



**International  
Banking Federation**

**ISDA**

International Swaps and  
Derivatives Association, Inc.

**LIBA**

LONDON INVESTMENT  
BANKING  
ASSOCIATION



**Piners Hall**

105-108 Old Broad Street  
London EC2N 1EX

**tel:** + 44 (0)20 7216 8947

**fax:** + 44 (2)20 7216 8928

**web:** [www.ibfed.org](http://www.ibfed.org)

**Joint trade associations' response to CP 150**

*Proposed enhancements to the Basel II framework*

**Pillar 1**

## **Introduction**

We share the goal of the Basel Committee on Banking Supervision (BCBS) of restoring market confidence, and acknowledge the need to revisit the capital framework of the Accord to ensure that it requires appropriate capital to be allocated to risks. We welcome the targeted approach that the BCBS is taking in revising those areas where issues have been identified rather than a more general revision of the Pillar 1 framework. In particular we accept the need to review the risk weights in respect of re-securitisation; the approach to liquidity facilities; and enhancing the requirements in respect of due diligence.

## **Key messages**

### **Re-securitisation**

We agree that recent events have shown up the deficiencies in the ratings of some structured transactions, such as CDO<sup>1</sup> of ABS or CDO<sup>2</sup>, where double or higher leverage is introduced through multiple tranching sequences that significantly increase the correlation and default risk and where credit analysis of the resulting securitisation position is based on the package of pooled securitisation risk rather than exposure by exposure analysis. We therefore concur that it is appropriate to revisit the capital requirements in this area, and the due diligence requirements more generally. However, we believe that the definition of re-securitisation will cover a number of transaction types that we believe should not be captured. In particular we are concerned about the impact on ABCP conduits that are used to finance activities in the economy more generally; and, certain restructuring transactions that have been endorsed by regulators as part of the effort to address the current problems. Furthermore we think that the definition of re-securitisation needs to include a concept of materiality to address legacy transactions and would recommend a threshold of 5 to 10%, i.e. those transactions where the nominal amount of securitisations comprises less than the materiality percentage of the total nominal of the pool would not receive the re-securitisation treatment. Such an approach will virtually eliminate additional leverage, while still providing flexibility for existing transactions which contain minor amounts of securitisation exposures.

We would also like to understand the basis on which the proposed re-securitisation charges have been calibrated. Since the rating agencies have substantially strengthened their approaches to re-securitisation we are concerned about potential double counting of the risk if the weightings have been based on historic rating information.

### **Impact assessment**

We appreciate the BCBS' commissioning of an impact assessment on the trading book capital charges. Given the substantive nature of the changes in this consultation, we recommend that the QIS be extended to the banking book as well.

### **Investor due diligence and penalty**

We support the BCBS' goal of improving due diligence and reducing investors' reliance on ratings. However, we are concerned by the likely impact the associated 1250% risk weight/deduction from capital penalty will have on the prospects for recovery of the securitisation market. Although we appreciate that 'appropriateness' language is included in relation to the information that investors should seek to acquire, because of the risk that regulators might impose the capital deduction, it is unlikely that senior management in banks allow investment in this asset class going forward and will likely seek to divest existing positions. Securitisation has been an increasingly important source of funding for the 'broader economy'<sup>2</sup>, for both the retail and corporate sector, and we think

---

<sup>1</sup> Collateralised debt obligation

<sup>2</sup> i.e. transactions where funding is directly provided to global businesses or consumers

that well managed securitisation should not be discouraged in light of the benefits noted by the Financial Stability Forum (FSF) of this form of financing.

We recommend that the test as to whether the requirements are met should be made by reference to factors that are in the investing bank's control, i.e. the investor should only face the penalty capital charge if it has failed by negligent act or omission to carry out due diligence appropriate to its trading or non-trading book and commensurate with its risks. In addition the penalty should be set at a more proportionate level; we suggest 150% of the capital charge that would have applied had the provision been met (capped at 1250%). In relation to existing positions held we strongly recommend the inclusion of a grandfathering provision to allow issuers time to obtain information that has not previously been collected or provided for in the transaction documentation and for investors to change systems to capture and monitor it.

### **Implementation timetable and transitional period**

We strongly agree that enhancements should be implemented to improve market confidence, but it is important, as the BCBS recognises, to be mindful of imposing additional capital requirements and systems changes during this period of economic stress. We recommend that the implementation date be deferred until 31 December 2010. We also recommend that there be a transitional period for certain aspects of the proposals for existing transactions; including, in particular, the investor due diligence requirements noted above. For those we would recommend an implementation date of the end of 2014. This suggested approach would provide a realistic timetable for both firms and regulators, would be consistent with the timetable proposed in the EU for those elements of the proposal that are already in train in the Capital Requirements Directive (CRD).

### **Comments on specific aspects of the proposals**

#### **Re-securitisation under the IRB**

##### *Definition*

We understand the aim of the BCBS in developing a simple and objective rule for determining a definition of re-securitisation. However, we think that the proposed definition of re-securitisation may have disproportionate consequences for some types of existing transactions that would otherwise provide a significant source of much-needed credit to the 'broader economy'. In Europe, over 90% of securitisations are 'broader economy' securitisations, with over EUR 800 billion of funding provided in 2006 and 2007. Money market funds which invest in high quality asset-backed-commercial paper (ABCP) are an important source of floating rate funding. Applying the re-securitisation approach to these transactions is likely to have a significant negative impact on the currently fragile market and increase pressure on firms' balance sheets because the estimated capital consequences will be priced in by the market in advance of the implementation of the proposals. The transactions where we believe the definition is likely to cause problems and where we believe that specific clarification as to their status is required are:

- Multi-seller ABCP conduits
- Restructurings of single transactions
- Regulatory approved restructurings

*Multi-seller ABCP conduits* – The FSF identified that the problems in the ABCP conduit/Structured Investment Vehicles (SIVs) sector of the market primarily resulted from investments in CDO of ABS, CDO<sup>2</sup> or similar highly leveraged securitisation positions and an absence of liquidity, which had a consequential impact on valuation. We agree, based on recent experience, that conduits that purchase CDO of ABS, CDO<sup>2</sup> or similar highly leveraged positions should be subject to higher risk management expectations, whether through capital (subject to our comments on the need to

avoid double counting in the risk weights), or other risk management tools, commensurate with their risk profile. Members are of the view that all types of conduits are likely to be caught by the proposed re-securitisation definition (including those that do not have the investments mentioned above). Conduits will be caught because on the asset side some the types of exposures they acquire may be regarded as securitisation exposures; and on the liability side they generally include, as well as the commercial paper and liquidity facilities (designed to replace commercial paper funding if needed), a small amount of programme-wide credit enhancement<sup>3</sup>. Conduits are different from SIVs, many of which have widely acknowledged weaknesses. We recommend that the BCBS further review of the position of conduits within the re-securitisation definition going forward in light of experience of the implementation of the enhanced investor due diligence requirements. For the immediate future, it is imperative that conventional multi-seller conduits are not captured.

Multi-seller conduits are a significant source of funding for receivables in the 'broader economy'. At end of December 2008, \$252.2bn<sup>4</sup> of EU sponsored ABCP was outstanding. These traditional multi seller conduits enable access to the capital markets at reasonable cost for a range of business including SME and larger corporate trade receivables, SME commercial loans, car loans and equipment leases. Given the desire of politicians and policy makers to find ways of increasing lending to businesses and consumers, we think it is important that the BCBS does not discourage this sector of the market at this time and that it recognise the funding benefits it can provide going forward. The increasing risk weight will increase the cost of funding through this route and will therefore impact businesses.

However, we recognise that a distinction between multi-seller and other types of conduits would need to be drawn objectively and take account of the issues identified in relation to the more complex structures. We think the factors that would distinguish multi-seller conduits are as follows:

- A single class of commercial paper is issued by the conduit (i.e. although commercial paper will have different issue dates, maturity dates, interest or discount rates, there is no credit risk tranching).
- The sponsor (or sponsoring syndicate) individually negotiates the content of the pool and the consideration directly with the seller.
- The liquidity facilities of the conduit, in aggregate, cover at least 100% of the ABCP outstanding.

