February 5, 2016

Comment on the Consultative Document: *Capital treatment for "simple, transparent and comparable" securitisations*, issued by the Basel Committee on Banking Supervision

Japanese Bankers Association

We, the Japanese Bankers Association ("JBA"), would like to express our gratitude for this opportunity to comment on the Consultative Document: *Capital treatment for "simple, transparent and comparable" securitisations*, issued by the Basel Committee on Banking Supervision (the "BCBS").

We respectfully expect that the following comments will contribute to your further discussion.

[Our comments on the questions of the Consultative Document]

Q1. 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?

(Our comment)

- We agree with the introduction of STC criteria into the capital framework under the condition that it will be implemented with a certain degree of flexibility at the discretion of national supervisors.
- Nevertheless, since there are various means to mitigate risks and in light of the intent of the STC criteria, the determination of compliance with the STC criteria should be based on whether risks are substantially mitigated.
- The BCBS is requested that the STC criteria on asset-backed commercial paper ("ABCP") programmes should not be bound by the framework of the Consultative Document.
- Further, those ABCP that the bank is involved in, or holds, through providing credit enhancement in full, etc. should be excluded, and discussed separately, from the framework of the Consultative Document for the sake of both the investor bank holding such ABCP and the bank providing credit enhancement to such ABCP.

・Asset backed loans (“ABL”) are a type of securitisations whose underlying asset is a short-term receivable under commercial transactions and where SPC’s funding tool is not CP but a loan from the sponsor bank. Since its structure itself is mostly similar to that of ABCP, ABL should be discussed within the same framework as ABCP.

(Basis, etc.)

・The Consultative Document stipulates in “Introduction” of section 4 that “While incorporating the STC framework into the December 2014 securitisation framework could increase its risk sensitivity, it might also introduce significant operational burdens”. In view of this trade-off, jurisdictions that consider that implementation costs exceed potential benefits will retain the option not to implement the STC framework as proposed in this consultative document.”

・Under the 2014 securitisation framework which mainly addresses the issue of securitisation products related to subprime loans originated in the US, conservative risk weights (“RWs”) are assigned to securitisation products. By incorporating the STC criteria into the capital framework and thereby lowering RWs, the STC criteria would be used widely by market participants in an effective manner and would also facilitate the development of securitisation markets.

・Nevertheless, given that accounting systems and legal frameworks differ across jurisdictions, the BCBS should allow national discretion to specifically determine whether the STC criteria are satisfied in the context of national legislation, etc.

・The Consultative Document describes that the BCBS and the International Organization of Securities Commissions (“IOSCO”) are currently considering whether, and how, the STC criteria for ABCP programmes should be issued. Given the unique transaction form of ABCP, the some of the STC criteria is not appropriate to apply to ABCP if the criteria is incorporated as proposed. Therefore, the BCBS is requested to take a reasonable approach for ABCP by carefully taking into account its business practice. (The same is requested for ABL.)

Q2. 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 1?

(Our comment)

・While we agree with the necessity to add certain criteria, some overly strict criteria, such as D15, D16 and D17, should be revised.

(Basis, etc.)

・If the criteria D15 to D17 are applied as proposed, many securitisation products that should be assigned a lower RW as a securitisation product (e.g. US CLO) may be excluded from this framework. Further, the Consultative Document does not provide clear rationale for the proposed quantitative criteria even though such quantitative criteria will impose undue regulatory compliance burdens on investors, originators and other related parties, which may undermine the objective to develop and vitalise securitisation markets through STC securitisation products (for details, see our comments on specific issues in the later section).

Q3. What are respondents' views on the compliance mechanism and the supervision of compliance presented in this consultative document?

(Our comment)

・With regard to the compliance mechanism of STC criteria, we request for a balanced regulation which reflects differences in securitisation practices across jurisdictions.

・Under such a compliance mechanism, the BCBS should allow a third party (e.g. credit rating agencies and distributors of securitisation products), in addition to originators and/or sponsors, to individually (or jointly) carry out the required attestation.

(Basis, etc.)

・For banks to assess the STC criteria compliance mechanism as an investor, they will need originators/sponsors to disclose their information.

・In the first place, it is preferable that each of the originators/sponsors and investors makes STC assessment respectively and complements each another. In order to ensure a consistent assessment across parties, it is necessary to put in place an integrated assessment flow and information-sharing processes and procedures for such a flow. Further, the Consultative Document stipulates in section 3(i) that "investors (…) must thereafter take into account developments that may invalidate the previous STC assessment, for example deficiencies in the frequency and content of the investor reports, in the alignment of interest, or changes in the transaction documentation". If however originators/sponsors are not required to carry out the STC assessment and thus investors need to make the determination on their own even

though they can only depend on limited information such as legal offering documents, there is a risk that regulators may overrule that STC assessment. Given this, such an approach may prevent investors from investing without any concerns, and also is not realistic.

