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	BSBV 115/Dr. Egger/St	3137	14th August 2013

EBA – Consultation on Draft RTS on the determination of the overall exposure to a client or a group of connected clients in respect of transactions with underlying assets under Article 379 of the proposed CRR (EBA/CP/2013/07)

The Division Bank and Insurance of the Austrian Federal Economic Chamber, as representative of the entire Austrian banking industry, appreciates the possibility to comment on the EBA Consultation on Draft RTS on the determination of the overall exposure to a client or a group of connected clients in respect of transactions with underlying assets under Article 379 of the proposed CRR and would like to submit the following position:

Q1: Is the treatment provided in Article 5 sufficiently clear and do the examples provided appropriately reflect this treatment?

The examples are clear. However, an example reflecting Artricle 5(1) of the RTS should be added to show that if the institution's total exposure to an underlying asset calculated according to Article 5(2) is higher than the value of the underlying in the transaction scheme then the exposure assigned to the underlying is capped by the value of the underlying.

E.g. Example 5:
based on the same transaction like Examples 1 to 4 but the institution invests an amount of 50 in the transaction of which 40 in the senior tranche and 10 in the first loss piece.

- Calculation according to Article 5(2): for the senior tranche the pro-rata ratio for the institution's exposure to the transaction is 4/5 (40/50), for the first loss piece the pro-rata ratio is 1/2 (10/20). Article 5(2)(b) requires to multiply each ratio with the lower of the value of the underlying and the value of the respective tranche.
  Underlyings A and B (4/5*Min(25;50) + 1/2*Min(25;20)) --> 20 + 10 = 30
  Underlyings C to F (4/5*Min(10;50) + 1/2*Min(10;20)) --> 8 + 5 = 13
  Underlyings G and H (4/5*Min(5;50) + 1/2*Min(5;20)) --> 4 + 2.5 = 6.5
- According to Article 5(1) an institution has to assign to an underlying asset the lower of a) the value of the exposure arising from the underlying asset and b) the institution's total exposure to the underlying asset. Since the institution's total exposure to the underlying asset (=b) has to be determined according to Article

5(2) as shown above and is higher than the value of the exposure arising from the underlying assets (=a), a) has to be taken and the exposures assigned to the underlying assets are:
Underlying A and B the Min(25;30) = 25
Underlying C to F the Min(10;13) = 10
Underlying G and H the Min(5;6.5) = 5

The treatment provided in Article 5 is clear but the wording is unclear because the word 'exposure' is used often, e.g. "... the exposure value of the exposure arising from ...". The use of a glossary could help to make the main text shorter and clearer.

Q2: Is there an appropriate alternative way of calculating the exposure values in the case of securitisations, which would be compatible with the large exposures risk mitigation framework as set out by the draft CRR?

Wefollow the argumentation of the EBA that the suggested calculation methods under article 5 - if a look through is economically feasible - should not consider tranche seniority or other credit risk mitigation features to guarantee a conservative 'worst-case' treatment of idiosyncratic risk.

Q3: Would the application of requirements provided by Article 6 (3) and (4) imply unjustified costs to the institutions? Would the introduction of a materiality threshold be justified on a basis of a cost-benefit analysis? Please provide any evidence to support your response.

The proposed policy does not appear to be reasonable for retail / consumer transactions such as RMBS, Leasing, Auto etc., because it is highly unlikely to generate relevant undetected bulk risk with consumer exposure.

For very granular transactions, which make up the majority of the ABS market, it will not be possible to identify the obligors. Even if collateral data is available for e.g. 10,000 of loans of a transaction, the identity of the borrowers in such a transaction will not be known.

- Also, from our point of view, the added value generated by the identification of the borrowers of such a granular pool is very limited, as these transactions are analyzed with aggregated ratios.
- From a data-protection perspective we also deem it very questionable whether it is possible for an originator or a servicer to deliver identification data of the borrowers (who are consumers in case of RMBS, Consumer loan transactions, Auto deals etc).
- The cost associated with the collection of borrower identification – if possible at all as outlined above – are relatively high with a limited recognizable benefit. Therefore, a materiality threshold in the form of a granularity threshold is the right way to balance cost and benefit.