We would therefore recommend that exposures to conduits meeting the above criteria would be treated as normal securitisation positions.

*Restructuring of single transactions* – As a result of recent market events firms are in the process of restructuring certain transactions. This typically takes the form of repackaging an existing note (or contiguous notes from the same transaction) in a vehicle and re-tranching the risk<sup>5</sup>. These transactions do not introduce new correlation or leverage risks and such restructuring has been approved by (and even encouraged by some) regulators to ensure that risks are crystallised early. This re-tranching provides liquidity by re-offering the original securitised positions in tranches that are of interest to new investors. However, it would appear that such transactions would fall within the proposed definition of re-securitisation. Since the re-tranching relates to a single pool of assets it is economically the same as unwinding the original transaction and creating the new one, or as though the transaction had been tranching at different levels at inception. Given the desire of policy makers that banks clean up their balance sheets, and the fact that the economic substance of the original securitisation is retained, we think that is essential that such transactions are scoped out of the proposed definition of re-securitisation.

---

<sup>3</sup> Generally 5-10%

<sup>4</sup> 70.2% of the \$252.2 bn was issued in dollars, 23.9% in Euro

<sup>5</sup> For example, issuing a transaction with 2 tranches ([0-3] and [3-100]) and then re-tranching the [3-100] tranche into 2 tranches (for example [3-7] and [7-100]) is not different from directly issuing a CDO with 3 tranches ([0-3], [3-7] and [7-100]).

*Regulatory approved restructurings* – As well as restructuring single transactions, firms have also undertaken restructurings that contain tranches from more than one transaction. These transactions similarly result in new securities but are based on a pool of existing securitisation positions. These transactions are typically comprised of assets from the same sector (e.g. US prime mortgages) and therefore they are distinct from CDO of ABS because little benefit is available from correlation, i.e. in re-structuring they are taken as the sum of the parts. Such restructurings have also been discussed extensively with, and approved by, regulators; some of whom have encouraged their use to address risks and deteriorating asset quality by reducing the risk of fluctuating credit quality on toxic assets. We therefore think that there should be supervisory discretion to exclude these transactions from the ‘re-securitisation’ category, where the regulator has approved the given structure, and risk-weight them according to the normal securitisation risk weights, so as to not undermine the regulatory-endorsed efforts to address the current problems. At the very least we think a grandfathering provision, which provides for existing regulatory approved transactions to be treated under the normal securitisation framework, should be included.

In addition, in relation to ABCP conduits, we would also like to confirm whether our understanding is correct in relation to liquidity facilities that are provided on a pool-specific rather than conduit-wide basis. We believe that the re-securitisation risk weights would not apply to those liquidity facilities in the transaction which relate to pools which contain no re-securitisation positions even if there are re-securitisation positions within other pools. The ramifications for a firm using the Internal Assessment Approach, with a liquidity facility on a pool that contains securitisation exposures, are also unclear.

Furthermore, we believe that it is extremely important to include a materiality threshold (higher than a single securitisation position) in the definition to address operational issues around existing transactions. Many existing transactions, for example CLOs<sup>6</sup>, contain provisions in their documentation to hold a small (typically 5%) holding of assets that would bring them within the proposed definition of re-securitisation. As a result the effect of the proposals is likely to be significant and underlines the need to conduct an impact assessment on the banking book as well as the trading book. We recommend that re-securitisation be defined as transactions where the securitisation position(s) percentage of total nominal value of the transaction is greater than 5 to 10%. The risk weighting approach could be modified accordingly to take account of the materiality threshold (see page 5/6 below). Such an approach would be more proportionate and with modifications to the capital treatment, still address the concerns identified in relation to recent market events.

The proposal also distinguishes between senior and non-senior positions for the purposes of applying the risk weights. We assume, although it is not clear, that senior refers to the position that would meet the definition in paragraph 613.

### *Risk weights*

It is difficult to comment on the appropriateness of the distribution of the new risk weights without an understanding of how they were calibrated. We are concerned that if the revised weightings have been derived on the basis of historic rating data they will overstate the amount of capital needed to address re-securitisation risks. As the BCBS will no doubt be aware, the rating agencies have been systematically reviewing their approaches to the rating of re-securitisations and are changing their assumptions and models. As a result, the rating criteria are becoming more conservative and downgrades are resulting from the application of the revised rating approaches. Since many transactions include a provision to hold a small percentage of securitisation positions, for example CLOs, this will mean that positions in such transactions will be captured by the re-securitisation risk weightings, which may be an unintended consequence of the definition<sup>7</sup>. We are

---

<sup>6</sup> Collateralised loan obligation

<sup>7</sup> Depending on how the definition is interpreted some conventional master trust structures may also be captured.

concerned that there will therefore be double counting of the risk in the revised risk weights<sup>8</sup>. If this is the case, then we are concerned that this will result in more fragility in the market and pressure on capital ratios as further losses are recorded.

As a result we think that it is imperative that an impact assessment is undertaken on these proposals, as part of the assessment of the market risk changes, to ensure that the risk weights remain both risk based and proportionate. Given the current fragility of the market it is important that unintended consequences are identified and addressed. We therefore believe that, depending on the outcome of the impact analysis, grandfathering should be given serious consideration.

We note the proposal that the floor on the Supervisory Formula Approach (SFA) for re-securitisations will be the lowest risk weight available under that approach. We agree with this principle.

As regards our proposal to revise the definition of re-securitisation, we think that possible concerns that the treatment is not prudent enough could be addressed by applying the re-securitisation risk weight to a portion of the position, either on the basis of the actual percentage of re-securitisation exposures within the pool or the threshold percentage. Such an approach would be more risk-based and mitigate disproportionate impacts on existing transactions.

We also note the proposed treatment of re-securitisation positions in the trading book. Our response to that proposal is included within our response to BCBS 148 and 149.

### **Self Guarantees**

We are very concerned about the possible implications that the changes that are proposed to paragraph 565 will have for certain transactions and think that the language (with the exception of that relating to overlapping positions) should be removed and replaced with the suggestion below to amend paragraph 581.

It would appear that the BCBS is concerned, as a result of recent events, that firms with liquidity facilities to a conduit may have taken a lower capital charge as a result of holding the commercial paper rather than drawing the liquidity facility because the rating of the commercial paper will take account of the liquidity facility and any other credit support provided by the firm. If our understanding is correct, we think that an easier way to address the issue would be to amend paragraph 581 to ensure that the firm takes the higher capital charge/risk weighted exposure amount rather than just the higher conversion factor when applying the requirements to overlapping positions. Since the treatment of the liquidity facility or other credit support depend entirely on the risk of the underlying assets the issue of self-guarantee would not arise. In such a circumstance a 100% conversion factor could be applied to the overlapping portion of any liquidity facility, if it was not being applied already. Since 581 is applicable to all types of transaction we think that this approach would work equally well for term transactions. If our understanding of the concern being addressed is incorrect, we would appreciate a further explanation.

