Setting the standard
for securitisation

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Basel Committee for Banking Supervision
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Submitted via email: baselcommittee@bis.org

15th March, 2013

Dear Sir/Madam

This is the response of the Prime Collateralised Securities initiative to the Consultative Document "Revision to the Basel Securitisation Framework" issued by the Basel Committee on Banking Supervision in December 2012, together with the technical notes contained in Working Paper No 22 and Working Paper No 23 issued in January 2013 (the "Technical Papers" and together the "Paper").

Prime Collateralised Securities ("PCS") is an independent, not for profit initiative set up by the securitisation industry (including banks and investors and with the support of policy makers), to reinforce the asset-backed securities market in Europe as a key to fostering robust and sustainable economic growth for the region.

PCS welcomes the opportunity provided by the Basel Committee to comment on the proposed new scheme to calculate the capital requirements necessary to underpin banks' holdings in asset-backed securities. We also strongly agree with the Basel Committee that a new framework is required and that it should be built upon the lessons learned during the financial crisis.

We would also welcome an opportunity to discuss our response with the Committee representatives at the London meeting scheduled for April.

Although we recognize the global nature of the Basel Committee's work, within Europe – which corresponds to PCS' remit – we believe that much rests on reaching the appropriate calibration for a capital framework for the asset-backed holdings of European banks. Within the next five years, PCS estimates a funding gap of at least €4 trillion in the European economy, resulting from a combination of bank deleveraging, new regulatory regimes and the funding needs of the real economy. Although some of this gap will be filled by the corporate bond market, much of it will require, amongst other funding channels, a strong and resilient securitisation market. Although, clearly, securitisation cannot alone compensate for the entirety of the missing funding, it will have to be part of the solution if Europe is to avoid a long period of economic stagnation.

In this regard, we draw the Committee's attention to the White Paper to be published by PCS on Monday 18th March and entitled: "Europe in Transition – Bridging the Finance Gap".[1]

We limit our comments on the Paper to issues relating to the overall approach adopted by the Committee as well as to some high-level technical issues having to do with the assumptions and the conceptual architecture of the Paper's quantitative analytical approach.

Finally, PCS notes that the timeframe for the consultation period was, in our view, extremely short and did not have allow for a sufficiently deep analysis of all the aspects and consequences of the proposed framework. Bearing in mind the importance of the asset-backed securities market for the global and European economy, we very much urge the Committee to take this into account when weighing the various responses it receives. We would also very much like to invite the Committee, once it has had the opportunity to review the responses to the Paper, to issue some further and more detailed proposals. Such proposals should then be the subject of a further consultation. It is essential, in our view, that sufficient time be given to industry participants and policy makers to review in detail the workings and consequences of any new securitisation framework.

Overall Approach

We believe any new securitisation framework should take into account some key principles we set out below.

Balance

As stated above, PCS believes that a robust securitisation market is essential for the economy. PCS also believes that appropriate prudential rules, including capital requirement rules, are essential to avoid a repeat of the systemic financial breakdown experienced in 2007/2008. These two considerations strongly point towards an approach that balances the needs of the economy with the need for financial stability, without sacrificing either. As we will outline below, PCS is concerned that, in a number of aspects of the proposed framework, overly conservative proposals unsupported by data may have crept in under the banner of "prudential" considerations, without fully accounting for the necessary balance.

Consistency

PCS believes that one cannot look at the capital requirements for a given asset class in isolation. It is essential that the capital requirements of the various asset classes covered by the overall Basel Accords are consistent in the amount of capital needed

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[1] The White Paper will be available on March 18th 2013 at www.pcsmarket.org

to cover the estimated quantum of risk. When such consistency is not achieved, regulatory arbitrage is likely to occur. In addition, the financial system will likely begin to migrate to the assets for which a comparatively lower capital requirement will have been set. This both creates systemic risk, in and of itself, and reduces asset diversification within the system. Diversification within the financial system we believe to be a source of stability.