・The securtising parties (i.e. originator/sponsor) include a number of non-financial corporations which are expected to strongly resist being uniformly subject to oversight, albeit to a limited extent, by financial authorities. In this view, the compliance mechanism needs to be built on an appropriate supervisory framework that takes into account situations in respective jurisdictions.

・It would be an option to have a third party (e.g. a rating agency) make the designation in order to realise effective functioning of the compliance mechanism. Although the BCBS indicates its concerns in the Consulting Document that this option (i) could lead to significant additional costs and (ii) might also be contrary to the high-level concept of reducing reliance on external assessments (e.g. ratings), the BCBS is requested to reconsider this option by taking into account the following:

(i) Increase in costs

・It is considered that rating agencies already have enough information to assess compliance with the STC criteria when rating securitisation products. Therefore, no additional cost would incur to obtain additional information. If there are any distributors of securitisation products, such distributors would also have sufficient information for the STC assessment, and therefore, it is unlikely that the option will lead to a significant increase in costs.

・However, in the cases where ratings are not obtained and there are no distributors, the option could lead to a significant increase in costs. Given this, a preferable framework would be to have the originator/sponsor attest compliance with the STC criteria only in such cases.

(ii) Contrary to the high-level concept of reducing reliance on external assessments (e.g. ratings)

・Reduction of reliance on external assessments can be achieved by obliging investors to make the STC assessment. From the perspective of the banks as an investor, the originator/sponsor’s assessment is also regarded as an external assessment. Therefore, having the originator/sponsor make the STC assessment will not lead to reduction of reliance on external assessments.

・ Adding assessments by third parties (e.g. rating agencies and distributors of

securitisation products) will (a) ensure the appropriateness of the assessment criteria (because such third parties have extensive practical experience in securitisations and thus it would be likely that they can make a more appropriate determination of compliance with the STC criteria relative to the originators who are not necessarily well experienced in securitisations) and (b) uniform the assessment criteria (because the number of third parties is much smaller than that of originators).

Q4. What are respondents' views on the alternative capital requirements for STC securitisation presented in this consultative document?

(Our comment)

- The alternative capital requirements for STC securitisation would facilitate the development of securitisation markets.
- With a view to developing securitisation markets, the RW floor and the p-parameter should be further lowered to 7% and 0.5 (which is the same level as the Basel II) from the range between [10-12]% and [0.6-0.8], respectively.

(Basis, etc.)

- Securitisation products which are based on diversified underlying are deemed as a considerably safe product. Given this, any securitisation products qualifying for STC criteria which are designed to further mitigate structural risk and credit risk should be assigned a lower RW.
- Despite additional costs arising from the STC assessment, a lowering in RW will ensure incentives for investments in STC securitisations which function to provide funds to the real economy.

[Our comments on specific requirements, etc.]

We hereinafter would like to comment on specific requirements, etc.

○Overall

・Please confirm that the “Additional guidance for capital purposes” is set forth only for reference purposes.

○ A1: Nature of assets (Homogeneity)

(Request, etc.)

・Please confirm that the “Additional guidance for capital purposes” in this section is set forth only for reference purposes.

(Basis, etc.)

<<Level monthly payments for the full amount of loan>>

・In light of the intent of introducing the STC criteria, homogeneity required in “A1. Nature of assets” is presumably intended to exclude those products inherent with excessive risks, such as interest-only loans in which the borrower pays only the interest during the initial payment period that were observed before the financial crisis in the U.S. However, imposing on retail exposures a requirement “loans that have level monthly payments that fully amortise the amount financed over its original term” may give rise to a situation where securitisation products which should not be excluded will be deemed as not qualifying for the STC criteria.

・Specifically, in the Japanese securitisation market, many securitised products make use of retail products (e.g. mortgage loan and auto loan) as underlying assets. If the homogeneity requirement is imposed, we consider that receivables that qualify for the underlying assets of STC securitisations may decrease considerably for the following reasons:

(i) The payment term under many contracts of residential mortgage loan and auto loan is comprised of “monthly payments and bonus-based payments”. Particularly, in most cases, the payment term of residential mortgage loan is determined under the assumption that bonus will be paid. Therefore, it is likely to include payment methods that are different from level monthly payment, such as prepayment and bonus-based payment.

(ii) Many auto loan contracts adopt balloon payment (where the final payment constitutes approximately 20 to 40% of the total payment amount).

(iii)In the case where revolving credit facilities are used in relation to credit card loans and credit card receivables, only a few will be able to satisfy the above homogeneity requirement.

・The same can be said in the U.S. and Europe for those receivables to which above (ii) (iii) is applicable. Further, some of U.S. CLOs are backed by different forms of underlying loans. Therefore, such underlying assets are not considered to be homogeneous in terms of the payment term. On the other hand, some underlying assets satisfy the homogeneity requirement in terms of the purpose of use of funds.