As regards paragraph 565, it is likely that the capital requirement that will result from the inability of a firm to recognise a rating will be deduction of the position. This cliff effect in the capital charge is disproportionate and without an impact assessment the implications for existing transactions is unknown. For example, we think that the proposal will capture positions in term transactions where a small senior liquidity facility is provided to a third party transaction, for the purpose of addressing timing differences on the underlying assets. In this situation the RBA or an inferred rating will not be available, nor will the IAA on the facility (as it is not to an ABCP conduit) and without the ability to calculate  $K_{irb}$ , supervisory approval for the SFA will also be unavailable. In the

---

<sup>8</sup> For example if a senior granular securitisation position is downgraded from AAA to A- the risk weight would increase from 7 to 20%. If it is deemed to be a senior re-securitisation position the risk weight will increase to 60% and to 100% if it is deemed to be junior.

absence of the SFA, the implications of the proposal for a holding in an 'AAA' note would be to increase capital required by a multiple in excess of 60 (assuming the non-granular risk weights are used) and in excess of 150 if the granular risk weights are used. In addition any interest rate or currency swaps, and the liquidity facility itself provided to the vehicle would also likely be deducted. Such an increase would overstate the level of capital held for the risk being taken. While we appreciate that for new transactions it would be possible for other parties to provide the liquidity, these requirements will also apply to existing transactions. For existing transactions, deduction will force firms to sell their positions into what is an already fragile market. We therefore recommend that the amendment to paragraph 565 be withdrawn (with the exception of the material on overlap) and replaced with the higher risk weight proposal suggested above

While we acknowledge that the consultation does not deal with the issue of retention as a means of aligning interests between originators, sponsors and investors we are aware that such discussions/proposals are underway in various jurisdictions. We think that further consideration needs to be given to these proposals in light of such discussions. For example in a synthetic transaction, a firm could take an unfunded equity position in the pool. Such a position would influence the rating of the transaction. If a firm is then required to hold a portion of each more senior tranche sold to investors, it could be in the position of having to deduct these positions, although their risk profile would not warrant such a treatment.

We also believe that the general principle that the firm should not be worse off than if it held the assets directly on its balance sheet should apply in this instance.

### **Standardised approach to re-securitisation risk weights**

See comments on IRB section above.

### **Operational criteria for credit analysis**

The industry strongly believes that transparency and proper due diligence are essential to restore confidence in this asset class<sup>9</sup>. As a result we are strongly supportive of regulatory measures to strengthen risk management standards in this area.

However, we are extremely concerned by the proposal that banks will have to deduct exposures where they do not fully meet the due diligence standards, especially where a failure is a result of factors outside the firm's control. We think that a more appropriate and proportionate charge should be applied and recommend a scalar of 150% of the risk weight that would have applied but for this provision (capped at 1250%).

Although we recognise that 'appropriateness' language is included in relation to the information that firms should be able to access, information needs will differ between different types of transaction and there will inevitably be an element of judgement. Given the risk of regulatory review delivering a different conclusion after the investment decision has been made, and the subsequent application of the capital penalty, it is likely that banks will avoid investing in this asset class. It is also likely that they will want to divest existing positions. Therefore the recovery of the securitisation market will be materially compromised and there will be additional pressure on valuations, profits and bank capital if there is further selling into what are already fragile conditions. It is important to note that the securitisation market has been an increasingly important source of funding for the retail and corporate sector over the last few years and these transactions have continued to perform according to expectations. In Europe alone over 90% of securitisations

---

<sup>9</sup> For your information, a group of European industry associations have implemented ten initiatives with this focus. One of these initiatives, developed by the ESF and EFAMA and the IMA is a set of investor guidelines for structured credit products. Other initiatives by the European industry associations include good practice guidelines, by asset class, on the information that investors should be able to expect to receive both at inception and on an ongoing basis. Further efforts are underway by the associations to make such information more 'user friendly' through the use of standard templates.

issued in 2006 and 2007 (over €800bn) were directly funding the 'broader economy' and banks have been a significant part of the investor base. In addition securitisation offers benefits in enabling firms to de-leverage their balance sheets and diversify their funding sources. Therefore we believe that it is extremely important to introduce a more proportionate and more risk-sensitive capital charge, as recommended above.

In addition, the ability to access information may not be within the control of the investor, if for example the issuer fails to produce the required information for a given period. We therefore think that proposed paragraph 565(iii) stating that 'Banks must be able to access performance information on the underlying pools on an on-going basis in a timely manner' should be deleted and replaced with 'Banks should have procedures, appropriate to their trading book and banking book and commensurate with their risks, to monitor on an ongoing basis and in a timely manner...'. We also think that the application of the increased capital charge should take account of whether the absence of information was as a result of the investor's negligent action or omission. The investor should not be penalised as a result of a failure outside its control. We also believe that the investor should be permitted a period to rectify any breach, before the application of the increased capital charge. We would suggest a period of three months. Given the penalties associated with non-compliance we think that this approach appropriately puts the emphasis on what firms can control. Further guidance will be needed on the implementation of these provisions, for example in relation to how frequently the analysis will need to be undertaken.

Finally we would suggest that it is important to determine the appropriate information at inception of the transaction, as it is very difficult to amend data provisions after the transaction has been issued.

### **Securitisation liquidity facilities – Standardised approach**

We appreciate that the turmoil in the markets has considerably changed banks' experience of draws on liquidity facilities to commercial paper and we recognise the appropriateness of increasing the conversion factors for short term facilities.

### **Securitisation liquidity facilities – IRB approach**

The phrase 'covering all losses on the underlying receivables pool that exceed the amount of over-collateralisation/reserves provided by the seller has never been entirely clear. This phrase does not appear in the parallel CRD provisions. We would recommend that it be deleted, since liquidity facilities are generally not required to fund defaulted assets.

The US implementation language regarding the seniority of liquidity facilities appears to address the issues that the proposed language is attempting to address and we support the American Securitization Forum's recommendation for similar language to be included:

'Both the most senior commercial paper issued by an ABCP programme and a liquidity facility that supports the ABCP programme may be senior securitisation exposures if the liquidity facility provider's right to reimbursement of the drawn amounts is senior to all claims on the cash flows from the underlying exposure, except amounts due under interest rate or currency derivative contracts, fees due, or other similar payments.'

### **Market disruption lines – Standardised and IRB approaches**

As noted above we understand that experience of liquidity draws has significantly changed as a result of recent market events and therefore recognise the appropriateness of removing the preferential conversion factor for market disruption facilities. As the eligibility requirements are so stringent, our members do not think that the impact of this change will be material.



Piners Hall  
105-108 Old Broad Street  
London EC2N 1EX

tel: + 44 (0)20 7216 8947  
fax: + 44 (2)20 7216 8928  
web: [www.ibfed.org](http://www.ibfed.org)

**Joint trade associations' response to CP 150**

*Proposed enhancements to the Basel II framework*

**Supplemental Pillar 2 Guidance**

## **Introduction**

Our member firms welcome the Supplementary Pillar 2 Guidance and believe it represents a helpful addition to the corpus of work that has been released by the BCBS and other international bodies such as the Financial Stability Board and the Committee of European Banking Supervision (CEBS) – although we believe that BCBS material should take primacy as it is the globally recognised standard setter in prudential capital matters for internationally active banks. We note the guidance also complements recent BCBS papers, for instance the principles for Economic Capital and for Stress Testing. The focus on some of the specific risk management topics covered by the supplemental guidance, for instance concentration risk and liquidity risks, are already the subject of principles issued by the BCBS and we assume that the material in this paper should be treated as supplemental guidance to those principles.

In their discussions our members have identified the following key points they wish to emphasise:

### **Key Messages**

#### **Capital matters but is not the only answer.**

We support a comprehensive analysis by firms of the entire range of risks they face and agree that the Pillar I capital requirements for credit, market and operational risk represent minimum requirements.

We firmly believe however that there are certain risk categories for which additional capital is not a primary mitigant. Oftentimes improved systems and controls or governance structure, and more comprehensively available reporting and public disclosures can be better alternatives.

In particular we believe that capital should not be designated as the sole mitigant to control liquidity risk. We look forward to the BCBS's forthcoming work on liquidity buffers and emphasise that an internationally coordinated approach would help to avoid creating conflicting jurisdictionally based liquidity buffers and the resultant trapped pools of liquidity.

#### **Proportionality**

We also welcome the reaffirmation of the long-held view shared between firms and regulators that the sophistication of a firm's risk management programme should be commensurate with the nature, scale and complexity of its operations and the overall level of risk it accepts. This should also be reflected in the form of the regulatory dialogue which should take into account the differences between a firm's ICAAP and the supervisory assessment of its capital adequacy.

#### **Scope**

Our members have in place processes to manage the capital adequacy at local entity level but do not wish to prepare a detailed ICAAP report for the regulator on every local entity. Having to do the latter would create a piecemeal rather than holistic understanding of the group operations, as it would not be aligned with how internationally active banks manage their operations, and would discourage geographic diversification. In view of these difficulties we do not believe that the high costs that would be entailed by this approach would be justified in any cost benefit analysis and would expend resources on supervisory reporting that would be better employed on risk management.