When PCS compares the outcomes for the capital required to hold a securitisation and a corporate loan, for example, it would appear that consistency is not being achieved. For example, the capital required for a AA 5 year securitisation in a classic asset class such as residential mortgages under the RRBA table is 7.76%. Senior tranches of European RMBS, despite the depth and length of the crisis, have suffered, so far, no losses. The capital requirement though is effectively equivalent (8%) to that required for an unsecured loan to a start-up company with no capital, cash-flow or track record. Similar questions arise from a comparison of the capital requirement for a covered bond backed by mortgages (10% RW under the SA approach and around 3%-5% RW under the IRB) and for the senior asset-backed tranche backed by the same mortgages, coming in at between ten and twenty times more capital.

Finally, it would appear that the proposed framework results (in quite a number of circumstances) in the capital required for a securitisation tranche being greater than the capital required were a bank to hold the credit risk of the entire pool of assets from which the tranche is carved.

Lessons of the crisis

PCS welcomes the Basel Committee's statement that the new framework must incorporate the lessons learned during the financial crisis. In contradiction with the Basel 2.5 framework, the new framework can benefit not just from the immediate lessons of the crisis but also from those gained from the vantage of a longer duration; lessons that can take account not only of the short term effects of the crisis of 2007/2008 but also of the longer term data that has since become available. This data is particularly useful as it corresponds to a period of severe economic recession in many jurisdictions. Our response sets out below (in the "Alternative Approach" section) what we believe are the lessons of the crisis – most very uncontroversial – and how they can form the basis of a new framework. We are concerned though that a number of statements in the Paper and the choice of a basic CDO model of single-B corporates as the basis of the RRBA calibration (and therefore the MSFA) suggests that the proposed framework does not fully account for the more reflective lessons of the crisis and may still be, to a greater or lesser extent, reflective of the now discounted view that "securitisation" *per se* presents unique risk characteristics.

"*High Quality Securitisation*"

As we elaborate in our "Alternative Approach" section below, PCS is of the view that the crisis has demonstrated the **flaws of certain types** of securitisations but the **resilience of others** as well as **the reasons for the differences** in outcomes. Notwithstanding PCS' doubts about the actual calibrations suggested by the Paper, PCS strongly welcomes the Basel Committee's approach, in Hierarchy B, in defining "high quality securitisations" as a starting point of its analysis. As set out later, PCS believes that a framework that uses actual pre-and-post crisis data, demonstrating the different behavior of **"high quality securitisations"** and **other securitisations** under stress scenario is the best method for deriving capital requirements for both categories.

Importance of the Revised RBA

PCS agrees with the aim expressed in the Paper to move away from CRA ratings as the basis for the capital requirement framework. PCS also acknowledges the mandatory requirements to do so imposed by legislation in a number of jurisdictions such as the United States. Nevertheless, it believes that the number of European banks that will be approved to use IRB for the underlying asset class is likely to be quite small – especially bearing in mind the jurisdictional fragmentation in Europe. Accordingly, one must conclude that the RRBA will be most likely the default approach for most European financial institutions in calculating their capital requirements. Bearing in mind the need for a balanced approach, this counsels against an unnecessarily "punitive" approach to the RRBA calibration, which could be otherwise justified by the policy aim to reduce CRA involvement in capital adequacy measures.

Alternative Approach – Question 4

Prior to responding to the questions set in the Paper, PCS would like to outline a possible refinement to the securitisation framework. Although this is ,technically, a response to Question 4 ("Are there alternative hierarchies or revisions to the two proposed (or a combination of both) that the Committee should consider?"), PCS hopes that this approach will assist the Committee to put PCS' other technical responses in context and, therefore, render them clearer.

The refinement to the proposed framework that PCS wishes to put forward is a modification of Alternative B, starting with a definition of "high quality securitisations" (as a direct but partial response to Question 3 – "As regards Alternative B, which methods could a bank use to conclude that a securitisation exposure is of high-quality?").

