European
Banking
Federation

EBF_019472
05 February 2016

The European Banking Federation is the voice of the European banking sector, uniting 32 national banking associations in Europe that together represent some 4,500 banks - large and small, wholesale and retail, local and international - employing about 2.5 million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that securely handle more than 300 million payment transactions per day. Launched in 1960, the EBF is committed to creating a single market for financial services in the European Union and to supporting policies that foster economic growth. Website: www.ebf-fbe.eu

EBF comments on the BCBS Consultative Document on capital treatment for "simple, transparent and comparable" securitisations

General comments:

1. Principal-based approach

The European Banking Federation (EBF) welcomes the initiative of the Basel Committee on Banking Supervision (BCBS) to adjust the capital treatment for "simple, transparent and comparable" (STC) securitisation. As stated in our comments on the consultation paper to criteria for identifying STC securitisation, developed jointly by the BCBS and the International Organization of Securities Commissions (IOSCO), a functioning securitisation market is essential to support economic development, and for providing sufficient credit to companies. To ensure a functioning securitisation market it is of great importance that a securitisation with lower structural risk gets a lower capital surcharge.

The lower structural risk will be achieved through a set of criteria which avoids complex securitisation structures and risky underlying assets. To improve the market acceptability of securitisations, we suggest that the criteria defined should not be formulated in too detailed a fashion. For example, the BCBS consultation document (the Consultation Document) has added additional guidance (for example on the nature of assets) which we consider is too detailed for a global standard and would not allow the application of enhanced transaction models in the future. Moreover, our members consider that the additional guidance added in the Consultation Document does not reflect commonly accepted market practice. As we understand the proposal, the "additional guidance" is of an explanatory nature in relation to applying the STC criteria for regulatory capital purposes, but is not part of the requirement and is not the only possible interpretation of such criteria. Against this background, we would advocate not to include the additional guidance in the criteria, but instead to make them part of a separate Q&A document in order to avoid an unbalanced interpretation in further regulation processes. In our view, the criteria should be generic and principle-orientated, as proposed in the BCBS / IOSCO consultation paper, to allow the fair application of such criteria and principles across jurisdictions with differing legal frameworks and market practices.

In addition to the adjustment of capital requirements for STC exposures in the banking book, attention should be paid to the prudential treatment of trading book exposures in STC instruments. The new framework for trading book securitisation exposures (the revised framework for market risk issued on 14 January 2016) raises the minimum capital requirements for STC instruments (on average 70% for CTP and 22% for portfolios excluding CTP). We consider that a preferential treatment for STC should be incorporated in the trading book framework in order not to hinder market making activity and to promote liquidity in high-quality securitisation markets.

2. Scope of the STC framework

Again, we would like to draw attention to the fact that short term transactions (specifically ABCP programmes) and certain synthetic securitisations which have been shown to have performed well and otherwise satisfy the concepts of STC, constitute important instruments for large parts of the real economy but unfortunately are not currently included in the proposals set out in the Consultation Document.

ABCP Programmes

We welcome that the BCBS and IOSCO are currently considering whether, and how, STC criteria for ABCP programmes should be issued. ABCP conduits play an important role in the financing of businesses. They are advantageous for corporates as well as for banks. Corporates can use the sale of own receivables as a substitute for other forms of funding (especially bonds or bank loans). Furthermore, for small and medium sized enterprises (SMEs) funding through ABCP programmes is often the only way to access the securitisation markets as their volume of potential assets is not sufficient for a term securitisation. Similarly, from a bank's perspective, providing a liquidity line to an ABCP transaction is typically less risky than a direct credit exposure to the corporate. This is predominantly due to the fact that the main driver of credit risk is not the corporate, but a diversified portfolio of independent debtors with a high granularity or the full coverage of the portfolio by a commercial credit insurance. Against the background of the significant importance of ABCP programs for banks and corporate customers we would like to ask BCBS and IOSCO to continue their work on "simple, transparent and comparable securitisations" in order to elaborate - together with the industry - tailor-made criteria for STC ABCP transactions.