We believe that an institution's ICAAP report to the regulator should be prepared on a consolidated basis, as only by taking a holistic view of the entirety of a group's activities and the way in which its activities are managed will the regulator be given a proper view of its risk profile. This reflects the way most groups manage their capital which is primarily on a consolidated basis, with the minimum

required amount held at subsidiary level and any surplus held centrally. So a consolidated ICAAP submission to the regulator is consistent with this operational approach.

We recognise that there will be occasions when it is appropriate for a subsidiary to undertake an ICAAP report but that these should be restricted to an ICAAP based on the locally-consolidated subgroup when that subgroup is of systemic significance to the overall institution. However we believe that instances where a local ICAAP is mandated should be the exception rather than the norm and that the best forum for discussing whether or not this is really necessary is in the relevant supervisory college, following appropriate input from the firm itself.

## **Colleges**

Properly constructed colleges, involving the supervisors responsible for regulating the most significant parts of the group as well as those from nations where the firm is systemically significant represent, we believe, the best way forward for the oversight of internationally active groups. The colleges, under the leadership of the consolidating regulator, in conjunction with the firm itself, should plan the scope of the Pillar 2 exercise in order to optimise the time taken and resources utilised by both the firm and the regulator and to avoid duplication of effort.

Discussion of the results of the supervisory review of a firm's ICAAP are also best carried out in the college environment, involving the firm itself, so that any necessary mitigating actions, which should not automatically include a requirement for extra capital, can be discussed and agreed together. Despite our support for central oversight of Pillar 2 we continue to support the importance of continued dialogue with local supervisors in the jurisdictions where an institution operates.

## **The role of ICAAP and supervisory review**

Supervisors in different countries apply different weights and importance to the role of the Pillar 2 process within prudential supervision. We believe that Pillar 2 is and should remain a key component of the regulatory architecture but believe that differential application could lead to supervisory distortions according to the rigour with which it is applied. This should be avoided.

## **Comment on specific aspects of the supplementary Pillar 2 Guidance.**

### **Firm-wide risk oversight**

#### *Board and senior management oversight*

We completely support the BCBS' belief that the senior management of the firm is responsible for ensuring that proper systems and controls are in place to ensure that it is run properly and in line with regulatory requirements, in accordance with its risk appetite and that new products are developed with due regard to risks potentially posed by new products. Our members already involve senior management and the Board in some new product approvals, but believe that for a realistic approach, materiality thresholds based on management judgement must apply.

It is important that the board of directors takes responsibility for the oversight of the governance of the firms systems and controls but not that it should have a deep and intimate understanding of the intricacies of risk management models themselves. Day-to-day operation of risk management systems should be delegated to experts in the various aspects of risk control.

We agreed with BCBS' view of the key features of a sound risk management system (including active board and senior management oversight; appropriate policies, procedures, and limits; comprehensive and timely risk identification, measurement, mitigation, controlling, monitoring and reporting; appropriate management information systems at the business and firm-wide levels; and comprehensive internal controls) and note its particular focus on capital markets activity. We also

agree that oversight mechanisms should overcome organisational silos as this represents sound, holistic risk management. We encourage regulators to work in this way too, via supervisory colleges.

We welcome the Paper's suggestion that the role of the Chief Risk Officer (CRO) should have high prominence within the firm, albeit that different firms will adopt different organisational structures so prescription in this area is not possible. The key feature of the CRO's role is that it should be independent of the business lines and be accorded a sufficiently high status within the firm to have the authority to analyse any risk position.

We support the assertions made in relation to compensation policies and that ultimate oversight of remuneration policy and practice rests with the governing body.

We believe that executive compensation policies should take into account more than just the capital condition but should rather be consistent with the overall long-term strength of the institution, of which capital forms only one part. Therefore, we would recommend replacing the words "capital preservation" in paragraph 20, with "strength of the firm".

#### *Policies, procedures, limits and controls*

We agree with The BCBS' proposals about the key features of a firm's policies, procedures, limits and controls and believe that this reflects the good practice already adopted by many of our larger more internationally active members.

However we encourage supervisors to exercise conservatism and caution when considering their potential reaction to a firm that, they believed, does not have, for instance, adequate limits in place, or an appropriate business strategy. Supervisors must identify where to draw the line in relation to their critique of a firm's business strategy and where they deem it necessary, should engage in the appropriate dialogue with the board. It is the responsibility of the board to set the strategic direction of its business and for the regulator to satisfy itself that appropriate structures are in place to set and monitor business strategy rather than to directly intervene in establishment or implementation of the strategy itself, which would result in the regulator acting in a shadow management capacity.

With respect to paragraph 21 which requires firms to set limits in accordance with the bank's role in the financial system, we would recommend that this be left to bilateral discussion with the firm's supervisors.

#### *Identifying, measuring monitoring and reporting of risk*

For all but our largest members we believe that the proposals that a firm's MIS should be capable of aggregating 'on' and 'off' balance sheet exposures and at the same time be adaptable and flexible enough to be used in stress testing are aspirational and will be highly demanding to implement in the short term, particularly in relation to real-time, cross risk management capability.

'Big' monolithic systems are not always the answer. To be able to make intelligent decisions it is important that a firm's senior management has access to numbers that it can trust and provide them with a common metric, based on, for instance regulatory or economic capital. Systems in themselves are not the answer - what matters more is that the outputs from different systems are aggregated and used intelligently in the making of reasoned decisions. This is not a systems-led exercise - it is the quality and usefulness of the reports that are delivered by the IT systems that matters.

#### *Internal controls*

We fully agree that the risk management function should be independent of business lines and that risk management processes should be monitored and tested by a suitably independent source.

Firms should have flexibility to determine the manner by which this independence is achieved, for instance by an independent control function, internal audit or third party review.

### **Specific risk management topics**

#### **Risk Concentration**

We support the thrust of the BCBS proposals and believe that our members already aspire to manage concentration risk in the way suggested, although at present the focus of our members is more on assessing concentration risk on a group-wide rather than a legal entity basis. A group wide approach is, we believe, more relevant. This is particularly so if either: 1) the firm has a sufficiently robust process of reallocating liquidity and capital around the group such that there is minimal vulnerability at the subsidiary level, or 2) the subsidiary is not systematically important. As such the decision on whether risk concentrations should be managed at the subsidiary level should be subject to bilateral discussions with the supervisor as part of the Pillar 2 process.

Therefore there needs to be a degree of pragmatism in relation to the implementation of the proposals and recognition that expert judgement will always have a role to play as it is generally not possible to compartmentalise risk. How counterparties are identified, exposures measured and stress testing is carried out, as part of the process of managing concentration risk, form an integral and indivisible part of a much broader credit risk management framework which also includes the recognition and realisation of the benefits of diversification.

As yet, no one approach to the management of concentrations has been proven superior. We suspect that there will always be a range of valid approaches to the management of concentration risk often reflecting firm-specific organisational structures or business models. A key area of divergent industry practice is in the range of different benchmarks against which firms monitor concentration risk, including the overall credit exposure, total assets, risk appetite, and various capital measures (such as internal, economic and regulatory capital). Regulators should not seek to require the utilisation of a particular style of approach – rather the approach taken should be the subject of regulatory discussion in Pillar 2.

#### **Off balance sheet and securitisation risk – risk evaluation and management**

We recognise that the management of exposures to securitisation and re-securitisation structures has resulted in a significant loss of value for some firms and that important lessons have been learned, particularly in relation to warehoused assets and pipeline exposures. Our members are now working to capture information on securitisation structures and their component parts. Significant progress is being made particularly as a result of the stress testing exercises that many firms have been undertaking.

We agree that the impacts of for instance, the bringing on balance sheet of a securitised structure should be examined as part of a bank's ICAAP. However the degree of granularity proposed - i.e. at each exposure level as suggested in paragraph 39 - is excessive. Rather the regulator, as part of its discussion on the ICAAP with the firm, should ensure that proper processes are in place to capture the impacts of each relevant exposure.

