March 20, 2014

Comments on the Basel Committee on Banking Supervision's Second Consultative Document: Revisions to the securitisation framework

Japanese Bankers Association

We, the Japanese Bankers Association (JBA), would like to express our gratitude for this opportunity to comment on the second consultative document: Revisions to the securitisation framework, released on December 19, 2013 by the Basel Committee on Banking Supervision (the "BCBS").

We hope that our comments below will be of assistance and offer an additional point of reference as you work towards finalising the framework.

General Comment

1. We support the revised hierarchy proposed by BCBS.

We support the hierarchy of approaches proposed in the Consultative Document in that (a) it reflects the concept of Alternative A, which we supported in reaction to the first consultative document, and (b) it places the Internal Ratings-Based Approach (IRBA), which is more risk sensitive, at the top of the hierarchy.

Nonetheless, some issues need further consideration and clarification, as discussed below.

2. The risk-weight floor of short-term securitisations should be reduced to 7%.

Historical performance[1] has proved that those asset-backed commercial paper (ABCP) and asset-backed lending (ABL) programmes, under which the maturity of both the underlying assets (primarily, account receivables) and tranches is one year or less, are highly likely to be redeemed even during periods of recession in Japan and globally.

Under these programmes, the creditworthiness of underlying pools can be maintained at an acceptable level and the possibility of senior tranches' redemption can be increased, because:

(a) these programmes are structured to provide dynamic credit enhancement[2],

(b) the fund-raising company is at all times capable of obtaining information about creditworthiness of their customers (from whom the company's account receivables are due), and

[1] See section 1 of "Supplementary Comments" for specific examples.

[2] A mechanism to adjust the subordination level according to changes in the pool's probability of default for the purpose of stabilising the cash flows of, in particular, senior tranches.

(c) the maturity of individual receivables is very short.

BCBS is respectfully requested to take into account the above facts and maintain the current 7% risk-weight floor, instead of applying the proposed 15% risk-weight floor, to the aforementioned programmes and other transactions where the maturity of both the underlying assets and tranches is one year or less.

The following benefits are expected if the floor is maintained at 7%.

(a) As risk of funds will be captured in a more risk-sensitive way, the price discovery function of markets can be maintained.

(b) The fund-raising company's essential funding tools for working capital can be retained and ensured.

On the other hand, if the floor is increased to 15%, risk would not be reflected at all in senior securitised exposures even in the situation where PD falls on a general level for a wholesale underlying asset (i.e. PD<4%) as indicated later in this letter,[3] and thus banks' regulatory capital cost could increase. We are strongly concerned that this may undermine the funding company's funding activities.

3. A sufficient preparation period should be provided for implementation.

If BCBS intends to publish the final standard without the grandfathering provisions as indicated in the Consultative Document, it should provide a sufficient preparation period for implementation. IRB banks will be obliged to establish procedures of relevant risk quantification. In addition, capital requirement of some securitisation exposures is expected to drastically increase from that of the current framework and, even in such circumstances, banks will need to retain the business relationship with customers. Furthermore, banks will also be required to adapt portfolios for the final standard in terms of their capital adequacy. Banks will consequently need sufficient time to address these issues. Specifically, from the viewpoint of the risk quantification, the period necessary for the estimation of IRBA parameters (i.e. five years) should be a factor determining the "sufficient preparation period," because banks applying the internal ratings-based approach (IRB) will basically consider applying IRBA to those securtisations to which the External Ratings-Based Approach (ERBA) is currently applied.

[3] See section 2(1) of "Supplementary Comments" for details.

Specific Comments

1. The level of the parameter "p" of the IRBA and sensitivity of its input "Mt"

(1) Sensitivity of maturity for retail transactions should be properly calibrated.

Based on the hypothetical calculation shown in sections 2(1)① and 2(2)① of "Supplementary Comments," there is a significant difference in the level of risk weights between tranches' maturities, particularly when the underlying assets are retail. Specifically, within the range of our analysis, the risk weight difference between one-year maturity and five-year maturity resulted in the maximum of a 110% difference. This difference significantly exceeds the difference of risk weights between investment grades (i.e. 50%) in the ERBA.