Balance Sheet Synthetic Securitisations

It is regrettable that BCBS is of the opinion that all synthetic securitisations should not be under the scope of the STC framework and does not even consider if there could be a set of criteria for synthetic securitisation which otherwise fulfil the requirements for being simple, transparent and comparable. The report recently published by the European Banking Authority (the EBA) on 18 December 2015 on synthetic securitisation (the Synthetics Report)[1]

[1] EBA report on synthetic securitisation, EBA-Op-2015-26, 18 December 2015 (available at: https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-26+EBA+report+on+synthetic+securitisation.pdf).

states that the evidence and analysis carried out by the EBA clearly indicates that synthetic transactions that are genuinely used by banks to transfer the credit risk of their lending activity off-balance sheet, i.e. balance sheet synthetics, have historically performed very well in comparison to other types of securitisation. The below graphs (reproduced from the EBA's Synthetics Report) indicate that balance sheet synthetic securitisation has in fact performed as well if not better than other types of securitisation in the past:

Figure 7: Lifetime default rate (%): balance sheet synthetic tranches, arbitrage synthetic tranches, traditional tranches, per rating grade (source: S&P, as of 2014 and the EBA calculations)

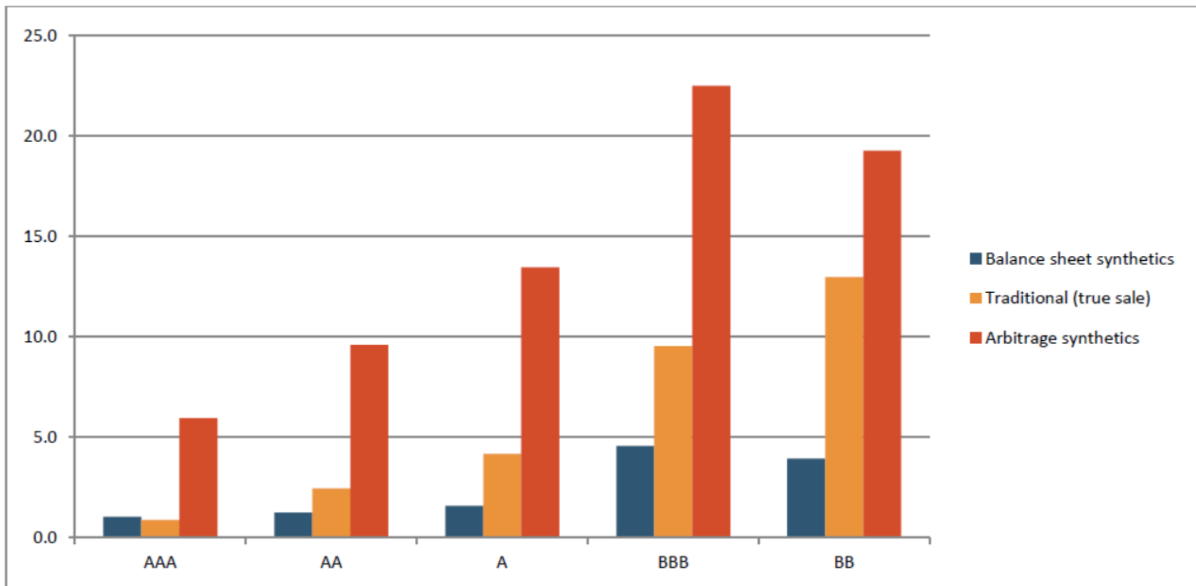
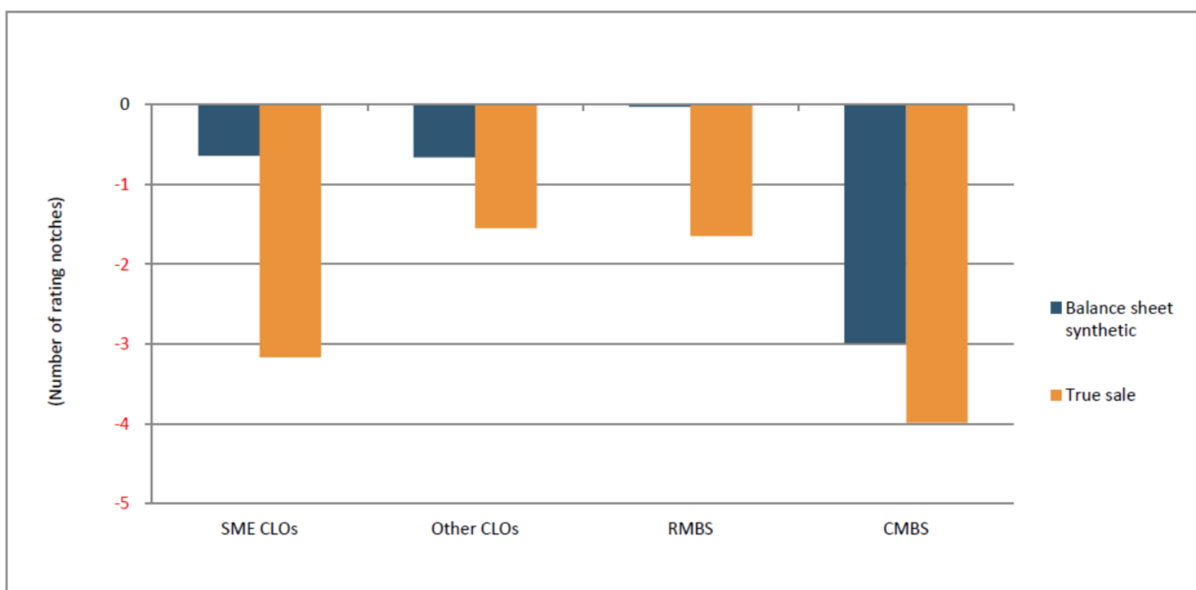