The lessons of the crisis

The crisis, as it pertains to securitisation, started in the 3rd quarter of 2007 with the issues relating to US sub-prime mortgage backed securities. As we now stand in the first quarter of 2013, we have the benefit of 21 quarters of data and information. In addition, the United States and Europe have experienced severe economic stress during this time, including in certain cases (eg Spain and Greece) levels of GDP decline and unemployment greater than those suffered by the United States in the early nineteen thirties. Data and information on the performance of asset-backed securities since 2007 is therefore not only extensive but also highly relevant in working out bank capital requirements sufficient to sustain financial institutions through stressed credit conditions.

During this time a number of securitisation classes performed extremely poorly, whilst others performed extremely well. At the outset of the crisis it was probably difficult to discern any pattern in these distinct outcomes. Also, it was not clear whether the better performance of some securitisations was merely the issue of time (in other words, they too would run into difficulties later on in the cycle), a purely random effect or indicative of more fundamental differences between securitisation types.

Time has allowed firmer lessons to be drawn from these differing outcomes and has led to a fairly general recognition that there are such things as "high quality securitisations" which, for general economic and financial reasons, should be encouraged[2].

PCS wishes to draw attention to the fact that all securisation types that ran into difficulties contained one of fours distinct elements (or, in some cases, more than one of those elements). Conversely, senior tranches of securitisations that did not contain any of these four elements performed very well, even when their underlying assets suffered high financial stresses.

Four elements

The four conditions that led to difficulties in securitisations since 2007 are not, in the view of PCS, particularly controversial.

(i) *Originate to distribute*: many securitisations whose underlying assets were originated by financial institutions that ran an "originate to distribute" model performed badly. This has now been recognised as the consequence of the dramatic decline in underwriting criteria that can be generated by this model. Such declines resulted from the replacement by some financial institutions of a long term funding credit analysis by a short term VaR analysis.

This does not mean that all securitisations produced under an "originate to distribute" model failed or are vulnerable to failure. Nor does it seek to imply that a collapse of underwriting criteria is the inevitable consequence of any "originate to distribute" model. It is perfectly possible to devise internal rules or regulatory schemes that can prevent such a collapse within the context of an "originate to distribute" model. [3]

However, one of the lessons of the crisis, is that securitisations produced under an "originate to distribute" model are, all other things being equal, potentially vulnerable.

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[2] See, for example, IOSCO's conclusions that "securitisation, when functioning properly, is a valuable financing technique contributing to economic growth and an efficient means of diversifying risk" - "Global Developments in Securitisation Regulation"- http://www.iosco.org/library/pubdocs/pdf/IOSCOPD394.pdf

[3] In this respect, we draw attention to the various "skin in the game" rules that have been introduced such as Art 122 a of the Banking Consolidation Directive - Directive 2006/48/EC (http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2006L0048:20100330:EN:PDF (as amended)).

(ii) *Leverage*: many securitisations which contained high levels of leverage failed (CDOs of ABS, CDO squared, CPDOs, etc…). Leverage implies that very small changes in the credit performance of the underlying assets have substantial impacts on the credit performance of the securitisation. As such, these securitisations relied on a purported degree of accuracy in the measurement of the credit risk (including issues of correlation) that proved highly illusory. Put differently, highly leveraged securitisations are very vulnerable to model risk and the CRAs, as well as the market, placed unwarranted faith in the capacity of models based on limited data sets to gauge credit outcomes.

Although it is possible, in the views of PCS, to create a robust "originate to distribute" model with the right safeguards, it is unlikely that it will ever be possible to make any leveraged securitisation "invulnerable to foreseeable events" (see page 10 of the Paper).

(iii) *Embedded maturity transformations*: securitisations are, in the majority, "pass throughs". The obligation to pay the holders of the securitisation bonds only arises when the debtors in respect of the underlying assets pay interest and/or principal. As such, they do not rely on a capital market refinancing to meet their principal obligations. A limited sub-set of securitisations did have embedded maturity transformations: structured investment vehicles and, to a substantial extent, commercial mortgage backed securities (CMBS)[4]. Securitisations relying on refinancing within a narrow window of time are vulnerable to market liquidity risks that are extremely difficult to model – if such modeling is even theoretically possible. As such they present specific and very difficult to quantify credit risks. They also did very badly during the crisis.