#### **Reputational Risk and implicit support**

Reputational risk is complex to assess and in our view is a result of the coming together of some of the risk issues discussed in this section of the paper which create a damaging outcome. We believe that reputation risk arises as a consequence of negative perception or rumour, founded or unfounded, or, for instance, the crystallisation of an operational risk event.

The outcome may be manifest in a number of ways such as: difficulty in raising funds (wholesale and retail), poor sales of products, inability to obtain licences to enter markets, underperformance of equity or the inability to recruit qualified staff.

Firms should and do consider reputational risks in the new product design phase, they do consider reputational risk in their stress testing and they do take it into account in their liquidity planning. Effective reputational risk management is grounded in having effective contingency plans to manage an event which could impact a firm's reputation and in bench-testing those plans on a regular basis.

In this context, to the extent they can be quantified, the potential impacts of reputation risk – reduced sales, lost revenue through product terminations/redemptions, or longer-term increased expenditure may well be best quantified as part of business risk modelling which firms should already be discussing with their national supervisors as part of their ICAAP/SREP process.

We also see implicit support in a similar light, as a form of business risk that should be discussed as part of a firm's ICAAP, since this represents a commercial (as opposed to contractual) decision to provide financial compensation or balance sheet support to protect a firm's franchise. Intuitively, a firm will only provide implicit support to its products or business line where it feels it has the financial resources and commercial justification to do so, and hence outside of stress testing we are sceptical about whether a specific quantitative capital treatment in ICAAP for this risk, as a separable form of business risk, is appropriate.

We also note that the discussion in this part of the Paper focuses on implicit support, which is already covered in Pillar 1 and raises concerns about whether the approaches in Pillar 1 and Pillar 2 are internally consistent.

### **Valuation practices**

The complexity of valuation is magnified in the absence of active, liquid markets and the capacity of firms to undertake such independent verification has been tested during the last year.

We agree it is therefore important for banks to have robust governance and risk management structures around their valuation processes.

Whilst we support the concept of transparency we doubt whether senior management will be keen to make public their modelling techniques and the range of instruments to which they apply. These may be proprietary and will comprise very technical documents which we believe it would be difficult for analysts to assimilate. We feel it best for the financial markets to determine what they demand to see for a security to trade.

The extent of reporting requirements has increased significantly over recent years. Supervisors and firms alike must recognise the trade-off between speed of publication and detail. We particularly question whether externally reported information on valuation practices provides useful information.

Finally, we fully agree on the importance of timely, relevant, reliable and decision-useful disclosures. Many banks have significantly expanded their fair value disclosures to reflect requests from the Financial Stability Board and CEBS, among others, and will be implementing the recently adopted revisions to IFRS 7<sup>10</sup>

---

<sup>10</sup> IFRS 7: Financial Instrument Disclosures for accounting periods beginning on or after 1 January 2009

## Liquidity risk management and supervision

We have already commented on the BCBS' consultation on *Principles for Sound Liquidity Risk Management and Supervision*<sup>11</sup>.

In our comments on the material in this Basel II enhancements paper we only wish to re-emphasise our concern that quantitative disclosure of liquidity information could have a negative impact on market perception. It cannot be interpreted easily and too much transparency could actually endanger a firm's ability to access liquidity if the information is misinterpreted.

In particular, we believe that regulators should not focus on capital to solve liquidity issues. It is the risk of occurrence of disruptions to the free flow of liquidity that must be mitigated, not the financial consequence. Liquidity buffers, and systems and controls designed to reduce the probability of liquidity disruptions are more effective liquidity risk mitigants. We look forward to the BCBS's forthcoming work on liquidity buffers but emphasise that an internationally coordinated approach is required to avoid creating jurisdictionally-based liquidity buffers.

## Sound stress testing practices

We have already commented on the BCBS' consultation on *Principles for sound stress testing practices and supervision*<sup>12</sup>.

We support the Paper's assertion that stress testing is but one of a range of tools that senior management of banks and regulators can use to assess the vulnerabilities that a bank faces.

The application of stress testing techniques to different types of risk are at different stages of development and the debate still continues about how amenable different risk types - for instance reputational risk - are to quantification. So the application of the stress testing principles to risk types must reflect the extent that the quantitative risk measurement of each risk type has evolved.

Firms apply stress testing in a wide ranging way so that senior management and the board can assess the results of the stress test in order to devise mitigating strategies. This is the real value of stress testing – it helps to elucidate the factors to which a firm is particularly vulnerable in order to determine what impact if any they might have on its capital and investment plan. If a capital weakness were identified we would expect this to be remedied but we would not expect senior managers, or regulators, to translate the results of stress tests into a need for more capital on a formulaic basis.

We note that this section of the Paper raises the issue of a leverage ratio as a supplementary ratio that could be considered in a bank's capital planning process. The Basel Capital Accord was specifically intended to considerably improve the traditional capital framework which often relied on non-risk sensitive leverage ratios which were felt to be inefficient and inappropriate. If the supervisory concern is related to monitoring and controlling excessive indebtedness in the economy and/or to address pro-cyclicality, other instruments may be available and appropriate to address them (such as budgetary and monetary policies, through-the-cycle ratings and ex ante dynamic provisioning). We look forward to engaging in the debate with regulators on the merits of a simple leverage ratio as the actual design and implementation of the ratio will crucially impact the future shape of our member firms' business models. But we would also welcome some evidence, based on back-testing, to confirm that a leverage ratio would indeed have helped prevent the current crisis. Whatever the eventual shape of a possible leverage ratio it is important that it be applied uniformly, as a global standard.

---

<sup>11</sup> [http://www.bba.org.uk/content/1/c6/01/43/85/Joint\\_Industry\\_Response\\_to\\_Basel\\_Liquidity\\_Principles.pdf](http://www.bba.org.uk/content/1/c6/01/43/85/Joint_Industry_Response_to_Basel_Liquidity_Principles.pdf)

12

[http://www.bba.org.uk/content/1/c6/01/55/35/Joint\\_Trade\\_Assns%27\\_Response\\_to\\_BCBS\\_Stress\\_Testing\\_Consultation.pdf](http://www.bba.org.uk/content/1/c6/01/55/35/Joint_Trade_Assns%27_Response_to_BCBS_Stress_Testing_Consultation.pdf)



**Pinnars Hall**  
105-108 Old Broad Street  
London EC2N 1EX

**tel:** + 44 (0)20 7216 8947  
**fax:** + 44 (2)20 7216 8928  
**web:** [www.ibfed.org](http://www.ibfed.org)

**Joint trade associations' response to CP 150**

*Proposed enhancements to the Basel II framework*

**Pillar 3**

## **Introduction**

The associations<sup>13</sup> support the BCBS' aim of improving disclosure as one of the means by which investor confidence can be restored, and recognise the need to provide appropriate information on the trading book, as well as revisiting the requirements for the banking book and the qualitative disclosures. In developing those disclosures it is important to strike the right balance between more disclosure, the reporting burden these requirements place on firms, and the ability of other market participants to assimilate and interpret the information.

This section has been divided into three subsections as follows:

- I. General comments
- II. Comments on the Consultation.
- III. Detailed comments on the proposed changes to table 9

## **Key messages**

### **Timetable**

We recommend that the revised Pillar 3 disclosures should be implemented for year ends on or after 31 December 2010 rather than the end of 2009 as currently proposed. This is because a significant portion of the disclosures relate to the trading book, where implementation does not take effect until 31 December 2010, and therefore firms will be unable to produce the requirements outlined. For systems practicality reasons we believe that it is appropriate to delay the banking book disclosures until the same date.

### **Status of FSF recommendations**

The FSF's recommendations currently require firms to disclose detailed information on securitisation and re-securitisation activities. We assume that the BCBS Pillar 3 proposals are intended to supersede these recommended disclosures and would appreciate confirmation that this is the case.