Figure 8: Average change in credit quality (notches) synthetic securitisation vs. true-sale securitisation per asset class (Source: S&P as of 2014)



In particular, as illustrated by "Figure 7" above, the EBA concludes that "*the default performance of balance sheet synthetics is comparable to that of traditional securitisations for*

high rating grades whereas for balance sheet synthetics is better for lower rating grades.". The EBA's analysis draws a clear distinction between different types of synthetic securitisation, coming to the conclusion that balance sheet synthetic transactions can and should be distinguished from pure "arbitrage" synthetic transactions of the type which did not perform well during the financial crisis. The above conclusion by the EBA is consistent across the different asset classes. The EBA therefore supports the extension of capital relief to balance sheet synthetic securitisations and recommends lowering capital charges on super-senior tranches retained by originators, rather than attempting to lower capital charges on investors' positions. In our view this approach is correct as investors participating in synthetic deals are generally not subject to regulatory capital rules.

Furthermore, we would like to stress, as is illustrated by the conclusions and recommendations of the EBA Synthetics Report, that (balance sheet) synthetic transactions in many aspects are less complex than true-sale transactions: an SPE may not be required, the legal risks relating to the transfer of ownership and segregation of the secured exposures are not applicable and there are no cash-flows to be trapped etc. The only "additional" complexity of synthetic securitisation, the counterparty risk, can be eliminated by limiting the universe of eligible counterparties and requiring funded collateral from non-eligible counterparties.

Only synthetic securitisations permit securitisation of credit claims that are independent of individual loans. This focus on the borrower - rather than on the individual loan - would in itself contribute greatly to the financing of SME loans. Considering the above, the EBF is of the view that narrowing the scope of STC qualification to non-synthetic securitisations is counterproductive to the faster economic recovery tailored to the needs of the borrowing companies in the real economy – something which is being called for by economic policymakers.

Therefore, the EBF strongly encourages the BCBS and IOSCO to continue their work on STC securitisations in order to elaborate additional conditions to include balance sheet synthetic securitisation in the scope of the STC designation.

Against this background, the EBF fully supports the introduction by the EU Commission (the Commission) of synthetic securitisations into the list of instruments eligible for the simple, standardised and transparent (STS) securitisation recognition, as foreseen in the Commission's most recent proposals for STS securitisation[2] (the STS Proposals).

The Commission targets in particular those senior tranches of securitisations of SME loans where the credit risk related to the mezzanine tranche (and in some cases the junior tranche)

[2] Contained in the third Council Presidency compromise dated 30 November 2015 in relation to Regulation laying down common rules on securitisation and creating a European framework for simple, transparent and standardised securitisation and amending Directives 2009/65/EC, 2009/138/EC, 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 (the Proposed STS Regulation) and Regulation amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms (the CRR Amendment Regulation)

is guaranteed (or counter-guaranteed) by a restricted list of third parties, including in particular the central government or central bank of an EU Member State.

The EBF also supports the extension of the list of eligible guarantors and the inclusion of promotional entities contained in the STS Proposals.

The EBA's Synthetics Report very clearly supports the Commission's legislative proposal on synthetic securitisation. Moreover the Synthetics Report calls for the following further amendments (each of which are fully supported by the EBF as steps in the right direction):

A) the amendment of the criteria determining eligibility for qualifying regulatory capital treatment in order to clarify that not all STS true-sale eligibility criteria proposed by the Commission are suitable and have to be complied with by synthetic securitisations;

B) the introduction of the eligibility of fully cash-funded credit protection provided by private investors, which further extends the list of eligible guarantors, subject to strong safeguards (such as cash collateralisation).