(iv) *Transparency*: During the crisis it became clear that many investors did not have at their disposal sufficient information on the credit risks of their asset-backed holdings to perform a reasonable assessment. This led to massive and uncontrolled disposals (or attempted disposals) generating substantial mark-to-market losses for financial institutions.

Lack of transparency can come either in the form of an absence of necessary data or in the form of complexity. When related to complexity, the data is available but either its quantity or the underlying complexity of the securitisation structure is such that even a sophisticated investor cannot derive a reasonable assessment of the risks of the instrument.

Usually, during the crisis, complexity has been associated with leverage (e.g. CDO squared products based on CDO's of ABS).

[4] Asset backed commercial paper conduits also embed maturity transformations but the risks of these are usually taken out by bank liquidity lines. In the context of the Basel capital adequacy framework, the key issue is the treatment of these lines and the IIA. Issues regarding ABCP conduits fall outside the remit of PCS and are therefore not broached in our response.

In the view of PCS, the transparency issue is in the process of becoming of mainly historical interest. Market conventions and regulatory initiatives such as the loan-by-loan data requirements of central banks for repo collateral purposes, as well as the disappearance of complex products, have resolved the issue. This does not mean though that regulatory rules need not encompass this aspect, to make the improvement permanent.

Consequences for a securitisation framework

The four elements outlined above provide, in the view of PCS, a good definition of "high quality securitisation" when combined with some credit component. Securitisations that are free of any of these elements, because of their simplicity and transparency, have proved during the crisis to be resilient and considerably less vulnerable to model risk.

Accordingly, PCS agrees with the Committee's assertion in the Technical Papers that the "inputs to the RBA exclude certain factors that, in addition to credit rating, appear to be material risk drivers for securitisation tranches." However, we would assert quite strongly that those factors are not solely, as the Paper appears to imply, "quantitative" inputs (such as tranche thickness and maturity). One lesson we feel should be learned from the crisis (and particularly from the issues that arose with CRA CDO models) is that "qualitative" elements (such as simplicity, transparency, absence of maturity transformation, low or no leverage and control of "originate to distribute" business models) are also material risk drivers.

As a consequence, we would favour a securitisation framework that encourages simplicity and transparency. We are concerned that the proposed framework effectively does not do so, as it treats all securitisations, however complex or opaque, in a similar manner. In addition to treating them in the same manner, it also appears to calibrate all securitisations against regulatory concerns about the performance of securitisations that did not fall in the category of "high quality". (See page 5 of the Working Paper No 23).

Some credit component still needs to be included since one could, in theory, create a very weak non-investment grade security that did not contain any of the four elements. However, this credit component (ie the rating) has shown itself during the crisis to be far more stable in the case of "high quality securitisations", relying less on the type of complex analysis that the CRA's felt able (but in many cases were not able) to conduct. The credit analysis of such securitisations is also far more easily replicable by reasonably sophisticated financial institutions. Using, as the starting point of a securitisation framework, a definition that included such qualitative elements would therefore also reduce the relevance of CRA's and affords the highest likelihood that, over time, the agencies may be removed from the regulatory framework.

Calibrating for the lessons of the crisis

Once the framework adopts a definition of "high quality securitisations", PCS believes that the calibrations of the risk weighting should then proceed using the available data. However, this data needs to be processed in a way that captures the correct data sets. In other words, the Committee should consider testing the performance of “high quality securitisations” during the crisis based on data that related only to those types of securitisation: those that were free of all four negative elements. A calibration based on an analysis of data relating to “RMBS” or “securitisation” generally, without distinguishing between data that related to “RMBS” or “securitisations” containing one of the four negative elements and data which related to “high quality securitisation” would effectively be ignoring the lessons of the crisis.

