is the RBA appropriately calibrated and formulated? Should other risk drivers be incorporated?

A risk weight is treated in a conservative manner in the proposed approach. This is because, for tranches rated BB or better, this approach assumes 4.73% of PD and 60% of LGD in terms of the credit quality of loans comprising the underlying assets pools subject to analysis, which is considerably higher than actual situations. Additional reasons for such a treatment may be that the RRBA is calibrated based on the MSFA which incorporates issues as pointed out in Q8.

While the concept of tranche thickness, which is newly added as a risk factor in the Proposed Document, is an important factor, this concept does not take into account the fact that in practice securitisation transactions use excess spreads as a credit enhancement, and hence a thin tranche can obtain a high rating due to this credit enhancement. The proposed treatment would result in a sharp rise in risk weights of high-rated thin classes of tranches even though excess spreads are available for such tranches.

In addition, the rate of increase in maturity-based risk weights should also be revisited. As the regulations on rating agencies have been strengthened subsequent to the crisis, the rating agencies, in the process of credit rating analysis, generally grant a credit rating that matches the level of credit enhancement, taking into account the maturity of the underlying assets and the period of time required for the redemption of the tranches. The longer the maturity, the higher the level of credit enhancement needed in order to obtain the same credit rating even if a product with a PD of one year has the same underlying assets. Under the RRBA, maturity effects may be double-counted, and hence it is not considered appropriate to use the maturity (“M”).

The level of risk weights under the RRBA is based on the assumption that external credit ratings represent a simple expected loss (EL) ( $EL = PD * LGD$ ). However, in practice, the existing external credit ratings do not use a simple EL but rather factor in the tolerance of a stressed situation, for example, multiplying by a scale factor of stress. Such a current practice should be appropriately taken into account.

As a result of reflecting the factors stated above, the aggregated risk weights of securitisation exposures comprising the same underlying assets will be much higher than the risk weights of the underlying assets, and will fail to ensure a comprehensive consistency.

In Japan, AAA-rated securitisation exposures are granted a stable rating as the one-year downgrade rate is 1.7% and the five-year one is 0.7% according to the rating movement of Japanese securitisation products (Figure 21 of Moody’s: *Rating Movements for Securitisation Products in Japan (1994 to 2011)*, June 2012). In addition, with regard to the rating movement of CDOs only, the one-year downgrade rate for AAA-rated CDOs is 6.2% and the five-year one is 11.3%, while the one-year downgrade rate for AAA-rated ABSs is 0.3% and the five-year one is 0.2%. These indicate that the downgrade rate greatly varies depending on asset types. Risk weights should be set by reflecting these attributes. Particularly for housing loans extended by the Japan Housing Finance Agency (“Housing Agency”) accounting for the majority of securitisation products traded in the securitisation market in a broad sense, the average historical default rate is approximately 0.4%, which has not exceeded 2% at the maximum, and a recovery rate associated with such a default rate is 60 to 70% or so. Assuming that these rates are used for the PD and LGD (LGD=1- “a recovery rate”), the EL will be 0.12% to 0.16%. This significantly falls below the EL of 2.83% (=PD(4.73%)\*LGD(60%)) estimated based on the described PD and LGD, and accordingly such estimation does not represent the actual situation. For AAA-rated exposures issued by the Housing Agency, this results in excessive capital charges in comparison with the risk weights of housing loans. Also, with regard to a senior securitisation exposure, treating the average risk weights assigned to the underlying asset exposures as a cap on risk weights is permitted. However, in the case where it may be difficult for a bank employing the IRB to make an independent estimation under the IRB for products held for investment purposes, and thus we respectfully request the BCBS to clarify that such a bank can estimate risk weights of the underlying asset exposures based on the SA in calculating a cap of risk weights, as described below in Q19. We agree on the treatment stated in Item 4 of FAQs in the quantitative impact study (QIS) proposing that, in the case where the independent estimation is difficult, a cap of risk weights for mixed pools should be calculated under the SA.