・In Japan, even though those receivables that have unlevel payments mentioned in the above are included in underlying assets, securitisation products rated AAA have never defaulted and will not require overly complex cash flow analysis.

・If, of retail exposures, the homogeneity requirement is applied only to auto loan, there is no reasonable reason to justify such exclusive application to auto loan.

・In order to enhance the effectiveness of the STC criteria, the BCBS should allow assessment from the perspective of whether there is a risk in substance in light of each jurisdiction's business and market practices (i.e. actual form of loan payments), instead of formally imposing a requirement such as "loans that have level monthly payments that fully amortise the amount financed over its original term".

<<Same legal framework>>

・Given that some underlying assets of U.S. CLOs are subject to the Uniform Commercial Code ("UCC") while some are subject to the U.S. regulation of the Securities Act Rule 144 in addition to the UCC, deciding that the underlying assets are not homogenous simply because the governing law is different would not be appropriate to actual conditions. Similarly, in Japan for example, it would not be reasonable, in consideration of actual conditions, to determine that the homogeneity requirement is not met in the case of securitisations whose underlying assets include both auto loan receivables and auto lease receivables.

○A2: Asset performance history

(Request, etc.)

・Consistent with the current Basel capital framework, the minimum performance history for both retail and non-retail exposures should be five years in principle. To clarify that such a period of time will be applied "in principle", this should be positioned as guidance, instead of a requirement.

・Further, the BCBS should permit a shorter period of time than five years if the originator, etc. has the performance history that includes a stress period in the credit

cycle for such assets.

(Basis, etc.)

・It may not be effective to simply set the minimum performance history, such as five years and seven years, in the first place. In those markets that were relatively overheated for a long period of time, such as subprime mortgage in the U.S., even if the originator, etc. has the performance of five years, a highly-stressed period may not be included in that period. To the contrary, despite the performance history of only four years, that period may include a financial crisis period with extremely high stress (e.g. 2010 financial crisis) and thus could be considered as effective performance history.

○A3: Payment status

(Request, etc.)

・A requirement provided for in “Additional guidance for capital purposes”: i.e. “at least one payment should have been made on the underlying exposures”; should be deleted. Or, at least an exemption should be granted to the case (of CLOs) where the underlying exposure is a loan.

(Basis, etc.)

<<At least one payment on the underlying exposures>>

・Since a one-time (lump-sum) payment is made in many cases of accounts receivable, all of them will be excluded. In Japan, although there are many securitisations whose underlying receivables without any payment history are considered as eligible receivables, there has been no particular problem.

・Taking into consideration that the requirement of “A2. Asset performance history” will enable an analysis of delinquency risk of the first payment, cash flow analysis will not become overly complex even without imposing such a requirement as “at least one payment should have been made on the underlying exposures”.

・In the case of CLOs, there could exist some receivables that are added into the portfolio before the payment starts. Therefore, the requirement of at least one payment will limit those CLOs that qualify for the STC criteria.

○A5: Asset selection and transfer

・With regard to a description in “Additional requirement for capital purposes”: i.e. “An independent third-party legal opinion”; please confirm that the BCBS does not set any rules pertaining to the method for obtaining a legal opinion on the true sale

(specifically, that such a legal opinion can be obtained via e-mail or by any other means).

○A6: Initial and ongoing data

(Request, etc.)

・Ongoing disclosure of attribute data should be required to the extent that such data can demonstrate that the same level of diversification as the initial data is ensured. Where the ongoing data provision is required, such a requirement should be deemed as satisfied by the fact that processes and procedures that enable quarterly disclosure of such data are in place.

・Please confirm that, insofar as due diligence is conducted appropriately, parties other than third parties are also allowed to conduct the initial review.

・If it is difficult to take the above requested approaches, the BCBS is requested to provide additional guidance so that the scope of data to be disclosed after securitisation on an ongoing basis will be limited to the performance data related to those assets to be securitised.

(Basis, etc.)

<<Ongoing data provision>>

・In the Japanese securitisation market, in most cases, investors hold securitisation products up to maturity. Therefore, ongoing data regarding the performance of securitisations is not being disclosed for secondary market investors because there are only limited uses of such data.

・In Japan, originators' system requirements can cover data processing for initial identification of receivables at the time of originating securitization. However, compliance with the ongoing data requirement during the period after the origination will directly lead to increased costs. This will disincentivise the originators to use securitisations and thus undermine the objective of invigorating securitisation markets.

・On the other hand, while investors need to make the STC assessment regularly to ensure that the product is an eligible STC securitisation product, it is not always necessary to provide attribute data to investors on an ongoing basis as long as it can be confirmed at the overall underlying asset level that the initial level of diversification and creditworthiness are maintained.