### **Pipeline and warehousing risks**

We understand that the sudden evaporation of securitisation funding caused serious problems for some institutions and that regulators have a valid interest in this area. However, we believe that pipeline and warehousing risks would be more appropriately handled in the discussions on liquidity regulation and that any related disclosures pertaining to the use of securitisation funding are considered there.

### **Sponsored transactions where no risk is retained**

We appreciate that sponsored vehicles have been the focus of much attention during the current market turmoil and that counterparties are interested in increased disclosure and we support the separate disclosure of sponsored and originated transactions. However, implementation discussions on the existing requirements highlighted the information gathering problems faced by firms that have sponsored vehicles and not retained an interest in them. While we recognise that the introduction of retention requirements being discussed would make this problem less severe going forward, for existing transactions, firms in this situation will simply not have maintained data on the exposures securitised within their systems. To collect data on such past transactions will be a significant undertaking and as a result we would strongly urge the BCBS to re-consider its

---

<sup>13</sup> As there has been no Pillar 3 reporting in the United States to date, the American Bankers Association does not take a position on the proposed revisions to Pillar 3 and reserves the right to revisit these issues in the future.

decision to remove 'need only be reported in the year of inception' in footnote 229, or, at the very least, to permit grandfathering of existing transactions where there is no risk retained.

## **I General Comments**

**(i) Implementation timetable** - In our view the proposed timeline for the Pillar 3 disclosures should be reconsidered and implementation should take effect for year ends ending on or after 31 December 2010 for the following reasons:

- A significant proportion of the changes in the proposal relate to new rules applying in the trading book, which come into force in December 2010. There is therefore an inconsistency in requiring the implementation of Pillar 3 disclosures in advance of the implementation of the capital requirements on which they are reporting. In other words, until the trading book rules have been implemented, it will be impossible for firms to comply with certain of the requirements as set out.
- It would be technically possible for firms to be in a position to apply the new disclosure requirements for banking book positions for year ends on or after 31 December 2009, as proposed. However, implementing the new banking book disclosures on this basis would create profound discrepancies between trading and banking book disclosures. In addition, the systems changes necessary to bring about these disclosures will still require considerable time and effort to implement and we think that firms should be given sufficient time to make the necessary adjustments. A two-stage process would only add to the burden. We would note, however, that systemically relevant institutions will already be producing some of the disclosures proposed as a result of the FSF recommendations.

As a result, we believe that the most appropriate way forward would be to set a single implementation date, 31 December 2010, for all disclosures that firms would need to make under the Pillar 3 framework.

**(ii) Improving disclosure** - Securitisation is obviously, and rightly, an area of focus at the current time and improving transparency and disclosure is one of the important aspects to be considered in improving market confidence and restoring more normal market conditions. Pillar 3 disclosures, in turn, are one aspect of the regulatory and industry actions in that arena. We are supportive of both regulatory and industry initiatives to bring about positive changes through transparency and disclosure. However, when developing the Pillar 3 requirements it is vital to ensure that the appropriate balance is struck between increasing disclosure and information overload.

**(iii) Clarity** - It would be helpful to preparers if the Pillar 3 text outlined the objective that is sought in each specific disclosure requirement, as we have found, in implementation discussions on the existing requirements, the precise aim is not always clear. Such an approach would reduce the possibility of misunderstanding of the requirements and therefore enhance the consistency and comparability.

**(iv) Distinguishing between regulatory and other disclosures** – For users to gain benefit from the disclosures it is important that they understand the basis on which they are prepared. As the requirements have further evolved to encompass more information that sits outside the regulatory system we think it will be necessary to clearly signpost those disclosures that relate to regulatory information and those that do not. The requirements could help in that regard by clearly setting this out. Where firms derive their data from other sources – such as financial statements – we recognise that firms should provide explanation of this fact to reduce ambiguity on the type of data they are disclosing and thus avoiding users drawing false conclusions.

**(v) Flexibility vs. comparability** – There is a balance to be struck between flexibility, which is necessary to take into account the individual nature of the institution involved, and

comparability, which is beneficial to users. We are therefore pleased to note that the BCBS has focussed on the information that should be disclosed rather than imposing standard reporting formats. However, to achieve comparability, it is important that there be a common understanding of the concepts used. The industry implementation discussions have demonstrated that even terms that appear straightforward can be interpreted in different ways. While we welcome greater consistency of terminology used by the BCBS, there are still instances where standardisation could go further. Additionally it would be helpful if the final version of the requirements provided further clarity on the precise meaning of the various concepts that it uses.

- (vi) Status of FSF disclosures** - The FSF recommendations currently would oblige the banks to disclose detailed information on securitisation and re-securitisation activities. The Pillar 3 proposals appear to incorporate elements of these disclosures. As a result we would like confirmation that the Pillar 3 requirements supersede the FSF recommendations.

## **II Comments on the Consultation**

### **(i) Securitisation exposures in the trading book**

We acknowledge that the current Pillar 3 framework does not capture securitisation exposure in the trading book and that recent events have demonstrated that additional disclosures in this area are sought by bank counterparties (a finding confirmed by the industry survey undertaken in the EU). We welcome the distinction made between banking and trading book disclosures and support the structure proposed, whereby qualitative disclosures will cover both books (unless it is appropriate to provide separate information) and the quantitative disclosures are considered separately.

However, the banking book requirements are sometimes copied across to the trading book even where their direct transfer is not appropriate. The risk management methodologies and some of the capital requirement calculation methods associated with the two books differ and this is not always reflected in the corresponding disclosures - for example the application of the credit risk mitigation requirements to the trading book is unclear (items (o), (p), (v) and (w)). We have indicated in section III where we believe problems are likely to arise as a result of this copy across approach and wherever possible we suggest alternative requirements that will deliver the objective of the disclosure involved more appropriately.

### **(ii) Sponsorship of off-balance sheet vehicles**

We appreciate that sponsored vehicles have been the focus of much attention during the current market turmoil and that counterparties are interested in increased disclosure.

Definition of sponsor and exposures securitised by the bank – we note that the definition of “sponsor” in footnote 225 is identical to that used in para 543 (b) of the framework for the purposes of calculating capital requirements. We think that this is appropriate and should be referred to in requirements (g), (h), (o) and (p), which relate to exposures securitised<sup>14</sup>.

In defining exposures securitised by the bank, footnote 229 refers to sponsored transactions included in section (b), which will also include transactions that are on the bank’s regulatory balance sheet, rather than footnote 225. This creates an internal inconsistency within (g), (h), (o) and (p) which on the one hand refer to disclosing transactions within the securitisation framework (i.e. those that are off the regulatory balance sheet) and to section (b), which includes other transactions (that are on the regulatory balance sheet). A requirement to report sponsoring activities that are not covered by the securitisation framework would be confusing for users

<sup>14</sup>

Although this will depend on the definition of on /off balance sheet discussed later in this section

because it mixes regulatory and non-regulatory information, and leads to duplicate reporting, since quantitative information is already required by non-securitisation-related Pillar 3 rules. It is essential to ensure consistency between quantitative disclosures under Pillars 1 and 3. We therefore regard the definition in footnote 225 to be the relevant one and would consequently recommend its use for quantitative disclosure purposes.

In general we think there is a lack of clarity over the use of 'on' and 'off' balance sheet within the proposals. Since consolidation disclosures are incorporated elsewhere within the Pillar 3 framework, we do not think that this distinction is relevant for the securitisation disclosures. We believe that 'on' and 'off' balance sheet, in relation to originators and sponsors, should relate to whether assets have been removed (or in the case of synthetic transactions recorded to another party) from the consolidated balance sheet, as the disclosures will normally be made at the consolidated level. For practical systems reasons, as well as user understanding, we believe that the disclosures should reflect the regulatory determination of risk transfer rather than the accounting determination. We also think the regulatory distinction between 'on' and 'off' balance sheet should be used for securitisation positions retained or purchased. Further guidance on how to disclose, or a separate category, should be considered for derivative exposures.