[Table: Estimation of RMBS issued by the Housing Agency under certain assumptions]

	Risk weight of housing loans	Risk weight under the RRBA
RMBS	35%	58%

Even if an upgrade to the most senior tranche (AAA/Aaa-rated) is achieved, and a subordinated rate improves as redemptions increase, the credit rating would not be upgraded. Accordingly, the risk weight to be applied will not improve, and a higher risk weight than other calculation methodologies will be maintained. Therefore, in addition to the calculation methodology proposed, adjustments such as the incorporation of a subordinated rate is considered necessary (see the illustration shown below).



[Table: Comparison of the aging effect for ABSs with a final legal maturity of 10 years and straight-line redemption rate of 10% per annum]

Assumption  $K(irb)=10\%,K(SA)=10\%,W=0$

EAD	PD	LGD	AVC
100	0.01	0.45	0.12

	Issuance	t+1	t+2	t+3	t+4	t+5
Asset	100	90	80	70	60	50
Class A	70	60	50	40	30	20
Attachement	30%	33%	38%	43%	50%	60%
Dettachment	100%	100%	100%	100%	100%	100%
Maturity	10	9	8	7	6	5
MSFA	7.93%	7.47%	6.71%	5.97%	4.95%	3.57%
RRBA	4.64%	4.64%	4.64%	4.64%	4.64%	4.64%
SSFA	5.60%	4.78%	3.68%	2.85%	2.01%	1.60%

Q8: Is the MSFA appropriately calibrated and formulated? Does it incorporate the appropriate risk drivers? Is the calibration of tau and omega appropriate? If not, what evidence can respondents provide to support an alternative calibration?

The proposed MSFA does not take into consideration excess spreads largely contributing to the provision of credit enhancement to senior exposures, and credit enhancements under the waterfall structure, such as accelerated redemption. In addition, a substantial decrease in the level of the  $\tau$  and  $\omega$  parameters extends the loss burden which is originally allocated to subordinated exposures to also senior exposures. This results in an unreasonable and excessively conservative level of capital charge to highly-rated senior exposures (a level beyond the intention of the requirement to increase capital charge to senior exposures for reducing cliff effects). Given that a capital charge should basically be set at a level that is commensurate with the risks of such exposures, if the MSFA makes conservative adjustments without incorporating any credit enhancements under the securitisation structure and excess spreads, it is not considered reasonable to use the  $\tau$  and  $\omega$  parameters in response to a modeling risk to make additional and conservative adjustments. Therefore the original level should be retained.

Q9: Is it prudent to allow the use of the MSFA by banks making use of the foundation IRB approach?

It is considered appropriate to permit a bank making use of the foundation Internal Ratings-based approach (FIRB) to apply the MSFA. LGD used under the FIRB is generally set at more conservative percentage than that under the advanced Internal Ratings-based approach (AIRB), thereby a sufficient level of conservativeness in capital charge is ensured. This could be confirmed based on the QIS results.

Q10: Is the SSFA (particularly the constant term  $p$ ) appropriately calibrated? Please provide justification and evidence, to the extent possible, for alternative appropriate levels of calibration?

With regard to CLOs in the U.S., a certain report (Moody's *CLOs and the Simplified Supervisory Formula Approach (SSFA)*, December 2012) indicates that even  $p=0.5$  imposes an excessive level of capital charge, as compared to the 10-year accumulated loss ratio, and accordingly it may be extremely conservative. Furthermore, the rationale for  $p = 1.5$  is also not specified. We respectfully request the BCBS to, in light of the QIS results, make an assessment, especially on short-term securitisation exposures backed by accounts and notes receivable as provided in Q5, including maturity adjustments, to avoid setting an excessively conservative level of capital charge.

Q11: Is the SSFA properly formulated or should other risk drivers, such as maturity, be incorporated?