Furthermore, section 2(3) of "Supplementary Comments" compares the difference of sensitivity of maturity to risk weights for underlying wholesale and retail exposures. As a result, a cliff effect is observed in the case of retail exposures.

Given the above results, it is possible that more conservative risk weight than under the ERBA may be required in the case of long-term securitisations with retail underlying assets.

Therefore, considering the results of the quantitative impact study (QIS), BCBS is requested to calibrate the coefficient of "Mt" to calculate the parameter "p" for underlying retail exposures in a way that the level of conservatism among approaches will not be reversed or that cliff effects do not arise.

(2) The level of the "p" parameter

We would like to provide the following two comments with regard to the level of the "p" parameters.

(a) As shown in sections 2(1)③ and 2(2)③ of "Supplementary Comments," "p" approximates to the floor of 0.3 and hardly show risk sensitivity to the underlying asset's PD in the case of one-year maturity. If the QIS actual data also support the conclusion that "p" is not risk sensitive, the p-parameter floor should be reduced based on the principle of risk sensitivity (described at the bottom of page 3 of the Consultative Document). If this p-parameter floor is supposed to be introduced as a backstop to address some kind of risk (e.g. model risk); the risk should be identified specifically first, and then the basis for the floor level of the p-parameter should be clarified.

(b) As shown in section 2(2)④ of "Supplementary Comments," in some cases, the value of "p" under the IRBA exceeds the value of "p" under the Standardised Approach (SA; a revision of the Simplified Supervisory Formula Approach (SSFA)) (i.e. p=1), which is subordinate to the IRBA in the hierarchy of approaches. The "p" should be capped at 1, at a minimum, in order to ensure a mechanism of incentivising banks to apply the more sophisticated approach similarly to the preceding paragraph (1) in our specific comments.

2. The definition of maturity should be reviewed to reflect securitisation practices and an actual economic substance.

According to the Consultative Document[4], if "unconditional contractual payment dates" are not available, the "final legal maturity" shall be used. As the definition of such unconditional contractual payment dates is unclearly expressed, this may result in a conservative approach in contrast to actual contract practices. To address this issue, BCBS is requested to clarify the following points.

(1) JBA would like BCBS to clarify that the WAM (weighted-average maturity) of the original contractual cash flows of the underlying assets can be used as long as this is a conservative approach.

For example, in the case where the bank, as an investor, holds senior tranches (pass-through redemption), the bank and the securitisation vehicle does not specify in advance in the contract with regard to individual CFt arising from the vehicle. Even, the "unconditional contractual payment dates" are not explicitly defined in the contract. If the use of the WAM of the original contractual cash flows of the underlying assets, which is matched to each tranche, is permitted, it is possible to assign the longest possible maturity, while eliminating the banks' estimations such as an expected maturity under the assumption of prepayments of the underlying assets. At least, for senior tranches which do not incorporate turbo redemption provisions [5] for subordinated tranches, we respectfully request WAM of the original contractual cash flows of the underlying assets at the time of calculation, which is reasonably conservative, should be allowed.

(2) For the replenishing (revolving) transactions such as ABCP/ABL programmes, the proposed maturity is very conservative. Given that these transactions are structured so that investors are protected against a significant deterioration in the quality of the future underlying assets which will be transferred to the bank in the future, we request to clarify that the regulatory maturity should be set as the "commitment period" + "the WAM of the original contractual cash flows of the existing[6] underlying assets" could be

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[4] Extracted from paragraph 23 on page 25 of the Consultative Document:
"For a securitisation exposure residing in a tranche subject to a determined cash flow schedule, tranche maturity (M_T) is defined as:

$$M_T = \sum_t t \cdot CF_t \Big/ \sum_t CF_t,$$

where CFt denotes the cash flows (principal, interest payments and fees) contractually payable by the borrower in period t. The contractual payments must be unconditional and must not be dependent on the actual performance of the securitised assets. If such unconditional contractual payment dates are not available, the final legal maturity shall be used."

[5] A mechanism to change to the waterfall whereby, upon a certain condition is met, distribution of dividends to investors in subordinated tranches is suspended and dividend/principal payments to investors in senior tranches are accelerated.

