



# Japan Securities Dealers Association

JSDA

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March 18, 2014

RE: Comments on the Consultative Document “Revisions to the securitization framework” (Published in December 2013)”

Dear Sir/Madam:

The Japan Securities Dealers Association (JSDA)<sup>1</sup> welcomes the opportunity to comment on the second consultative document “Revisions to the securitization framework” published by the Basel Committee on Banking Supervision (BCBS) in December 2013.

It is our hope that the JSDA’s comments will prove useful to the BCBS in the process of producing the final standard.

## **General Comments**

### **Flexibility in Interpretation of Requirements to Allow for National and Regional Authorities’ Discretion**

Securitization transaction structures, market practices, and other details vary according to each country and region. Therefore, for the time being, we believe that a certain degree of flexibility in the interpretation of regulations and the definitions and interpretations of terminology should be accepted for the final

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<sup>1</sup> Japan Securities Dealers Association (JSDA) is an association functioning as a self-regulatory organization (SRO). Its legal status is a Financial Instruments Firms Association authorized by the Prime Minister. Today JSDA comprises around 500 members consisting of securities firms and other financial institutions operating securities businesses in Japan. It also acts as an interlocutor for the securities industry between the market participants and other stakeholders, separately from its self-regulatory functions.

As a fully empowered SRO, JSDA extensively regulates market intermediaries. Its self-regulatory functions encompass rule-making, enforcement, inspection, disciplinary actions, accreditation of sales representatives, and dispute mediation.

capital requirements framework and its application in individual countries and regions. This flexibility is necessary to implement appropriate regulations that take into account each country's and region's practices and other customs. Moreover, final decisions on the framework should allow for adequate discretion by supervisory authorities in each jurisdiction.

## **Comments on Definitions and Other Terminology**

### **Delinquent underlying exposures ratio (W)**

Delinquent underlying exposures used in the ratio (W) of delinquent underlying exposures to total underlying exposures in the securitization pool of the Standardized Approach are defined in paragraph 73 of Annex 1 as "underlying exposures that are 90 days or more past due." However, the definition of delinquencies is not necessarily the same in each country and region. Given these differences, unifying definitions in all jurisdictions would require a considerable amount of time and cost. Furthermore, strictly following this definition of "90 days or more past due" could also produce difficulties with the frequency of determining the delinquent underlying exposures ratio. For example, in Japan 1) calculations are commonly made monthly and 2) there are differences in the frequency of calculation depending on the risk management policy of the originator and servicer and on administrative or system-based limitations.

Consequently, if it can be deemed that using a definition of "three months or more past due" for delinquencies in monthly calculations, etc. of a delinquent underlying exposures ratio is by and large equivalent or even more conservative in practical terms to using a definition of "90 days or more past due", we believe that definition should be permissible as an alternative. If making decisions on such definitions and interpretations on a case by case basis is incompatible with such an international agreement, we believe that the supervisory authorities of countries and regions should be given adequate discretion to revise their definitions and interpretations in line with the new capital requirement framework based on conditions in their country or region for a certain period of time.

### **Tranche Maturity (M<sub>T</sub>)**

We understand that, as a result of consideration of the many comments received on the first consultative document, from the point of view of being conservative, the original proposal was retained and, when the contractual cash flows cannot be determined, the final legal maturity of the tranche must be used as the  $M_T$ . Although we agree that a conservative approach should be taken, adhering to the current proposal results in large gaps with actual conditions for some  $M_T$ , raising the concern of imposing excessive capital requirements. For example, many ABS products in Japan are structured as “pass through” instruments. Hence the timing and the amounts of the cash flow for the tranche are not stipulated in the contract. Still, the securitized assets in the tranche have individual maturity dates and repayment conditions as per their contracts and though prepayments may shorten maturity in some cases, maturity dates are not extended. Under these circumstances, the effect is generally the same as if the timing and amount of the cash flow of the tranche were stipulated by contract. Therefore, there is no practical difference between using WAL calculated using the cash flow of securitized assets based on the assumption that there are “no prepayments or defaults” as the  $M_T$  for tranches without contractual cash flows and using WAL for tranches with contractual cash flows. However, if the current proposal is adhered to, even if the WAL of a short-term tranche is about one year, because of the fact that the final legal maturity is longer than the tranche with the longest WAL, in almost all cases a five-year  $M_T$  will be applied, resulting in a low risk sensitivity application of the capital framework.