○B11: Documentation disclosure and legal review

(Request, etc.)

・Notwithstanding the “Additional guidance for capital purposes,” we consider that privately documented initial offering material does not need to contain the same level of transparency and disclosure to investors as the initial offering material for publicly registered/offered transactions which is uniformly required under applicable laws and regulations, such as the Financial Instruments and Exchange Act in Japan.

・It is requested that certain securitisation products structured for professional investors will be exempted from the same level of documentation which contains detailed descriptions and is reviewed by a third party as required for publicly offered transactions, provided that the documentation contains sufficient information for such investors to make investment decisions.

(Basis, etc.)

・If the same level of disclosure as public offering is uniformly required, the balance between investors’ benefits and costs may be harmed depending on transactions (and ultimately, may lead to a decline in investor return). Further, it could adversely affect agile structuring of securitisations at the appropriate timing.

・With provision of information through term-sheets and draft contracts, in addition to data provided pursuant to A1 to A6, professional investors would be able to make investment decisions.

・On the other hand, securitisations structured for specific investors may involve provision of more detailed data than what is prepared for public offering.

○D15: Credit risk of underlying exposures

(Request, etc.)

・This issue should be revisited after the RW of mortgage loans is finalised under the ongoing revisions to the Standardised Approach for credit risk (second consultation).

・While it is mentioned that “Careful consideration is needed on whether the risk weight requirement should be applied on individual exposures or on a portfolio-weighted average basis”, the latter would be appropriate for the U.S. CLOs. (Under U.S. CLOs, CCC-rated receivables are generally permitted to be included up to approximately 7-8%. Therefore, although there are individual assets with lower ratings, a stable asset distribution is ensured as a whole on average.)

・As for residential mortgage loans, it is requested that a RW equal to or smaller than 75% will be assigned to such loans, similarly to retail exposures.

(Basis, etc.)

・The second consultative document of the revisions to the Standardised Approach for credit risk provides for a mechanism that determines the RW of residential mortgage loans based on the LTV ratio (i.e. a RW of 55% will be applied in the case of LTV exceeding 90% and 100% or below). The LTV ratio of most residential mortgage loans in Japan exceeds 90%, and thus a RW of 55% is likely to be assigned. On the other hand, the repayment rate of residential mortgage loans in Japan is high and their risk as an underlying asset of securitisations is low. In this view, such securitisations should not be excluded uniformly based on such a requirement.

○D16: Granularity of the pool

(Request, etc.)

・The rationale for the granularity of 1% is unclear and its reasonableness needs to be assessed.

・Under the condition that granularity is ensured as a whole, the granularity of individual exposures should be permitted up to approximately 5% if there is only a small number of obligors to which exposures exceed the concentration limit.

・If the objective is to ensure the appropriateness for employing statistical approaches, it is more reasonable to add such a requirement as: “the number of receivables included in the underlying asset is 100 or more”.

(Basis, etc.)

・Risks of securitisation products can be sufficiently captured by other requirements.

・The appropriateness of the granularity of 1% needs to be assessed given that the concentration requirement for representative asset classes of U.S. CLOs are set at the level of 2 to 2.5% in some cases and that there are cases where the granularity exceeds 1% in the U.S. ABS market.

・If the granularity threshold of 1% is applied, securitisations that qualify as STC will be limited mainly to securitisation products of the retail pool. To expand the scope of eligible products to include those low-risk securitisation products (e.g. accounts receivable and corporate loans), the maximum granularity threshold should be set at a higher level.

・In securitisations, measures addressing the default risk of large-value obligors are usually taken, such as increasing the amount of credit enhancement as the concentration rate increases. In this view, when setting the maximum granularity, the proportion of credit enhancement should be taken into account.

・It would be unreasonable to apply the same granularity requirement to both retail

exposures that are measured by taking statistic approaches (top-down approach) and non-retail exposures whose credit analysis is performed in detail at the level of individual loans (bottom-up approach).

○D17: Relationship between the originator and the servicer of the securitised assets

(Request, etc.)

・A description requiring the originator and the servicer of the securitised assets to be the same legal entity should be deleted.

(Basis, etc.)

・Risks of securitisation products can be sufficiently captured by other requirements.

・Requiring the originator and the servicer of the securitised assets to be the same legal entity overlaps with “C13. Fiduciary and contractual responsibilities”.

・If it is determined that this “same legal entity” requirement will be imposed, the BCBS should at least provide for an exemption to allow a (third-party) servicer licensed under the law on the servicer license in jurisdictions like Japan where a legal system grants servicer license pursuant to such a law. Those servicers licensed in accordance with such a system (if necessary, requirement that the law strictly prohibits the servicer from concurrently engaging in another business can be added) are expected to have the same, or higher, level of incentives for maintaining and enhancing recovery performance relative to the originator.