[6] "Existing" here means existence on a reporting date, not on a last day of commitment period.

used as the maturity.

Here, a case where the bank, as a sponsor, substantially holds the senior tranche of the replenishing ABCP/ABL programmes is illustrated. The maturity of the replenishing period is dependent on the underlying assets added during this period. If this scheme is structured so that investors are protected against a significant deterioration in the quality of underlying assets replenished to the bank (or the vehicle) in the future (for example, setting clauses related to qualified receivables, covenant and early redemption), the homogeneity is ensured between existing underlying assets and future underlying assets. Under such conditions, the "remaining term of the committed replenishment" + "the WAM of the original contractual cash flows of the existing underlying assets" is highly likely in the practice. Therefore, we propose that this reasonable maturity concept should be included as one of the definition of the maturity in paragraph 23 of the Consultative Document.

(3) **Setting the maturity based on the performance of calls should be allowed.**

A considerable difference may exist between the final legal maturity (i.e. 30 years) and the call period (i.e. an expected holding period, which is individually calculated) in the case of RMBS tranches with a call provision seen in jurisdictions such as the U.K.. Taking into account business practices prevailing in some jurisdictions where redemptions are executed at the initial call date, it is also requested that not the legal maturity date but the initial call date is allowed to be used as maturity under the condition that the historical performance of redemptions is confirmed.

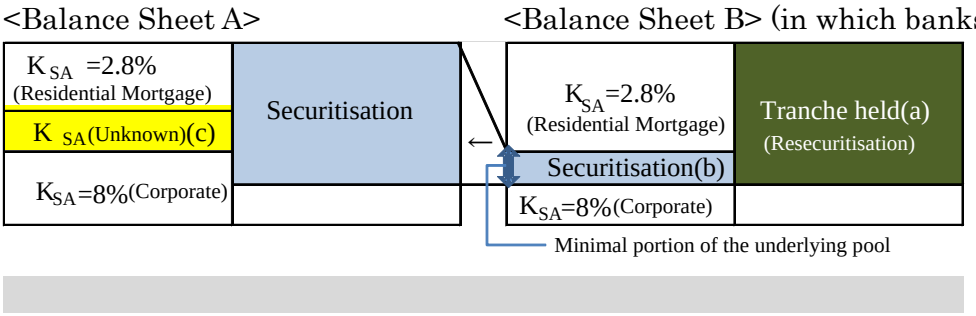
3. Other issues

(1) **JBA would ask for further clarification on due diligence requirements for resecuritisations.**

When the percentage of the underlying securitisations (denoted (b) in the diagram below) within the entire underlying pool of resecuritisations (denoted (a)) is limited and it cannot obtain necessary information (e.g. K_{SA}) within the reporting timeline of capital requirements due to practical constraints, the risk weight of 1,250% should be applicable only to (b), or only unknown portions denoted as (c). JBA would like BCBS to clarify this point.

Securitisations including other securitisations, albeit the amount is de-minimis, are defined as resecuritisations for regulatory purposes. Banks holding resecuritisation exposures need to obtain K_{SA} for all the portion of the underlying securitisation for regulatory purposes. In some cases, however, banks are not fully able to obtain accurate K_{SA} information within the reporting timeline in practice (referred to as "K_{SA} (Unknown)" as (c)). If the due diligence requirements set out in page 28 of the Consultative Document are strictly applied to this case, the risk weight of 1,250% would be applied to (a). This treatment is however deemed to be extremely conservative relative to actual risk if the (b) accounts for only a limited portion of the underlying pool

or K_{SA} information is available for most part of underlying assets. In addition, requiring 1,250% risk weight to (a) may undermine incentives for banks to understand risk characteristics of the underlying assets. Therefore, from the perspective of enhancement in the risk management, it is respectfully requested to clarify the issue discussed above.



(2) The use of an inferred rating derived from pari-passu tranches should be allowed.