With regard to some products, there are a number of transactions which make publicly available 3-months delinquency data or more conservative data, such as 60 to 90 days, instead of disclosing the 90-days or more data. If 90-days or more delinquency data is strictly required for all transactions, additional costs for developing and/or improving the operating structure and process, etc. may need to be incurred. It is therefore requested to permit the use of data assessed to be virtually similar (e.g. the 3-months data) and conservative data (e.g. the 60-90 days data), and the application of a grandfathering rule, considering the existing transactions and financial practice of each jurisdiction.

Q12: Has the BCRA been appropriately calibrated and formulated?

With regard to mezzanine tranches,  $F=2$  is considered not appropriate as it may result in an excessive capital charge. We understand that the Backstop Concentration Ratio Approach (BCRA) is a calculation method aiming to achieve an increase in the required capital of underlying assets which is equivalent to a leverage scale factor. With regard to tranches below mezzanine, doubling such a factor is inconsistent from a theoretical standpoint, and hence justification for setting  $F=2$  is considered to be low. It is therefore requested to consider this in light of the QIS results.

Q13: What factors should the Committee consider in weighing whether the  $F$  parameter should be set at 2 for senior as well as non-senior tranches to avoid arbitrage opportunities?

It is understood that a cap of risk weights is applicable only with regard to senior tranches under the BCRA. If so, with regard to senior tranches,  $F=2$  is not considered effective for avoiding arbitrage opportunities.

Because, under such a treatment, RW cap for the  $K_{SA}$  is applied to a bank which, for the purpose of using arbitrage opportunities, insists that the  $K_{IRB}$  cannot be calculated but only the  $K_{SA}$  can, This results in the same situation as the application of  $F=1$  under the formula of the BCRA. (Assume that “arbitrage opportunities” in Q13 means that a bank obtaining an approval for employing the IRB under Alternative B intentionally applies BCRA, instead of the  $CRK_{IRB}$ , to achieve a lower capital charge, even it has the information on underlying assets needed to calculate the  $K_{IRB}$ ).

As a method for avoiding arbitrage opportunities with a framework for the cap for risk weights unchanged, certain operating requirements may be established. As one example of those requirements, only an originator who has an access to the information on underlying assets can apply the BCRA, not the  $CRK_{IRB}$ , by demonstrating to national supervisors a reasonable rationale for the application of the BCRA or that the application has not resulted in arbitrage.

Q15: Is the proposed treatment for mixed pools appropriate, or should another approach be employed?

The BCRA is a simple calculation method but does not reflect the factors including tranche thickness and maturity. It is therefore preferred to permit the use of other approaches on a pro-rata basis from the standpoint of making a more accurate measurement. On the other hand, considering bank’s practical burden, we respectfully request the BCBS to permit the use of a pro-rata basis only under the BCRA to the extent that it does not lead to regulatory arbitrage, even such a treatment may be risk-sensitive, because there are many instances where it is practically difficult for a bank acting as an investor to make a measurement under the IRB.

Q16: Is the definition of maturity appropriate, in light of the Committee’s objectives?

The concept of the “unconditional contractual maturity” principle is not appropriate in light of actual business practice. It is therefore requested to clarify that “expected maturity” can be interpreted as the definition of maturity. Even if a securitisation exposure is not amortised based on the contract, as a result of observing the historical performance, there are products, such as RMBSs, which are highly likely to be redeemed by passing through the prepayment of the underlying assets. Given such an analysis, the use of an own estimated average life, based on the historical performance, as “M” should be permitted.

If the “expected maturity” and the “own estimated average life” are not permitted, for transactions consisting products with at least the most senior exposures and without accelerated redemption for subordinated tranches, a weighted-average remaining period or weighted average maturity at the time of calculation of the underlying assets should be allowed.