Although such an approach may, at first blush, appear to involve a lot of additional work, PCS believe this is not the case. Since transparency is a matter of future behavior that can be regulated and the lack of transparency primarily generated “mark-to-market” losses and systemic dislocation, it is not necessary to filter the existing historical data for “transparency”. Although an important element to the unfolding of the 2007/2008 crisis, lack of transparency is not a key driver of default in securitisations. This means that the data only needs to be analysed based on filters for “originate to distribute”, leverage and maturity transformation. These are quite straightforward filters to apply: the last two are bound to clearly defined and readily identifiable securitisation product types, whilst the first is bound to the identity of the originating bank. Therefore, the sorting of data into a relevant “high quality securitisation” set would not, in our view, require the acquisition of a large amount of additional data but the filtering of the existing data through a simple scheme.

PCS acknowledges that the Committee has based its calibration on an assumption that securitisations are based on a pool of single-B unsecured corporate loans rather than historical data sets. If we understand correctly, this was done to acknowledge that rating agencies had changed their methodology and therefore historical data would not be necessarily a good starting point. However, PCS would like to draw attention to the following points:

(i) the CRA’s changes relate to those areas where they made severe mistakes, namely the securitisations that performed badly. In other words, these changes, by and large, did not affect “high quality securitisations”. It follows that historical data, for “high quality securitisations” should still be a valid starting point irrespective of rating agency methodological changes;

(ii) notwithstanding the departure from historical data sets, the choice of a pool of single-B corporates with a PD of 4.73% appears to PCS to be substantially at odds with the observed PD’s of virtually all the granular asset classes that provide the backbone of securitisations, even through a severe economic downturn. We are led to conclude that such choice must be related, in some fashion, to the very poor performance of securitisations that did not meet the definition of “high quality securitisations”. As “high quality securitisations” did not suffer these types of poor performances, historical data relating to high quality securitisations would appear to us to be a more valid starting point than what looks, at first sight, to be a fairly arbitrary benchmark.

Therefore, in response to Question 4, PCS would suggest a better approach would be to use the definition of "high quality securitisation" provided above and calibrate the RRBA and MSFA on an analysis of the actual performance of such high quality securitisations (rather than securitisations generally) during the severe economic crisis experienced since 2007 (and, if relevant, earlier periods of stress, such at 2000-2001 or, in the United Kingdom, 1990-1992).

For the purposes of consistency, such calibration should then be equalized with the calibration of other asset classes (corporate bonds, covered bonds, etc…) based on their historical performance.

Specific responses

Question 1: "What additional costs and benefits of the two hierarchies should the Committee consider? Which hierarchy presents the greater benefit relative to its drawbacks? Which hierarchy would best address the shortcomings identified with the current framework, whilst meeting the Committee's objectives?"

The existence of two separate hierarchies creates, in our view, the possibility of regulatory arbitrage. Hierarchy A is headed by the MSFA which, for reasons set out above ("Importance of the Revised RBA"), PCS fears would be used by few banks. Hierarchy B requires at the outset a definition of "high quality securitisation" which PCS believes is the most important lesson from the crisis and should form the basis of future calibrations.

However, although PCS supports a framework that begins with a definition of "high quality securitisations", this does not imply that we support the actual structure of Hierarchy B. In particular, in the same way as we believe capital requirements for "high quality securitisations" should be calibrated on historical data for such tranches, we believe capital requirements for tranches that do not meet the definition of "high quality securitisations" should be calibrated on some prudent analysis of historical data.

Bearing in mind the requirements of balance and consistency, PCS believes that defaulting to the Concentration Ratio K_{irb} for all other securitisations is unduly punitive. We think this is particularly true of the junior tranches of securitisations whose senior tranches qualify as "high quality securitisations". In other words, the junior tranches of securitisations that did not contain one of the four problematic elements performed, during the crisis, in line with expectations. If a AAA/AA rating (or other equivalent credit score) is a requirement of a "high quality securitisation" then the Concentration Ratio K_{irb} fails to reflect the actual performance of lower rated tranches of otherwise "high quality securitisations".

Also, the present structure of Hierarchy B would seem to recreate the cliff-risks that the Committee explicitly sought to dispel.

Accordingly, PCS supports a framework that begins by dividing securitisations into "high quality securitisations" and "other securitisations" (as per Hierarchy B) but then follows either the path of Hierarchy A or a path similar to the existing path for "high quality securitisations" in Hierarchy B but for both types of securitisation (ie without defaulting to the Concentration K_{irb} for tranches that do not meet the "high quality securitisation" definition). This should certainly be the case for tranches which would fall in the "high quality" definition save **only** for their credit rating.