Furthermore, the materiality of an underlying exposure in respect to the portfolio of an institution depends also on the structure of the transaction. For instance the investment mandate can ensure that the underlyings are not connected with any other direct or indirect exposure in the institution's portfolio that is higher than 2% of the institute's eligible capital. In this case the exposure should be considered immaterial enough for assigning it to the transaction as a separate client instead of the unknown client.

In our opinion, the absence of a materiality threshold would indirectly constitute an overall portfolio limit for diversified securitization exposures, capped at the maximum amount that is allowed to be allocated to the unknown client. In our view, it is economically not feasible and sometimes factually impossible (e.g. due to data protection laws) to identify and interlink individual exposures of highly diversified securitizations.

European consumer securitisation programs (auto loans, auto leases, consumer credits, equipment leases) with highly granular portfolios form an important pillar for refinancing for the issuers, and bank investors typically make-up for 40-60% of the investor base. These programs comprise inter alia VCL and Driver from Volkswagen Financial Services, Bavarian Sky from BMW Bank, several programs from Santander Consumer Finance in Spain, Portugal, Germany, UK, Scandinavia, Silver Arrow from Daimler, E-Carat and E-MOT from GMAC and similar programs from captive finance subsidiaries from FIAT, Renault and Peugeot.
As the individual obligors will not be identified or interlinked, these transactions would have to be subsumed under the unknown client. Consequently, this would strongly decrease the ability of institutions to provide secured, low-cost funding for the affected sectors.
One of the basic concepts of the securitization programs named above is diversification. The transactions are typically structured in a way that idiosyncratic risk is basically removed and credit risk is assessed on an aggregated basis. Maximum borrower concentrations are regularly below 1% of the total portfolio size. See for example: The securitization programs of Volkswagen Leasing GmbH and Volkswagen Bank GmbH – the latest issuances VCL 17 and DRIVER 10 actually have maximum obligor concentrations of 0.05% and the number of obligors per transaction are 48tsd and 70tsd respectively.
Even if we assume a worst case scenario, where a bank has a position in such a securitization in the maximum allowed amount of 25% of eligible capital, single obligor risk will be as low as 0.0125% of eligible capital.
Especially in cases where the underlying assets are loans/leases to individuals or SMEs, we do hardly see a theoretical possibility that the exposures underlying the securitizations impose more than negligible idiosyncratic risks to the bank. We therefore see only very limited (if any) improvements in measuring idiosyncratic risk by identifying and linking each obligor of such a transaction.

If the exposures underlying the securitization consist of non-retail obligors, a bank may already be significantly exposed to the obligors of the securitization via direct business relationships and therefore idiosyncratic risk may be increased by assuming exposures in such securitizations. We therefore propose to continue to apply a reasonably calibrated materiality threshold that ensures that the additional idiosyncratic risk stemming from the securitization exposure is small compared to the overall risk position of the bank to an obligor (see Q4) and that avoids high additional costs for the institutions to identify and link exposures that only negligibly contribute to idiosyncratic risk.

Partial look-through
Article 6(4) of the RTS seems to prevent a partial look-through. According to our information, EBA does not intend to discontinue the partial look-through. Therefore, the RTS should state clearly that the partial look-through can still be applied.

Moreover does that mean that according to Article 6 (4) in the case of a partial look through we have to add the total transaction with underlying assets to the “unknown client” even if we add, for example 95% of the underlying exposures of the transaction to the separate obligor? That

would mean that a partial look-through is useless and thus some institutions would not do any look-through at all because total look-throughs are often not possible.

Q4: Keeping in mind that such materiality threshold would need to be sufficiently low in order to justify that all unknown underlying assets of a single transaction would be assigned to this transaction as a separate client, what would be the right calibration? Would the reference value (the institution's eligible capital) be appropriate for this purpose? Please provide any evidence to support your response.

From our point of view it makes sense to continue to identify the borrowers of loans accounting for more than 5% of the total pool balance in a transaction with underlying assets. 5% seem to be sufficiently low.