**Mandatory disclosure of sponsorship** – We support the separate disclosure of vehicles sponsored from those that are originated, but would highlight two issues that we think require further consideration: (i) firms may in practice act as both sponsor and originator to the same vehicle; and, (ii) the loss of the derogation to provide information on sponsored vehicles where no risk has been retained will cause significant problems for firms.

In implementation discussions on the existing requirements it became apparent that vehicles containing third party assets and managed by a firm could also, in practice, contain assets that are originated by that firm. In such a situation, reporting the entire transaction within the originator category is likely to misinform investors about the nature of the securitisation activity that the firm is undertaking. We recommend that firms report the assets originated within the 'originator' category, and the whole transaction within the 'sponsor' category and explain the double counting. We think that this approach could provide more useful information to users and recommend that this approach be given consideration as an option.

Implementation discussions also highlighted the information gathering problems faced by firms who have sponsored vehicles and not retained an interest in them. While we recognise that retention requirements being discussed will make this problem less severe going forward, in respect of existing transactions, firms in this situation will simply not have maintained, within their systems, data on the exposures securitised. To collect data on such past transactions will be a significant undertaking and as a result we would strongly urge the BCBS to re-consider its decision to remove 'need only be reported in the year of inception' in footnote 229, or, at the very least, to permit grandfathering of existing transactions done on this basis.

### **(iii) IAA and other ABCP liquidity facilities**

As noted above in 'Improving disclosure' (Item (ii) in General Comments), we believe that users are interested primarily in information about the relevant risks, and not in the methods used to generate this information. We think that information on methodologies will mainly be of use in determining how best to compare the results of different firms; it should be sufficient to provide a qualitative summary. As a result we question the usefulness of providing significant information on the IAA methodology and on the types of securitised exposures for which the IAA is used in the qualitative requirements. In the quantitative disclosures we think that users will be more interested in the risk weight band information than the method by which it was achieved, since this provides information on the regulatory assessment of risk. We think that any split, beyond Standardised and IRB approaches, will make the disclosures cumbersome and not provide useful information to users.

**(iv) Re-securitisation exposures**

We understand the BCBS' aim of enhancing transparency in this area, which has been identified as one of the causes of the financial crisis. Nevertheless, we think it is important to maintain a balance between these and other securitisation disclosures, and other Pillar 3 disclosures more generally. Emphasis needs to remain focussed on disclosing the information which users will find relevant. Over time, some of this information may lose its relevance while other types of exposure become more significant. The rules should therefore be principles-based and balanced in the level of detail they require, to allow sufficient scope for banks to report information that is relevant without to the need for extensive revisions or additions to the framework every time the situation evolves. We would note, therefore, that re-securitisations will be disclosed separately as a result of the different Pillar 1 and Pillar 2 rules for securitisations and re-securitisations. However, it is important that the requirements are reviewed periodically to ensure that the requirements continue to provide information that is useful to users.

**(v) Valuation with regard to securitisation exposures**

In general, we believe that valuation and accounting policy disclosures are best covered in a bank's financial statements and would point out that most firms have been providing significantly more information since the financial turmoil began. We would urge supervisors to accept references to the banks' financial statements in Pillar 3 disclosures as an appropriate means of complying with the requirements rather than requesting similar, but not identical, information.

**(vi) Pipeline and warehousing risks with regard to securitisation exposures**

We understand that the sudden evaporation of securitisation funding caused serious problems for some institutions and thus regulators have a valid interest in this area. However, we believe that pipeline and warehousing risks would be more appropriately handled in the discussions on liquidity regulation and that any related disclosures pertaining to the use of securitisation funding should be considered there.

We would note that the risks to which a bank is exposed are already incorporated in the disclosure of non-securitisation exposures calculated under Pillar 1. The additional disclosure of warehousing risk envisaged here will result in duplicate reporting within Pillar 3. This is likely to confuse users.

Irrespective of this point, it would be necessary for further guidance to be given on when exposures are considered to constitute part of a pipeline or warehousing arrangement, otherwise the information disclosed could be misleading if interpretations differed from one bank to another. In practice, much of a firm's balance sheet is potentially available for securitisation. The decision to do so will be market driven and may change very quickly.

We therefore recommend that this requirement be reconsidered.

**(vii) Other**

We support the recommendation.

**III Detailed comments on the proposed changes to table 9**

Proposals which are not specifically commented on below have our express support.

## Qualitative disclosures

### (a) General qualitative disclosure requirements with respect to securitisation

In relation to the qualitative requirements, we support the use of a broad definition of securitisation, which encompasses both banking and trading books and transactions that are both 'on' and 'off' the regulatory balance sheet as we think that providing such information will be helpful to users. However, where this results in the scope for qualitative and quantitative disclosures being different, there should be an explanation provided to ensure users understand the context of the information they are receiving.

*First bullet point, final phrase: type of risk assumed and retained relating to re-securitisation activity*

It is important to disclose the roles assumed by a bank with respect to securitisation activities. These roles do not differ between securitisation and re-securitisation activities, however. We therefore question whether this additional disclosure will provide useful information and recommend, therefore, that it be deleted.

*Footnote 223: term "layers"*

"Tranche" is a more appropriate term than layer as it is consistent with the terminology used elsewhere in the framework, i.e. when discussing what tranche level banks typically invest (senior, mezzanine, junior) and the exposure type including tranche that underlies their investments.

In addition, the expression "significantly active" requires clarification.

*Second bullet point: nature of the risks*

Where assets have been effectively securitised firms will only have risks associated with them to the extent that they retain positions in the transaction. Liquidity risk, for example, is a function of maturity transformation performed by the transaction and the risk will be borne by the liquidity provider (which may or may not be the originator). The relevant risks regarding assets are already covered by the disclosure requirements for such non-securitisation risks under Pillars 1 and 2. In addition, the risks to the bank resulting from its exposures to securitisations are to some extent already disclosed in the description of the roles that the bank plays. We think that it would be helpful to rationalise the bullets in this section, and provide greater clarity on what is being sought.

*Third bullet point: roles played by the bank in the securitisation process and footnote 224: examples of roles played by the bank*

We think that the roles are primarily determined by the Pillar 1 rules, i.e. originator and sponsor, but in addition the bank could also describe any relevant roles it assumes in the transactions it enters into if this information is judged material. We think that this is a sensible and pragmatic approach.

*Fourth and fifth bullet points: monitoring changes and hedging*

These proposed requirements appear to relate to all securitisation exposures and not just re-securitisation. We would note that there are Pillar 2 provisions that also require risk management information to be disclosed and would therefore recommend that further consideration be given to any overlap between these two sections to avoid unnecessary duplication.

If it is still thought relevant to include more detailed requirements in the securitisation disclosures then we believe that the proposed requirements could be simplified and clarified by spelling out the desired objective. As we understand it, this is to disclose an appropriate amount of information on the firm's risk management and hedging practices.

It should be noted that the names of the bank's counterparties may not be disclosed for data protection reasons. Instead, the information could be provided in aggregate form broken down by credit quality, for instance (investment grade/non-investment grade).

As regards hedging, it would be helpful to use the term "credit risk mitigation", as defined by Pillar 1, and to clarify that the mitigants relate to those of entire securitisation positions rather than those within a securitisation transaction. Furthermore, it would be helpful to clarify the term "material" in "material hedge counterparties".

*Sixth bullet point: regulatory approaches*

We do not think that it is helpful to users to provide information on which capital calculation methodologies are used for which exposure types because their use is not exposure type dependent. IRB or Standardised approaches (in the trading or banking book) may, and probably will, be applied to any exposure type.

**(b) Types of SPE where the bank acts as sponsor**

This requirement seems to stem from the FSF recommendations on disclosure practices. Although we understand that regulators wish that such information be provided, we would note that some of the types of vehicles noted in the Senior Supervisors' Group report relate only to US designations. See above for our comments regarding 'on' and 'off' balance sheet.

*Footnote 225: definition of the term "sponsor"*

Please see our comments above on section II.6(ii).