Question 3: "As regards Alternative B, which method could a bank use to conclude that a securitisation exposure is of high-quality? Would the use of these methods likely result in a capital charge consistently related to credit risk across banks and countries? Would Alternative B produce material cliff effects as exposures deteriorated below high-quality?"

Please see our suggested approach to "high-quality" in the preceding section: "Alternative Approach". The present dichotomy between the paths for "high quality securitisations" and other would create very material cliff effects. However, an analysis based on the lessons of the crisis should lead, in our view, to a treatment of securitisations that did not meet the definition of "high quality" based on a combination of the qualitative aspects of such securitisations and their historical performance. Although the outcome would depend on the actual results of such analysis, there is strong anecdotal evidence that such results would lead to much lower cliff effects for those securitisations that only failed to meet the definition of "high quality securitisations" because of their rating. This would be most relevant for junior and mezzanine tranches of securitisations of the type that performed well in the crisis (see "Alternative Approach" above).

Question 4: "Are there alternative hierarchies or revisions to the two proposed (or a combination of both) that the Committee should consider?"

Please see the preceding section: "Alternative Approach".

Question 6: "Is the RBA appropriately calibrated and formulated? Should other risk drivers be incorporated?"

Granularity: We are unsure that an assertion that granularity is not relevant in estimating credit risk is correct. We would suggest that additional work be done to determine whether this is indeed correct for "high quality securitisations". We suspect that the poor performance of certain granular securitisations for other reasons (eg US sub-prime RMBS or CDOs of ABS) may have resulted in a generalization that does not hold true for "high quality securitisations" where we believe the evidence is likely to demonstrate the traditionally acknowledged link between granularity and credit resilience.

Floor: We are not clear how the floor of 20% was selected. To the extent that this floor is derived mathematically or intuitively from the poor performance of securitisations that were not of high-quality, we would urge the Committee to rely on the actual stressed performance of high-quality securitisations to derive any floor, rather than what appears to be an arbitrary number. Also, from a consistency point of view a floor of 20% does not seem consistent, for the highest possible quality securitisations, with, for example, a RW of less than a quarter of that amount for a covered bond backed by the same assets.

Maturity: The ratios appear to be different for different rating levels. We do not understand the principles applied to generate the steepness of the maturity curve and so find it difficult to comment.

Also, CRAs will take maturity into account in determining a rating. In the case of pass-through securitisations, (the vast majority of securitisations) the maturity of the asset-backed security matches the maturity of the underlying assets. In turn, the maturity of the underlying assets is a key factor for the rating (and/or the tranche thickness at a given rating level). Therefore, such a steep maturity multiplier in the RRBA would appear to be a case of double counting.

A similar double counting appears to take place in the MSFA.

Taking into consideration the economic impact of short term versus long term lending and the concern within Europe about the lack of long term bank finance, especially for SMEs, the steepness of the maturity curve (tripling capital requirements for AAA senior tranches) is a matter of serious concern.

Contractual Maturity: The use of the final contractual maturity to determine the maturity component of the formulae appears substantially unrealistic for the retail assets that back the vast majority of securitisations. We would strongly urge the Committee to gather actual data on pre-payment rates for the various retail asset classes. We recognize that a prudent approach would then be to stress these results. However, a framework that assumes that in a pool of 5000 residential mortgages or 50,000 credit card accounts each and every single borrower ceases all payments other than interest for twenty years or more (as allowed by the relevant mortgage or credit card documentation) appears to go beyond any meaningful prudential boundary.

Use of ratings: The Technical Paper states that the RRBA assumes that "a credit rating reflects a debt instrument's [Estimated Loss] and that credit rating processes for tranches and corporate bonds are consistent so that identical ratings imply identical ELs across asset types."