The granularity threshold discussed by the EBA on Page 10 of the CP constitutes – in our view - a sound alternative mechanism to capture the absolute risk amount stemming from exposures underlying transactions.

As an example we assume a bank with EUR 1bn of eligible capital and a large exposure limit of 25% or EUR 250mn. EBA's suggested threshold of 0.25% of eligible capital would therefore allow the bank to treat securitization programs as individual clients, if the largest exposure does not exceed EUR 2.5mn or - in other words - contributes more than 1% to the bank's large exposure limit of EUR 250mn.

We now further assume that the bank invests in two different securitization programs (purchase of the entire programs): 100mn in Program ONE with a maximum concentration of 3% (maximum exposure of 3mn) and 10mn in Program TWO with a maximum concentration of 6% (maximum exposure of 0.6mn). If we apply the current granularity threshold of 5% to these two transactions the bank could treat Program ONE as a separate client and has to look through Program TWO and assign the exposure amounts that exceed the 5% threshold (up to 0.6mn) to the obligors. Under the newly discussed scheme the bank would have to look through Program ONE and link the exposures that exceed EUR 2.5mn to the respective obligors, as the maximum exposures exceed 0.25% of eligible capital and does not have to assign and identify the exposures of Program TWO.

Considering the securitisation portfolio held by our institution, the current granularity threshold of 5% for determining whether a look through has to be applied is sufficient to guarantee a conservative treatment of additional idiosyncratic risk stemming from exposures underlying transactions. A removal of this threshold or a modification of the calculation method would not result in any significant additional insight or benefit for the institution or the competent authorities.

However in case the materiality threshold is defined on the basis of eligible capital as discussed above this would mean that the same transaction would be treated differently by the different institutions. An institute with a large eligible capital would treat the transaction as a separate client and an institute with a small eligible capital would have to treat it as part of the unknown client. This would contradict the intention of a level playing field. Furthermore, the same transaction could be treated differently in the large exposure calculation of an institute on solo basis and of an institutes group on consolidated basis.

The aim of this draft seems to be to force the institutions to look-through. However the problem is that credit institutions get the necessary information to apply a look-through approach for some transactions too late relating to the reporting deadline. So, even a lower granularity threshold will not have the effect that a look-through approach is used more often.Lowering the granularity threshold would mean a lot of additional effort and costs as having collected the information for the 5% limit.

Follwing the arguments made above we suggest to leave the 5% granularity threshold unchanged.

Q5: Would the requirement to monitor the composition of a transaction at least monthly, as provided by Article 6 (5), imply unjustified costs to the institutions? Please provide any evidence to support your response.

Given a reasonably calibrated materiality threshold, monthly monitoring will not lead to unjustified costs for institutions. Nevertheless, monitoring reports are only available on a quarterly basis for certain securitization transactions. We therefore suggest that for existing transactions where data is only provided on a quarterly basis, the composition is to be monitored on a quarterly basis or a sufficiently long transition period for adapting the reporting frequency is given.

Without such a threshold, diversified, revolving securitization transactions would require the institution to identify and link thousands of obligors each month, which would imply prohibitively high costs (potentially preventing institutions from further funding these transactions) and as outlined in Q3 would practically not improve the measurement of idiosyncratic risk.

Q6: Are there other conditions that could be met by the structure of a transaction in order to not constitute an additional exposure according to Article 7?

Securitisation transactions in Europe do not have a UCITS format. Article 7 paragraph (1)(a) is complied with by market standard features: limited recourse and no petition language, definition of sources of funds (mainly proceeds from underlying assets plus e.g. proceeds from a cash reserve account) and priority of payments ("waterfall" which defines the order of priority of payments for every payment date).

Some institutions might not know how to find out whether a transaction involves a payment obligation of a certain person according Article 7 (1) b) or not. Unless these institutions are not 100% sure that this is not the case they will have to consider all transactions with underlying exposures as additional exposures.

Please quote a concrete example regarding Article 7 (1) b).

Additional remarks

Other transactions with underlying assets
Which transactions other than securitisation positions and shares in CIUs are transactions with underlying assets? Kindly provide a list of examples.

Kindly give our remarks due consideration.

Yours sincerely,

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