*Footnote 226: related entities*

The term "related entities" is used in para 423 of the Basel framework in the context of rating systems and their treatment of "connected groups". This understanding of the term makes little sense in the context of footnote 226. We are also unclear as to the purpose of the requirement, particularly since consolidated risks already need to be reported elsewhere. Without further clarification, we would recommend that this requirement be dropped.

**(c) Summary of the bank's accounting policies for securitisation activities and footnote 227: differentiation where relevant between securitisation/re-securitisation exposure valuations**

Please see our above comments on section II.6(v).

**(d) Names of ECAs used**

We do not think users will find this information helpful. In a survey of users undertaken to facilitate good practice guidelines on Pillar 3 disclosure requirements in the EU<sup>15</sup>, this was found to be the least useful of existing Pillar 3 disclosures. Users are interested in the level of risk that a firm has assumed and Pillar 3 can most certainly offer a different perspective by providing information about the regulatory assessment of risk. Like firms' internal systems and those of the rating agencies, the Basel framework assesses risk by applying a common risk measure to all exposures (a Standardised risk measure or an IRB risk measure). It is the output of this measure that will be of most interest to users and not the input information, which they may find confusing and/or overwhelming.

---

15

### **(e) Description of the IAA process**

Please also see our above comments on section II.6(iii).

We are not clear as to what these new requirements are designed to achieve, particularly in respect of the following:

- What is meant by the structure of the IAA process? The relationship between internal ratings and external ratings is set by the framework since the IAA must be based on an ECAI methodology.
- Control mechanisms – while it would be possible to deliver some high-level information on the policies that a firm has in relation to its use of the IAA in calculating capital, it will not be possible to go into a great deal of detail because of proprietary considerations.
- Internal rating systems do not always use stress factors. If simulations are used instead, it will not be possible to indicate comparable stress factors.

*Footnote 228: examples of exposure types*

The introduction of new terms is not always helpful. It might be better if the footnote indicated that further analysis of the exposure type is required for securitisation exposures.

### **Quantitative disclosures in the banking book**

#### **(g) Outstanding exposures “defined under” the securitisation framework**

The term “subject to” should be retained and not replaced by “defined under”. As we understand this requirement, the disclosure relates to exposures which have undergone an effective risk transfer and are thus *subject to* the rules of the securitisation framework. If the term “defined under” is used, by contrast, the disclosure will also cover exposures which do not meet the risk-transfer test and are not subject to the securitisation framework but constitute non-securitisation positions which are already disclosed in other tables of Pillar 3.

*Footnote 229: definition of “exposures securitised by the bank”*

This definition should be made more precise by clarifying the expression “or acquired from third-party entities”. We assume the intention is to cover not only exposures taken onto the balance sheet temporarily but also positions which have been purchased by the SPV in question.

An alternative approach might be to remove ‘by the bank’ in (g), (h) and (o), and for footnote 229 to state that exposures securitised are those that are originated by the bank, whether generated by them or purchased onto the balance sheet from third parties, and, exposures included in sponsored schemes, whether the SPV purchased them from the bank or third parties.

#### **(h) Exposures impaired/past due and losses recognised**

Please see our above comments on (g) regarding use of the term “defined under”.

The objective of this requirement is unclear. Is the intention to focus on all securitised exposures, i.e. which are off-balance sheet for regulatory purposes, or on the retained positions to which the firm is exposed? The second bullet would certainly appear to relate to the latter.

Furthermore, this requirement seems to relate to a mixture of accounting and regulatory information. We therefore think it is necessary to: (a) define the scope more clearly, and (b) identify which elements of the requirement relate to accounting. The “impaired/past due” category does not reflect accounting terminology. The terms used for accounting purposes are “impaired” and “past due but not impaired”. Furthermore, this information might not be available since there are

assets where an “impaired” or “past due” definition is not applicable (e.g. future flow assets) or where the pool is measured at fair value.

*Footnote 230: examples of recognised losses*

We do not agree with the addition of “recognition of liabilities for probable future financial support” since these have no relevance to losses incurred. If a firm has not yet taken on a position, it cannot have incurred a loss.

**(i) Aggregate amount of on- and off-balance sheet securitisation exposures**

We would draw attention once again to the problem of the different distinctions made between ‘on’ and ‘off’ balance sheet for accounting and regulatory purposes. We assume that it is the regulatory perspective which is relevant here (see also our above comments on (b), second sentence).

**(j) Aggregate amount of assets awaiting securitisation**

We understand the objective as being to capture assets where the decision to include certain assets in a securitisation has resulted in a change in accounting treatment. While this is reasonably clear in (c), the scope of (j) is not clear. In addition, commercial confidentiality considerations are involved in providing information on future securitisation transactions. Please see our above comments on section II.6(vi).

**(k) First bullet point: breakdown by regulatory capital approach of securitisation exposures retained or purchased**

This requirement effectively requires the delivery of a three- or possibly even four-dimensional table. We have reservations about the usefulness to users of introducing a breakdown by regulatory capital approach. At most we think the distinction should only extend as far as IRB and Standardised approaches. Users are interested in the level of risk that a firm has assumed (please see our above comments on (d)).

**(m) Breakdown of re-securitisation exposures**

It would be helpful if the term “hedging/insurance” could be replaced with “credit risk mitigation”. Furthermore, “financial guarantor” does not reflect the terminology used elsewhere in the Basel framework. It would also be helpful to explain the objective of this requirement, which appears to duplicate the requirement in (a), fifth bullet point (see above).

**(n) Summary of current year’s securitisation activity**

The same footnote is used for both “exposure type” and “asset type”. We believe it is essential to first define all securitisation-specific terminology and then use these defined terms consistently.

**Quantitative disclosures in the trading book**

**(o) Outstanding exposures defined under the securitisation framework**

No comment.

**(p) Total outstanding exposures securitised and subject to the market risk approach**

We do not understand what item (p) is trying to achieve in relation to item (o). Where the exposures are originated by the firm, they will all have been subject to the market risk approach and already reported in (o), broken down by exposure type. Where the assets in a sponsored

scheme are sourced from third party banks, the firm will not know whether they have been subject to the market risk approach and therefore will not be able to make this disclosure. Where the assets are sourced from outside the financial system, the market risk approach will not be relevant. We think that this requirement should be reconsidered.

**(q) Aggregate amount of on- and off-balance sheet securitisation exposures**

We question whether a breakdown into on-balance and off-balance sheet securitisation exposures will provide meaningful information about market risk (see also our comments on (b)).

**(r) Aggregate amount of assets awaiting securitisation broken down by exposure type**

Please see our comments on (j).

**(s) Aggregate amount of securitisation exposures retained or purchased**

We are unclear as to what should be disclosed under the amount subject to the market risk approach. If this means disclosing exposures that are also included within models, as well as subject to the securitisation capital charges, this will result in a double counting in the disclosures. If it is intended to cover counterparty risk, then this is unclear.

In addition it would be helpful if the terminology between pillar 1 and pillar 3 could be kept consistent, i.e. specific risk charges for positions under the securitisation framework for the second bullet

**(t) First bullet point: capital requirements for securitisation exposures in the trading book**

We assume that this requirement relates only to the second bullet in (s).

As noted above we do not think that it is useful to provide breakdowns of exposures by reference to the capital calculation methods.

Our understanding, based on the consultative document "Revisions to the Basel II market risk framework", is that the SFA may be applied to unrated exposures in the trading book. In the case of the SA and RBA, these are reproduced in the tables in paragraphs 712 (iii) and (iv), however the terminology used to describe them in those sections is slightly different. In addition it is unclear whether the IAA can be used within the trading book at all.

Furthermore we are unclear whether counterparty risk associated with trading book transactions should be disclosed as part of the trading book disclosures or as currently, part of the banking book disclosures.

**(u) Securitisations subject to early amortisation treatment**

The early amortisation treatment is typically applied to banking book transactions in which the (mainly credit card) exposures are securitised with the bank acting as originator of the securitisation. Since the underlying exposures cannot normally be assigned to the trading book and any repurchased securitisation positions would also be in the banking book, we believe that this disclosure will be an empty set.

**(v) Breakdown of re-securitisation exposures**

Please see our above comments on (m).