In the Document, “unconditional contractual payment” is required as a criterion of the tranche “maturity.” Under current practice where it is typical for ABSs to execute pass-through redemptions and set an expected maturity, if the “expected maturity” is not deemed to be “unconditional”, then the “legal maturity”, which is excessively conservative, needs to be selected. Particularly, for retail receivables, prepayments generally occur at a certain frequency, and thus the legal maturity is considered to be more extremely conservative than the actual holding period. Given the current business practice, the use of the expected maturity of a tranche should be accepted, and, if it is determined not to permit “planned” or “expected” as a rule, for senior exposures, then capital requirements should be calculated using the holding period reflecting the actual situation by permitting the use of a weighted-average remaining period or weighted average maturity of the underlying assets.

Q17: Is the proposed 20% risk-weight floor set at an appropriate level? Please provide justification and evidence, to the extent possible, for alternative levels for the risk weight floor.

This is not considered an appropriate level.

According to S&P’s data on annual default rates for global securitisation exposures, the weighted-average default rate of AAA-rated exposures during 1978 to 2011 is 0.12% (standard deviation of 0.12%). When analysing this value, the proposed floor of 20% appears to be reasonable. However, this default rate also reflects historical default data for AAA-rated exposures during the period in which issues associated with the rating standards had emerged. This implies that any effects of improvements to the rating standards through developing the regulations for rating agencies which have already been implemented to date are not considered in this default rate. Therefore, the proposed securitisation capital framework lacks an appropriate balance as a total securitisation regime.

In addition, the 20% risk-weight floor is considered to be higher than that for the other exposures. For example, AAA-rated corporates calculated under the SA have less than 10% risk weight for one year. A risk weight of 20% is at the same level as that of BBB-rated corporates.

At least, the floor should be set at 7% for the MSFA.. Under the MSFA, it is not necessary to establish a uniformly higher floor since the risk assessment of underlying assets and tranche characteristics (such as, thickness, credit enhancement and maturity) are included in inputs and the MSFA is a risk-sensitive method which can be applied to various securitisation exposures. It is considered appropriate to set a floor so that the risk weight will be at the same level as the floor or the default parameters (PD:0.03%, LGD: 45%, M=1) under the FIRB framework. (In the case where the IRB model can be used, a securitisation exposure should be treated in the same manner as a corporate exposure.)

On the other hand, it is reasonable to set a lower floor for the RRBA which is a more risk-sensitive method than the SSFA.

Q18: Should the risk-weight floor for short-term exposures be the same as for long-term exposures?

In Japan, securitised accounts and notes receivables exceed 5 trillion yen, and major banks have not experienced default arising from such securitised products for the past 15 years. Most short-term exposures are intended to extend temporary funding, with a simple senior and subordinated structure. It is hence desirable not to apply the 20% floor to short-term exposures, given that the probability of default for short-term (less than one year) exposures is extremely low.

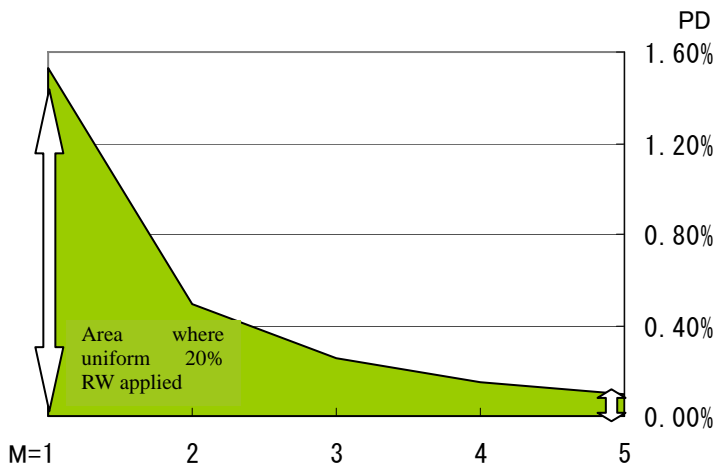
Estimation based on certain assumptions indicates that all of the transactions selected as a sample failed to satisfy a floor of 20%, as described below.