The use of an inferred rating derived from pari-passu tranches, which was mentioned in note 22[7] on page 12 of the first consultative document, should be incorporated in the final rules. While the Consultative Document does not provide any specific discussion on this matter, the use of an inferred rating for pari-passu tranches should be allowed unless there is a change in the basic concept. Nonetheless, different ratings between pari-passu tranches may arise resulting from a difference in maturity, as described in the Consultative Documents for the definition of "Senior"[8]. Given this, it is considered as reasonable to allow the use of an inferred rating for pari-passu tranches when, and only when, the rating of a tranche refers to the rating of another tranche that ranks pari-passu (reference tranche) and the maturity of the tranche held is equivalent to or shorter than the maturity of another referred tranche.

(3) The definition of the "W" parameter under the SA (Standardised Approach) should be expanded.

The Consultative Document defines the W factor as the ratio of the sum of the nominal amount of underlying exposures that are 90 days or more past due. Preferably, it should be amended to conservatively reflect those underlying exposures that are less than 90 days past due, such as exposures that are 30 days past due. This amendment would ensure that the securitisation framework is better aligned with banking practices, while maintaining conservatism.

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[7] Extracted from note 22 on page 12 of the first consultative document:
"For example, this requirement could be met with an eligible rating to a tranche, and an inferred rating derived from another eligible rating to another tranche that ranks junior or pari-passu."

[8] Extracted from paragraph 18(b) on page 24 of the Consultative Document:
"Also, when the different ratings of several senior tranches only result from a difference in maturity, all of these tranches should be treated as a senior tranche."

Comments to Questions

Question 1: BCBS seeks input as to whether the proposed treatment of derivatives other than credit derivatives achieves an appropriate balance between risk sensitivity and simplicity; and welcomes respondents' views on how to improve upon the proposed treatment.

We support BCBS's proposal in this respect and do not see any particular areas for improvement on the proposed treatment.

However, the proposed rules text in Annex I (paragraph 18) should be amended to explicitly state what is proposed in page 7 of the Consultative Document with regard to assigning risk weights to derivatives. Specifically, as indicated in page 7, the proposed rules should specify that the risk weight assigned to the tranche, which is the most senior as a result of not taking into account the seniority in the waterfall of a derivative contract, is assigned to the counterparty credit risk calculation of the derivative contract.

Question 2: While the formulation of the Internal Ratings-Based Approach is much simpler than the MSFA, BCBS recognises that there may be opportunities to make further simplifications by, for example, eliminating one or more of the four variables proposed to calculate "p," while achieving a degree of risk sensitivity similar to that of the MSFA. BCBS is interested in respondents' views on ways to simplify the parameterisation of "p".

Since the basis of selecting the four variables is not disclosed, it is difficult to discuss whether one or more of the four variables could/should be eliminated in order to simplify the parameterisation of "p." If, after scrutinising the QIS results, such four variables are still re-recognised as meaningful, presumably they need not be eliminated.

Question 3: If respondents favoured a pro rata calculation of the maximum capital requirement, BCBS would welcome arguments that justify that a pro rata cap would result in appropriately conservative capital requirements.

We support BCBS's proposal as we do not identify any particular case where the proposed pro rata cap is considered as a problem.

Supplementary Comments

1. Example of a member bank

(1) Japan

In Japan, a member bank engages in securitisation of its receivables from customers in the number and amounts as shown below. No default in such securitisations had occurred in the period specified below, which includes the year 2008 when the market was affected by the Lehman Crash. This proves the high performance of this scheme relative to the historical default of those loans issued directly to corporate customers.

No. of transactions	Amount (bil USD)
10,044	263

Period: 1/1/2008-12/31/2012 (5 years)
Exchange rate: 102.86 JPY/USD (1/31/2013)