As a solution to this issue, even though we believe the final legal maturity can continue to be used where the contractual cash flows cannot be determined for the tranche, we propose that use of the WAL as the  $M_T$  should be permitted in cases like the above where the effect is the same as if the tranche cash flow timing and amounts are stipulated by contract. Since the conditions for determining whether both approaches have the same effect differ according to product structuring and other factors in each country and region, each country and region should be given discretion in this point because of their greater understanding of the risk involved. For example, in Japan, when a tranche meets the conditions of i) securitized assets have individual maturities and prepayment conditions stipulated in their contracts, and extensions for assets that exceed their maturities do not occur, ii) securitized assets that fall into delinquencies cannot remain in delinquencies indefinitely and are deemed in default after a certain period, and iii) prepayments or defaults of securitized assets do not extend the maturity of the tranche, it can be supposed that the conditions for

using WAL calculated using the cash flow of securitized assets based on the assumption that there are “no prepayments or defaults” as the  $M_T$  of tranches without contractual maturity have been met.

As related matters, there are many cases where the risk should be recognized depending on a difference of maturities. In pass through securitizations in which tranches are structured in order of short-term and long-term, etc., if the WAL for the same securitized assets is used as  $M_T$ , there is a high probability that the risk capital requirements will be excessively high for the short-term tranches. The Basel Committee proposals already indicate that if these tranches are non-senior,  $M_T$  should be adjusted based on the thickness of the tranche (T). This is expected to contribute to not only appropriate differences in rating tables, but also risk capital requirements in line with actual conditions of maturities. As a result, we believe it would be desirable to give countries and regions as much room as possible for discretion with the adjustment of  $M_T$  for senior tranches with tranche thickness (T) in the same way as non-senior tranches.

### **Comments on Individual Questions**

*Q1. The Committee seeks input as to whether the proposed treatment of derivatives other than credit derivatives achieves an appropriate balance between risk sensitivity and simplicity; and welcomes respondents' views on how to improve upon the proposed treatment.*

The treatment of assigning a risk weight to a swap-related securitization exposure that is equal to the risk weight assigned to the most senior tranche that is junior to the swap does not present significant problems when there are many tranches and the risk weight gap between tranches is small. However, when there are only a few tranches (for example only a senior and junior tranche or just a senior, mezzanine, and junior tranche), the risk weight can become excessive and raise significant concerns that the treatment is overly conservative. In particular, if a conservative structuring approach is taken where only the tranches with the highest ratings or equivalent rating levels are sold to investors, there is a large gap in the risk weight between the most senior tranche and the tranche that is one rank junior. Therefore, if the currently proposed capital requirement framework is introduced, there is a concern that it will create a disincentive to structure such conservative products.

Given the differences in the practices and customs of creating securitization products in each country and region and by product category, it is not really appropriate to use the above treatment method for all securitization products. On the other hand, from the point of view of simplicity, it is also not desirable to have multiple rules allocated for each product. Consequently, as an alternative, we would propose that the risk weight for a swap-related securitization exposure be equal to not the most senior tranche that is junior to the tranche but to the tranche itself.

We recognize that the current proposals by the Committee place a high priority on conservatism. We believe that, compared with the current capital framework, the proposed framework will raise the overall risk weight assigned to securitization products, insuring a conservative standard.

Sincerely yours,

A handwritten signature in black ink, consisting of the Japanese characters '石倉 一' (Ishikura Koichi) followed by a horizontal line.

Koichi Ishikura  
Executive Chief of Operations for International HQ