TD Bank

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baselcommittee@bis.org
Secretariat of the Basel Committee
on Banking Supervision
Bank for International Settlements
CH-4002 Basel, Switzerland

Re: Toronto-Dominion Bank Comments on consultative document: "Revisions to the Basel Securitisation Framework"

Dear Basel Committee members:

The Toronto-Dominion Bank ("TD" or the "Bank") very much appreciates the opportunity to offer its comments to the Basel Committee (the "Committee") concerning the consultative document on revisions to the Basel securitization framework (the "Proposal").

TD is a chartered bank and is the second largest banking organization in Canada with total consolidated assets of approximately $800 billion. TD's intermediate U.S. holding company, TD Bank U.S. Holding Company, has total consolidated assets of approximately $200 billion.

TD is an AIRB approved bank in Canada and is compliant with the Basel III capital requirements on an "all-in" basis.

The Bank is also a member of the Canadian Bankers Association ("CBA") and is a signatory to its comment letter on the Proposal. While we actively participated in the preparation of the CBA comment letter and fully support its content, we feel it prudent to voice some of our specific concerns and insights with the Proposal given our unique perspective as a disciplined investor with significant holdings in asset-backed securities ("ABS").

A) Overview

TD pursues a low risk retail oriented business strategy and therefore is an active investor in high quality senior tranches of securitized consumer loan portfolios, principally through its U.S. retail bank operations. We believe we typify a bank that uses securitization prudently and effectively in order to deliver a low risk strategy for managing a deposit oriented franchise.

TD focuses on investments in plain-vanilla, transparent, senior tranche structures that are easily understood and that meet the bank's low-risk appetite. In addition:

- All of the investments are fully **term funded** and operate generally with a **"buy and hold"** investment strategy.

- Investing in securitized products provide the Bank with the **diversification benefit** of investing in a multitude of different asset classes as well as the ability to achieve an additional layer of **credit protection** from subordination and credit enhancements.

- We have a disciplined internal review, approval, and monitoring **credit risk management** process that requires a detailed credit assessment on all securitization collateral and structural features and does not rely on rating agencies.

- Our securitization investments, particularly auto loan, credit card, and mortgage ABS, **performed well throughout the recent financial crisis**, thereby validating the structural features of the securitizations and the high quality of the underlying assets.

TD is very concerned that the calibration used in the Proposal does not properly align required capital with actual risk, particularly for investments in high quality senior securitization exposures. Senior tranche note-holders are credit protected by both the subordinated note-holders and the originator, who absorbs the bulk of the risk. We feel the benefit from this type of credit protection is no longer being recognized in the proposed calibration. This is evidenced from the preliminary results of our QIS exercise, where the RWA on the Bank's high quality, senior securitization investments can potentially grow by a factor of nearly 7x under the Proposal, despite 93% of the investments being rated AAA and the remaining 7% being rated AA+.

TD is concerned that the proposed capital requirements will force low risk retail banks such as TD to reduce their exposures to senior high-quality products in favour of riskier products. The safer high-quality senior securitization exposures will migrate instead to unregulated funds that can price the risk more economically. The overly punitive capital treatment will compel banks to move out the risk curve in order to meet minimum capital-adjusted returns resulting in a less stable overall banking system.

B) Specific Concerns

Below, we highlight some of our more specific concerns with the Proposal:

I) MSFA is Not Accessible for Investors

The Proposal limits the MSFA approach to only those banks that have sufficient information to estimate IRB parameters on all underlying assets. Investors, such as TD, will be unable to utilize the MSFA, even if loan level data is obtained, since insufficient granular historical data exists to meet data governance requirements on model back-testing and validation. The result is that even a sophisticated AIRB approved bank such as ourselves, when acting as an investor, would not be able to utilize internal models for the securitization exposures due to the fact that sufficient granular historical data is not typically available to investors. Since a risk-based approach is not available under the Proposal, investors will be forced to use a non-risk sensitive and excessively conservative method such as the Revised RBA ("RRBA"). We believe it is unacceptable that AIRB approved banks, such as TD, would not have access to the MSFA or to an equivalent risk-sensitive measurement method.

II) Absence of Asset Quality Consideration

The Proposal is not sufficiently risk-sensitive as it fails to distinguish between differences in credit quality among asset classes. As a result, the Proposal unfairly disadvantages banks, such as TD, that invest in securitization structures that have low-risk underlying assets. For example, TD invests a sizeable portion of its U.S. investment portfolio in student loan ABS. Although these student loans are 97% guaranteed by the U.S. government and thus carry little to no risk to the bank, the proposed capital requirements on these exposures are treated the same as securitizations with much riskier underlying assets.

III) Calibration

As outlined in the CBA comment letter, we support multiple rounds of QIS exercises so the proposed floor and formulas in the approaches are calibrated to a level that is more commensurate with the true risk of the securitization exposure. Some of the calibration concerns that we have with the proposed RRBA and/or SSFA include:

- Both the RRBA and SSFA give little to no benefit to structuring or credit enhancements, which significantly reduce risk.
- RRBA is calibrated by assuming that the underlying pool is composed of single B rated corporate bonds with a PD of 4.167% and an LGD of 60%. This is not

representative of the Bank's ABS portfolio, which has high quality, homogeneous, retail assets as its underlying.