(2) Overseas

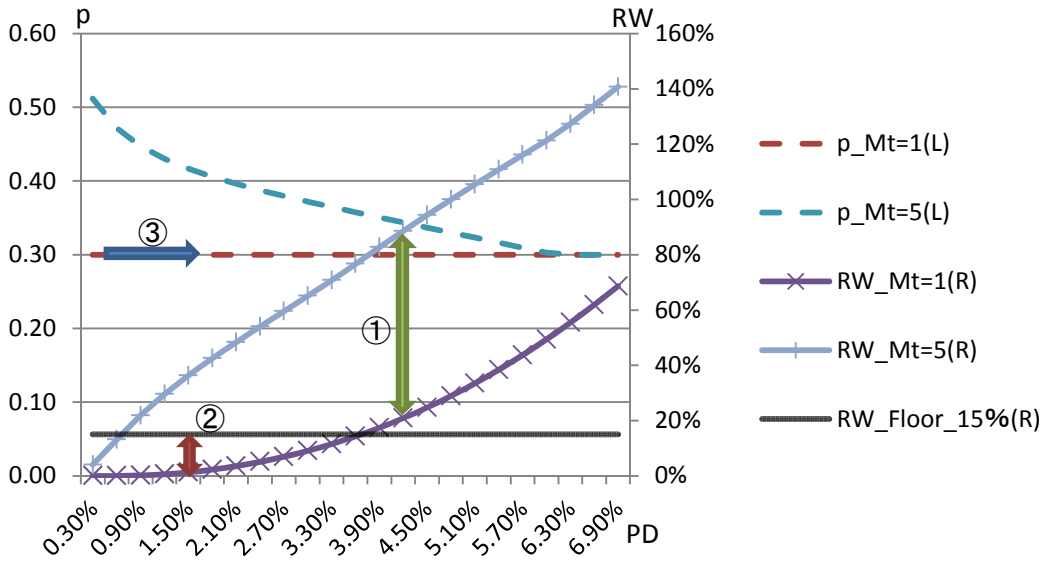
In overseas markets, ABCPs backed by receivables from customers have been issued since 2007, including the year of the Lehman Crash. Similarly to cases in Japan, there has been no default on a securitisation facility basis.

2. Analysis on the sensitivity of the IRBA parameters (Senior)

This section provides a brief analysis of changes in capital charges (RW) for securitisation senior exposures according to changes in the quality (PD) of the underlying assets ((1) wholesale assets case and (2) retail assets case) under highly probable assumptions. This is based on hypothetical calculations under the assumptions stipulated below. In each chart, the horizontal axis denotes PD of the underlying assets whereas the vertical axis on the right side denotes RW for securitisation senior exposures (solid line (R)) and the vertical axis on the left side denotes the parameter "p" of the IRBA (dotted line (L)). (One-year and five-year maturities are assumed.)

In addition, it is assumed that the underlying pool is tranched into only senior and equity.

(1) Where underlying assets are wholesale assets (A=15%, D=100%, LGD=45%, N=100, before taking into account scaling factors)



① Difference of RW between one-year and five-year maturities

Maximum difference of 72% (In the ERBA, the maximum difference arising between investment grades is 50%.)