In addition to the EBA suggestions, the EBF suggests the following further proposed amendments to the Commission proposals on synthetic securitisations:

i) the clarification that eligible SMEs are those that satisfy certain turnover and number of employee requirements rather than the requirement to include only the relatively small set of SMEs where the bank has an exposure below €1.5m (as required for the application of the SME Supporting Factor). If this amendment is not taken on board, the number of SMEs which would benefit from this provision would be significantly lower and of much smaller size, in contrast with the CMU objectives stated by policy makers to ensure an appropriate flow of bank and market financing to SMEs;

ii) the reduction of the requirement that at least 80% of the pool exposures should qualify as SMEs (the European Investment Fund when granting its guarantees considers it sufficient that 75% of the exposures are SMEs);

iii) the inclusion of other forms of protection for protection buyers in addition to the suggested method of depositing cash collateral with the protection buyer, such as the investment of cash received from the protection seller in low risk securities such as sovereign securities, which similarly serves to protect protection buyers from counterparty risk of the protection seller. This will increase the investor base and provide a level playing field among banks, as some investors are currently prevented by internal policy from depositing cash at certain counterparties (protection buyers), especially lower rated banks; and

iv) the extension of the scope of eligible borrowers to other categories relevant for the real economy, in addition to SMEs.

European Banking Federation

3. Divergence between regulatory frameworks

As we set out in more detail in our response to Question 1 below, we are also concerned that the current divergence between different regulatory processes designed to identify and formalise what may constitute "simple, transparent and standardised" or "simple, transparent and comparable" securitisations (for the purpose of preferential capital treatment or otherwise), may lead to confusion for investors and securitisation market participants and in doing so have the opposite effect to that for which these frameworks and processes have been designed. The ultimate aim of both the BCBS / IOSCO STC criteria and the STS Proposals in the EU has been stated (amongst other things) to be to help the recovery of the securitisation markets on the basis of sound and prudent market practices and to help investors and local supervisors in better assessing the risk of securitisation exposures. To the extent that different frameworks are developed by different regulators which ultimately diverge in a number of important ways, we are concerned that this intention could be defeated as securitisation market participants (investors, originators/sponsors and issuers) as well as international and national supervisors and regulators, may be left unsure as to how to apply the potentially divergent and/or conflicting frameworks across different jurisdictions to transactions which contain structural elements or participants addressed by a number of different frameworks. As has been shown in the past, it is often a lack of certainty that is most damaging to the recovery of markets and the encouragement of growth on a sound and prudential basis. As such, we would ask that the BCBS / IOSCO consider the other proposals and frameworks being developed in relation to the same or similar scope as that covered by the STC criteria (such as the STS Proposals) with a view to maximising the harmonisation of the implementation of those frameworks.

Specific comments:

Q1. Do respondents agree with the rationale for introducing STC criteria into the capital framework? Are there any other aspects that the Committee should consider before introducing STC criteria into the capital framework that are not already reflected in the rationale above?

The rationale for introducing STC criteria into the capital framework is supported by the EBF as it should be positive for the securitisation market. However, in our answer to the initial BCBS/IOSCO consultation paper we recommended to limit a number of criteria for the STC qualification in order to capture the largest number of securitisations that can be reasonably labelled as STC. Therefore, while we support introducing STC criteria into the capital framework, we do not believe it is necessary or appropriate to include additional criteria, especially not criteria related to credit risk (see our comment below on inconsistency). We believe that before any additional criteria are added it should be clearly explained by the BCBS and IOSCO for what purpose the original set of criteria would be used.

An additional concern that we have is whether the STC landscape will be a level playing field. We have concerns that comparability will not be achieved across different jurisdictions, due to the differences in legal systems. In this regard we would note that it is our understanding that the STS Proposals represent the EU Council's proposal for the implementing legislation

for the STC framework. Setting aside the somewhat confusing competing nomenclatures of "STC" and "STS", we note that there seem to be discrepancies between the STS Proposals and those contained in the STC criteria reflected in the Consultation Document. Whilst we assume/understand that the intention is for material discrepancies to be harmonised by the time such proposals come into force (and we have not at this stage conducted an exhaustive comparison of the two sets of proposals, not least as we appreciate that both frameworks are at a draft stage), we note the following high-level observations in relation to potential divergence of approach between the current proposed STS and STC frameworks:

1. **Approach to Synthetic transactions**: As noted above, whilst the EBA has recently acknowledged (in its Synthetics Report) that certain well performing synthetic securitisations should be, subject to certain parameters, suitable for preferential capital treatment, the Consultation Document still completely excludes all synthetic securitisations from the preferential treatment afforded to STC securitisations. In common with other respondents to the Consultation Document we would therefore urge the BCBS to reconsider the inclusion of certain types of synthetic securitisation within the STC criteria.

