December 2013

Basel Committee Consultative Document on fundamental review of the trading book (BCBS 265)

Questions for the Committee regarding securitization (for a conference call, to be arranged)

The general approach

1) Can the Committee please provide insight into their decision to disallow the use of models for securitizations, particularly as it relates to correlation securitizations and given the significant amount of time and resources from banks and regulators alike to develop, implement and review these models? What are their largest concerns with regards to securitizations, which lead them to believe that models are inappropriate? The capital outcome of the change, which is currently unclear, and the applicability of the capital framework for traded correlation securitizations needs to be properly reviewed and assessed to ensure that this change is appropriate.

2) The proposed standardized approach for estimating the Credit Spread Risk ("CSR") component (and to some extent also for General Interest Rate Risk ("GIRR")) of securitization RWA has a number of approximations that attempt to capture portfolio diversification/ concentrations which in practice are likely to give less accurate results than can be provided by a robust internal models-based approach. Is there any scope for the retention of an internal model-based approach, at least for measuring the CSR and GIRR?

3) We would like better to understand how the CSR and Default Risk ("DR") components would be determined in conjunction, and how they would be calibrated. For example, does the Committee intend that the capital requirements for the General Interest Rate Risk, Credit Spread Risk, and Default Risk be additive? If so, since the risk-weight for Default Risk can be as high as 1250%, summing may result in the total capital requirements being greater than the maximum economic loss of the securitization position. This would result in the same double and triple counting of risks that were present in Basel 2.5 which we understood the Committee is trying to avoid. This is even more concerning given that the capital requirements for securitizations are already significantly higher than if the underlying assets are held on the balance sheet. Has the Committee considered taking the "mark" on these transactions into account, to appropriately reflect the remaining risk on the transaction? Or at the very least capping the capital at the maximum economic loss?

4) For any capital regime imposed on trading books, simplicity is of paramount importance. This is particularly important when one considers the various proposals for the Standardised Approach in BCBS 236 for the revised RBA, particularly Alternative A.

Interaction with the new securitisation framework (Basel 236)

5) We do not feel able to make an informed assessment as to the overall appropriateness of the proposed approach to securitizations without knowing the detailed specification of a critical component (the default risk framework) of the wider securitisation framework (Basel 236).

Without a detailed specification of this component we struggle to see how we can perform a meaningful quantitative impact assessment. How will these Basel 265 proposals be re-calibrated to reflect the final framework under Basel 236, and when is this expected to occur?

6) Can the Basel Committee please discuss their approach to aligning the capital requirements for securitizations between the trading book and banking book, especially given their expressed concern about the "risk of arbitrage"? The proposed framework for trading book assets differs significantly from the methodologies proposed in BCBS 236. We would appreciate further clarity on how the two approaches will be synchronized.

7) More generally, has the Basel Committee performed any review or analysis as to whether the proposed standard approach in BCBS 265 produces consistent results across the trading book and the banking book for securitizations, or for other product types?

Definitions

8) General – There is limited differentiation between structured credit / correlation products and standard ABS. In addition, the definition of corporate CDOs is unclear. Is the definition intended to cover only index-based products or does it cover cash CDOs including assets such as leveraged loans?

9) CSR (para 119, page 70) - How is MBS defined? It is referred to as Corporate MBS. Does this refer to CMBS only or is it intended to cover RMBS? If it is intended to cover RMBS, what types (conforming, non-conforming)?

10) Maturity and residual maturity are considered factors which determine capital. However, it is not clear what maturity concept is meant: legal maturity? Effective maturity? Weighted average life? Correspondingly, it is not clear under what cash flow assumptions "present value" should be calculated (see page 39: "Risk weights will be applied to the present value of cash flows and reflect the credit quality, residual maturity..."). See also Question 14.

Modelling and bucketing

11) A liquidity horizon of 250-days is identified on page 16 for "Credit Spread structured (cash and CDS)" yet securitisations (including CDOs) are required to use the Standardised Approach in which the GIRR identifies no specific liquidity horizon but uses only a single set of Vertex Risk Weights. Please explain what is intended to be covered by "Credit Spread structured (cash and CDS).

12) CSR Weights (para 116, page 70) – Why is there no ratings differentiation within the buckets for corporate CDOs (both HG and HY)?

13) CSR (para 120, page 70) - Is Bucket Number 5 (Residual) too broad? The range of assets underlying securitisations is broad and will have varying degrees of liquidity and spread risk.

14) Default Risk (para 159, page 80) – Should there be more LGD differential within seniority buckets for differing asset classes? Recoveries can be very different for tranches defined by attachment and detachment points.

15) Please provide guidance regarding the definition of cashflows for the purpose of calculating GIRR and CSR for securitisation positions. What assumptions can be used for modeling cashflows on ABS, where stated maturity can be very different from expected maturity (and

generally cash flow profile) for purposes of bucketing used in the standard approach calculation? See also Question 9.

16) CSR (para 119, page 70) – The proposed MBS, Credit Card ABS and Residual CSR tables incorporate significant “cliffs” between BBB- and BB-rated tranches which appear to be arbitrary and excessively large. How can this be reconciled with the stated objective of BCBS 236 of reducing such “cliff effects”?

17) Please confirm that ABS rating tables/buckets for CSR and Default Risk RW calculations will consider sovereign rating ceilings and be adjusted accordingly, so that similarly structured transactions with similar collateral pools are not significantly differentiated.