[Table: Estimation based on certain assumptions of risk weights for short-term exposures having accounts and notes receivables as underlying assets]

Tranche	RW under the MSFA	RW under the SSFA	RW under the BCRA	RW under CR-Kirb
Senior	20%	20% to approx. 150%	100%	20% to approx. 250%

While a uniform floor of 20% has merits of being simple and facilitating understanding, there is a demerit that such a floor inhibits adequate pricing functions and price discovery functions in the market, particularly for short-term securitisation exposures to which the MSFA is applied. The proposed revisions establish a floor for risk weights, leading to a higher capital charge for a long-term tranche than previously required. Thus, the MSFA assigns risk-sensitive risk weights to transactions with a wide range of parameters (such as PD/LGD) with regard to long-term tranches, and assigns uniform risk weights to transactions with a relatively wide range of parameters for short-term tranches, thereby the capital charge will not reflect the actual risk. For example, if a bank acts a sponsor of ABCPs, both ABCPs for which the PD of the underlying assets are 0.1% and 1.5% will be subject to the same level of capital charge (under specific conditions (M=1)). As a result, regardless of the magnitude of risks of an exposure, banks may add-on a uniform spread in providing funds to corporates, the funding party. In order to avoid such an issue, under the new regulation, the floor should not be increased to the risk weight of 20%. Even if the floor is not changed from the current framework, it is considered that the proposed revisions make a sufficiently conservative risk assessment through the maturity adjustments of tranches, and hence the purposes of the proposed revisions have been achieved.

[Figure: Relevance among the floor, PD, and M under a certain assumption (LGD=100%, etc.)]



ABCP programmes backed by accounts and notes receivables primarily focus on a very short-term (less than six months) transaction based on originators’ business stream and has features quite different from long-term exposures. In fact, the programmes had had a limited impact from the Lehman Shock. Unlike investment products, ABCP programmes have no risk of deterioration in exposures resulting from fluctuations in market value. Under such a scheme, risk characteristics, including the maturity of the underlying assets, should be thoroughly reflected in the securitisation framework. From the viewpoint that this is one of the critical alternative tools for an entity’s funding activity, a market contraction cannot be avoided unless a floor of risk weights is consistent with corporate loan exposures. The current 7%, which is consistent with the floor of risk weights for the IRB calculation, is therefore appropriate.

Q19: Are the proposed caps and their interactions with the proposed floor risk weight appropriate?

They are believed to be appropriate since it may be extremely conservative to require a capital charge exceeding the capital charge in the case where a bank holds underlying assets directly.

The Consultative Document permits the use of the averaged risk weights assigned to the underlying asset exposures as a cap to the risk weights for senior securitisation exposures. However, it is assumed that it may be difficult for a bank employing the IRB to make an independent estimation under the IRB for the products held for investment purposes, and thus we respectfully request the BCBS to permit such a bank to apply the SA framework for such underlying asset exposures.

Q21: Are the assumptions used in developing and calibrating the approaches discussed above appropriate in view of the Committee's stated objectives? Please provide empirical justification for alternative assumptions to those noted above.

Excess spreads should be incorporated into the calculations for both the MSFA and SSFA. Excess spreads are a credit enhancement inherent to each product which will be realised through the collection of the underlying assets, and hence the current MSFA and SSFA models reflecting only a subordinated rate is believed to be insufficient. Risk weights are originally used to calculate a capital amount to be set aside as a reserve for potential losses arising from positions held. This calculation includes certain principal collection as an assumption, and hence reflects future principal income. Accordingly, the treatment not to include in the model calculation the future margin income which will be paid by the time principal payment is made is not considered reasonable. Particularly, as stated in the Consultative Document, in the case of incorporating maturity in the calculation of risk weights, not taking into account the FMI earned during such a period results in excessive risk weights for long-term exposures.