2. **Approach to ABCP transactions**: As noted above, the Consultation Document excludes ABCP transactions from the scope of the preferential STC treatment. In contrast, the STS Proposals acknowledge that ABCP may be incorporated into STS criteria by developing separate criteria for securitisation positions at the ABCP programme and transaction level. Whilst we consider that the STS Proposals need some further work in relation to the treatment of ABCP within such framework in order to deliver the results for the wider economy that the proposals are designed to achieve, we would also urge the BCBS / IOSCO to consider the inclusion of ABCP transactions within the STC criteria for the reasons outlined more fully above.

3. **Approach to individual STC / STS criteria**: In certain instances the criteria contained in the STS Proposals (specifically Articles 8, 9 and 10 of the Proposed STS Regulation in relation to non-ABCP securitisations and proposed Articles 242 - 244 of the CRR Amendment Regulation) cover the same or substantially similar scope to the STC criteria (and/or vice versa), but with subtle differences. For example, amongst other discrepancies we would draw the BCBS / IOSCO's attention to the following:

    a. articles 8(1)-(3) of the Proposed STS Regulation (true sale requirement) cover similar but slightly different requirements to those contained in criterion A5 (Asset selection and transfer) of the STC criteria (compare for example the slightly different requirements in the STS Proposals (Article 244(4)(h)) and STC criteria (STC criterion A5) for the true sale to be evidenced by an independent legal opinion as discussed below);

    b. the STS Proposal requirement as to homogeneity contained in Proposed STS Regulation Article 8(4) contemplates "pools of auto loans and leases" being suitably homogeneous whilst the additional guidance to STC criteria A1 (Nature of assets) states that a collateral mix of auto loans and auto leases would be considered non-homogeneous (and therefore, we assume, non-STC);

c. other examples of potentially material deviations between the STS and STC proposals include (amongst others):

i. the exceptions to the 3 year credit-impaired requirement in Proposed STS Regulation Article 8(7)(a)(i) and (ii) are not reflected in the equivalent STC criterion A3 (Payment status) (or its additional guidance);

ii. the additional requirement for revolving period early amortisation events contained in Proposed STS Regulation Article 9(5)(c) is not reflected in STC criterion B9 (Payment priorities and observability);

iii. the requirement to make final offering documents available from the closing date contained in STC criterion B11 (Documentation disclosure and legal review) conflicts with the requirement to make such documents available within 15 days after closing in Proposed STS Regulation Article 10(4);

iv. the requirement in STC criterion A6 Initial and ongoing data) that the results of an AuP or other third party review of the initial portfolio be disclosed in the initial offering documentation (which is not a requirement of the STS Proposals, we understand for the reasons given in our specific response to STC criterion A6 in our response to Question 2 below); and

v. the requirement in the STC criterion D17 (Relationship between the originator and the servicer...) that the originator and the servicer be the same legal entity or affiliates with a common parent (other than for RMBS) which we note is a substantially wider requirement than the corresponding requirements contained in the STS Proposals (see for example Proposed STS Regulation Article 9(6)(a)).

4. **Approach to capital requirement calculations**: We note that the STS Proposals propose a reduction in the capital surcharge by a factor of 0.5 (see for example new Articles 260, 262 and 264 proposed to be included per the CRR Amendment Regulation) whilst the BCBS-IOSCO proposals propose a range of 0.6 to 0.8. It is not clear to us the basis on which this range has been chosen or how the final value within that range would be selected but we note that the STC criteria proposals represents, in a number of respects, a (more conservative) divergence from the current STS Proposals under the CRR Amendment Regulation as more fully discussed in our response to Question 4 below.