As this is a fundamental assumption underpinning the RRBA, PCS wonders whether the Committee has verified this assumption with the most important CRAs. It is the PCS' understanding that two of the three main CRAs (Standard & Poor's and Fitch) set their ratings to "first loss" – in other words – we are not aware that their ratings speak at all to EL and much less seek to generate any equivalence of EL across asset classes (such as corporates and securitisations).[5] Although Moody's methodology does speak to expected loss, PCS is not aware of any statement by Moody's that its practices should generate an equivalence as to EL across asset classes. Before such a crucial assumption is made, there may be benefit is seeking comfort from the CRAs that, based on their actual rating practices, such an assumption has a solid basis in fact.

[5] PCS is aware of the efforts made by Standard & Poor's and Fitch to make their ratings equivalent across asset classes, but – to our knowledge – this equivalence is a matter of PDs, not LGD or EL's.

This is doubly important as an assumed equivalence of EL between similarly rated "high quality securitisations" and corporates does not appear to be borne out by the historical data. Nor is such an equivalence intuitively logical: one would not, intuitively, expect the losses on a defaulted unsecured corporate loan to be similar in size or dynamic to those on a defaulted granular, highly secured tranched pool of residential mortgages with reasonable (ie around 75%) loan to value ratios.

Single B corporate inputs: The use of a simplified CDO model using an undifferentiated pool of unsecured single B corporate loans to calibrate the RRBA seems to us a difficult assumption to understand.

PD for such pool is calculated at 4.73% with an assumed LGD of 60%.

First, PCS is not aware of any rating agency that rates granular securitisations in the traditional asset classes (residential mortgages, consumer loans and leases) based on assigning an assumed rating to each asset and running a form of CDO model. The approach advocated here does not therefore connect with the actual rating methodology from which it purports to derive. We are therefore concerned that this key assumption does not appear to have any theoretical or practical grounding. Effectively, it seems to "hang in thin air".

Also, the actual historical performances of the assets classes underpinning securitisations (and particularly residential mortgages) have not shown anything like these levels of default or loss within the "high quality securitisation" category for which they are calibrated in Alternative B.

PCS is concerned that this assumption may be arbitrary, highly negative and not supported by any relevant data. We would advocate, as set out above, that the actual historical data collected during highly stressed economic periods, such as that since 2007, be used instead.

We are concerned that the use of such punitive assumption is not consistent with the principle of balance that we have advocated and, to the extent that other asset classes are not subject to such assumption, with the principle of consistency.

Conclusions

PCS welcomes the Committee's work on a new securitisation framework. In particular, PCS believes the introduction of the concept of "high-quality securitisation" as the starting point of such a framework is a major positive development.

PCS does have some material concerns though about the new proposed framework:

(i) we believe the concept of "high-quality securitisation" should be grounded in the lessons of the crisis and also encapsulate the "qualitative" elements that the crisis has shown are the hallmarks of resilient asset-backed securities;

(ii) we believe that the calibration of the RRBA and the MSFA should be based on the historical data gathered through a period of severe economic stress and not through a series of assumed parameters;

(iii) we believe the historical data should be analysed through the filters of the lessons of the crisis, so that "high-quality securitisations" can, like other assets classes such as corporate bonds or covered bonds, be calibrated against their own performance;

(iv) we have some material concerns about the severity of the bifurcation proposed in Hierarchy B and the punitive nature of the treatment of tranches that do not meet the definition of "high quality" solely as a result of being the junior tranche to a senior "high quality" tranche and believe this is not warranted by the data;

(v) we have some deep concerns over some of the technical assumptions used in the proposed calibrations;

(vi) we have some deep concerns that the outcome of the proposed new framework for high-quality securitisations would not meet the consistency principle that we believe needs to underpin the overall capital framework to ensure systemic stability;

(vii) we have some deep concerns that some of the technical assumptions' severity could be motivated by the regulatory reaction to the performance of securitisations that did not meet the "high-quality" definitions and that this could result in a framework that is not consistent with the principle of balance.

Thank you for the opportunity to provide comments on the Paper. Should you have any questions or wish for any additional information regarding any of the comments, please do not hesitate to contact me.

Yours faithfully

Ian Bell
Head of the PCS Secretariat