The proposed MSFA approach only takes into account a simple subordinated rate with a funded credit enhancement as a loss-absorbing capacity and does not entirely assess and consider in the model the product characteristics of unfunded credit enhancement, such as a waterfall scheme accelerating redemptions in proportion to the degree of deterioration in the underlying assets. In this respect, for securitisation exposures such as cash CDOs and RMBSs with unfunded credit enhancements as described above, among other things senior tranches, a risk assessment is not properly carried out and risk weights are excessively conservative.

Q22: Is the proposed treatment of retail securitisations using the same approaches as for corporate securitisations appropriate? Would additional complexity (in the form of an additional formula to adjust the AVCs of retail underlying exposures) be justified to remove the double-counting effect of maturity effects?

More complexity in the functions and eliminating double counting for maturity adjustments can be justified. It is not reasonable to avoid separate calculation for retail exposures and corporate exposures due to just the complexity, since such separate calculation is an approach that is also adopted for calculating general capital charges. Rather, it is considered reasonable that a model should reflect risk weights more appropriately by eliminating double counting as this outweighs the framework becoming complicated.

As described above in Q6, in cases of retail housing loans extended by the Housing Agency which is the largest issuer in the broader Japanese securitisation market (loans of 10 to 28 billion yen have been issued on a monthly basis for the most recent one year), the historical average default rate is approximately 0.4% and has not exceeded 2% at the maximum, while the LGD is lower than the assumption made as collateral are generally pledged in practice, which is inconsistent with the actual situations. A different level of risk weights for retail pools from that for wholesale pools should be discussed based on the QIS results.

[Table: Estimation of RMBS issued by the Housing Agency under certain assumptions]

RW under the MSFA	RW under the SSFA	RW under the RRBA
20%	69%	58%

Other issues

○ Treatment of re-securitisation

With regard to re-securitisation, a framework of applying higher risk weights than the original securitisation as provided in Basel 2.5 should be established, rather than only allowing a concentration ratio that does not reflect any subordinated credit enhancement.

In terms of re-securitisation exposures with relatively high uncertainty, applying high risk weights is considered to be reasonable. However this proposal uniformly applies the same treatment to any types of exposures including those where regulations should be strengthened (re-securitisation whose underlying assets are all securitised exposures) to those whose performance has not worsened (including re-securitisation whose underlying assets include only less than 5% securitisation exposure such CLOs). Uniform application of the calculation under the BCRA to these exposures is inappropriate as this will result in excessively conservative capital charges. For example, an approach that does not rely on any external credit ratings is considered to be an extremely rigid and conservative method. Further, such an approach may become one of the factors for creating cliff effects in comparison with other securitisations.

○ Revision to inferred rating

The Basel II inferred rating framework sets out that a referenced securitisation exposure subordinates to the tranche held, while we understand that the footnote 22 of the Document specifies that the framework has been revised to accept a case where the referenced securitisation exposure and the tranche held is pari pasu. We however believe that this change should be further clarified. Also, paragraph 618 (b) of BCBS 128, one of the requirements of Basel II capital framework, should be removed to ensure consistency with the implementation of the maturity adjustment under the RRBA.

○ Treatment of purchased receivables used as underlying assets

Where underlying assets are purchased receivables, Footnote 28 states that parameter estimation based on a “top-down approach” would be allowed under the MSFA for purchased receivables, which is not changed from the current framework. However, the treatment for a case where there is a dilution risk is not specified. We would like to confirm what treatment the BCBS assumes for such a case.



○ Simplified method

Given that a “top-down approach” is permitted under the MSFA, the current treatment of LGD=50% in the case of diversifying underlying assets ( $C1$  of 0.03 or less) should continue to be permitted. For the same reason, the current simplified method for N-value ( $1/C1$ ) also should also be permitted.