- The maturity adjustment in the RRBA is excessively and unjustifiably punitive, especially for senior AAA tranches, where the risk-weight for a 5-year ABS, at 58%, is nearly three times the size of the risk-weight for a 1-year ABS. For senior tranche securitizations with retail oriented collateral such as auto loans, credit cards and mortgages, these proposed risk-weights are not materially different from the risk-weight of the underlying asset, despite the significant credit subordination and structural protection provided to the investor.

- RRBA includes a significant maturity adjustment in determining capital requirements. For retail ABS, this maturity adjustment creates inconsistency with other parts of the Basel Accord as maturity is not considered in the determination of capital requirements for retail assets under the IRB whole loan framework.

- The SSFA applies a strict definition for "delinquent exposures" (i.e. 90 days or more past due) that unfairly penalizes against certain securitizations, such as student loans, which commonly have extended payment arrangements granted to borrowers. Further, not all asset types (e.g. auto loans) have an exact granular bucket for exposures that are "90 days or more past due", thereby further complicating the capital requirement calculation.

IV) <u>Interplay with other Basel Proposals</u>

The Basel III capital rules have already addressed many of the structural flaws in the banking system that manifested itself in select sectors of the securitization market. Any changes in the securitization framework should avoid double counting and excessive layers of conservatism. For example, the Basel III leverage ratio forces a floor capitalization level that will limit banks from over-relying on low risk-weight asset strategies, thereby sufficiently instilling balance sheet management discipline. Similarly, Basel III removes the AOCI filter, which forces banks to set aside capital for unrealized losses in investments, including securitization, that are classified as available-for-sale ("AFS") for accounting purposes. By needing to set aside capital buffers for changes in the fair value of AFS Securities due to market driven volatility, banks are intrinsically being penalized for holding longer-dated investments, thereby making the maturity adjustment and conservative calibration included in the Proposal redundant and unnecessary.

C) <u>Recommendations</u>

The following are some recommendations for improving the revised securitization framework:

I) <u>Ensure a Risk-Sensitive Approach exists for Sophisticated Investors</u>

As mentioned above, the MSFA under the Proposal will not be available for securitization investors as the requirements for its use are too restrictive. We fail to see the value of developing an approach that cannot be used by a significant stakeholder of the securitization market. As such, we recommend that sophisticated investors who maintain a disciplined independent credit assessment process be allowed to utilize pool level or other available data in the capital assessment process. This will ensure that a risk-sensitive approach, such as MSFA, is available to sophisticated investors. Similar to the concept of IRB in whole loans, we believe that it is important for investors who have disciplined credit risk management processes in place to be rewarded with the ability to have their capital requirements be better aligned with the actual riskiness of the exposure.

II) <u>Separate Calibration for High Quality Retail Securitization Exposures</u>

The calibration of the proposed approaches should be more risk sensitive so that the quality of the underlying assets is considered. We recommend that a separate calibration be applied to ABS that have high quality retail assets (i.e. high quality auto loans, credit cards, conforming mortgages) as the underlying. Given that these types of securitizations performed well during the recent financial crisis, we believe it is unfair for them to receive the same calibration as riskier securitization exposures that suffered significant losses during the same stress period. Without making a distinction on underlying asset quality, banks may be incented to gravitate toward riskier ABS investment holdings in order to meet minimum capital-adjusted returns, resulting in greater instability in the banking system. In addition, material capital inconsistencies will exist with other secured-type instruments, such as covered bonds, which will have significantly lower capital charges.

Finally, in order to ensure consistency with the rest of the Basel accord, we do not believe there should be any maturity adjustment in the calibration of the high quality retail securitization exposures since, as mentioned above, maturity is not considered in the determination of capital requirements for retail whole loans under the IRB framework.

III) <u>Multiple Rounds of QIS</u>

As suggested in the CBA letter, we recommend that the Basel Committee conduct multiple rounds of QIS exercises so that the floor and the formulas in the approaches become more risk-sensitive.

D) <u>Conclusion</u>

TD is concerned that the Proposal's capital treatment on investments in high quality senior ABS is overly punitive, that it will cause the product to become negative economic profit producing, and therefore will cause a re-examination of bank appetite for this product. We believe therefore that these proposed capital requirements will increase risk in the banking system by forcing lower risk retail banks to hold riskier assets in order to achieve minimum capital-adjusted returns and the safety of this product will migrate to the unregulated shadow banking system. In order to better align capital requirements with actual risk, we recommend a risk-sensitive approach, such as the MSFA, be made available to sophisticated investors that have a disciplined credit assessment process. We also recommend that a separate, less punitive calibration be applied to high quality retail securitization exposures, including the removal of the maturity adjustment. Finally, we recommend that multiple rounds of QIS exercises take place. We feel confident that through more empirical testing of market data, the Committee will adjust the new framework to be more risk-sensitive. TD appreciates your consideration of the views expressed in this letter and looks forward to future discussions on these issues.

Sincerely,

Rias Ahmed

CC:

- Gilbert Menard, Senior Director, OSFI Capital Division
- Richard Gresser, Managing Director, OSFI Capital Division
- Joel Starkes, Director, Securitization and Structured Products, OSFI Capital Division
- Ian Gibb, Capital Specialist, OSFI Capital Division
- Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System
- Charles Taylor, Deputy Comptroller, Capital and Regulatory Policy, Office of the Comptroller of the Currency