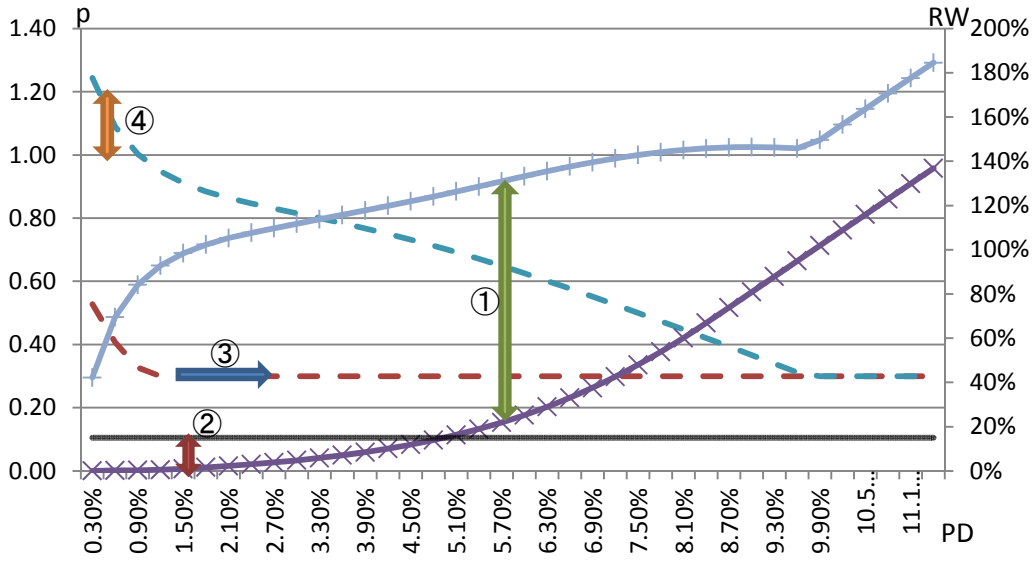
② Range lower than the RW floor

An average PD of the underlying assets in the 3% range is a standard level of PD for the underlying pool for normal borrowers. However, the risk sensitiveness within this range is completely lost.

③ Movement of "p" in the case of one-year maturity

The "p" parameter is not sensitive to the quality of the underlying assets.

(2) Where the underlying assets are retail assets (The same assumptions as (1) are applied except for the function of RW and LGD=75%)



① Difference of RW between one-year and five-year maturities

Maximum difference of 110% (In the ERBA, the maximum difference arising between investment grades is 50%.)

Compared to the wholesale asset case (1), the sensitivity to Mt is high and the difference extremely exceeds the maturity difference in the ERBA (50%).

② Range lower than the RW floor (Same as in the case of (1).)

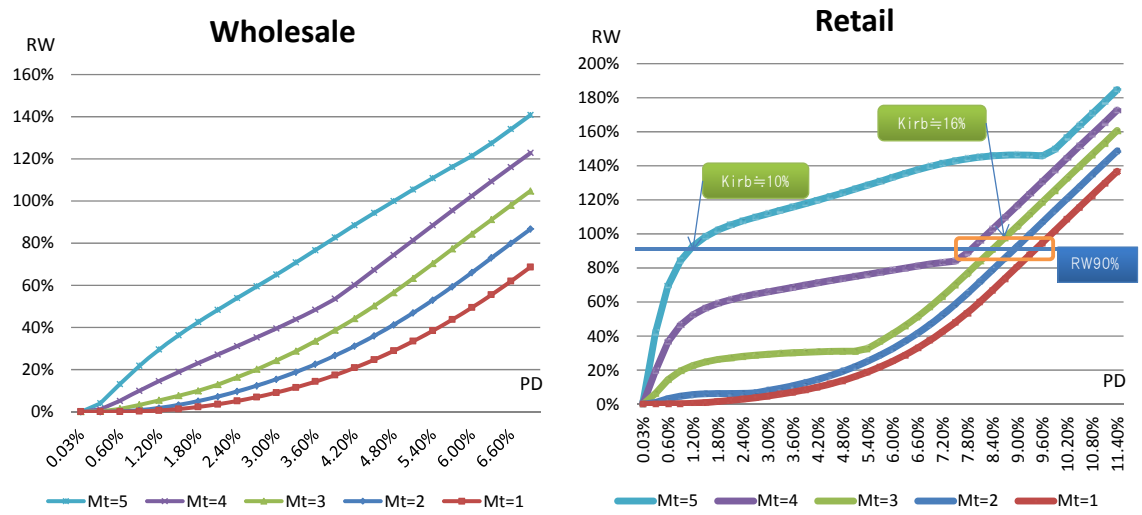
③ Movement of "p" in the case of one-year maturity

Except for the range of low PD (= low K_{IRB}), the "p" parameter is not sensitive to the quality of the underlying assets as in the case of (1).

④ Range exceeding p=1

In the case of low PD (= low K_{IRB}), which is deemed as a high-quality asset, the "p" parameter exceeds p=1 to a considerable extent. At least, the cap of "p" (the vertical axis on the left side) should be set equal to 1, similarly to the assumption used under the SA.

(3) Sensitivity of maturity in the case of underlying wholesale and retail exposures (The same assumptions as in (1) and (2) are applied.)



The sensitivtiy of maturity in the case of retail exposures is very high. For example, as shown in the above chart on the right, banks may apply the risk weight of 90% even to securitisations of those underlying pools with relatively large differnce of capital charge (Kirb), though the gap in maturity is minimal. In this case, a cliff effect occurs in between four-year and five-year maturity.