5. **Approach to scope of criteria**: We note that a further difference between the STS Proposals and the STC criteria relates to the scope of the criteria themselves. Whilst the STS Proposals require that originators, sponsors and SSPE's may only use the designation STS where they are all established within the European Union, and further provide that the requirements to provide information and otherwise comply with the relevant STS Proposals attach to the same parties to a securitisation (originators, sponsors and SSPE's), the STC criteria contain requirements binding upon the

originator/sponsor (with such terms used with a different meaning to the specific definitions in the STS proposals) which such overlapping but inconsistent scope has the potential for confusion and regulatory and legal arbitrage.

6. Timing of implementation of proposals: We understand that the BCBS Basel III framework (including those elements of the STC criteria) are proposed to become fully effective on 1 January 2018. Although it is not currently clear, we also understand that the STS Proposals will likely apply during the course of 2016. We would also therefore consider that in addition to the harmonisation of the divergences outlined above and more fully discussed below, the BCBS / IOSCO should consider the timings implicit in the various local or national regulators' attempts to define a workable STS/STC framework.

Whilst we appreciate that the STS Proposals and the STC criteria are not designed to cover exactly the same scope in exactly the same way, and that some or all of these and other discrepancies identified between the STS Proposals and the STC criteria in the Consultation Document may be harmonised during the course of the adoption process for both proposals, we consider that the discrepancies outlined above raise serious concerns that such divergence, if carried through to the final versions of such proposals, may lead to an unlevel playing field between securitisation market participants in different jurisdictions (or, indeed, between different parties to a securitisation within the same jurisdiction depending on the scope of the various proposals for STC and STS and the scope thereof) with a corresponding risk of potential regulatory arbitrage and confusion leading to potentially unintended liability for market participants. Clearly this has the capacity to have the opposite effect on the securitisation and wider global finance markets than is intended by the STC criteria and the STS Proposals. We would therefore ask that the differences between the STS and STC proposals are taken into account and considered as fully as possible by the BCBS / IOSCO as part of the consultation set out in the Consultation Document in order to minimise conflicting aspects and to maximise harmonisation of approaches to the same issues.

As a further comment, we have noticed an inconsistency in the rationale: whilst the Consultation Document starts by stating that: "The December 2014 framework takes into account...pool quality", it ends by stating: "securitisation with less risky underlying assets requires a lower capital surcharge than a securitisation with riskier underlying assets". In our view this creates a double charge for credit risk, first through the framework and once more through the surcharge. We consider that the surcharge should only reflect the structural risk of the securitisation and not the risk on the underlying assets.

Finally, if a minimum leverage ratio requirement should be introduced in 2018, depending on whether the minimum leverage ratio requirement is the binding capital constraint, any capital relief for the originator or sponsor institution may be subject to the securitised assets being derecognised from the balance sheet of the institution in accordance with the applicable accounting standard. In order to ensure that actual capital relief is obtainable to promote STC securitisation and avoid uneven level playing field issues associated with different accounting standards, it is of paramount importance that securitised assets where a risk transfer is recognised in accordance with the capital adequacy framework are excluded from the

leverage ratio calculation regardless of whether they are derecognised from the balance sheet of the institution in accordance with the applicable accounting standard.

Q2. Do respondents agree that, for the purpose of alternative capital treatment, additional criteria are required? What are respondents' views regarding the additional criteria presented in Annex 1?

We do not agree that the use of the criteria developed by BCBS/IOSCO for the setting of preferential regulatory capital requirements needs greater prescriptiveness. On the contrary, we suggest that the criteria to be defined should not be formulated in a too detailed fashion. For example, the BCBS added additional guidance (e.g. on nature of assets) is too detailed for a global standard and would not allow the application of enhanced transaction models in the future. Moreover, it does not reflect commonly accepted market practice. As we understand the additional guidance, it is of an explanatory nature but is not part of the requirements and is not the only possible interpretation. Against this background, we would advocate not to include the additional guidance in the criteria, but to make them part of a separate Q&A document in order to avoid an unbalanced interpretation in further regulation processes. In our view, the criteria should be generic and principle-orientated as proposed in the consultation paper of BCBS and IOSCO to allow the fair application of such criteria across jurisdictions with differing legal frameworks and market practices.

As regards the requirement of additional criteria to those included in the STC definition in order to deserve a preferential prudential treatment, we consider that their necessity should be further assessed. It should be taken into account that they are redundant to a large extent, given the fact that the capital framework already considers them in order to assess the amount of capital required. This is the case of the additional criterion D15 (Credit risk of underlying portfolio: Maximum Risk Weights) which is already considered in the capital framework for securitisation, which is risk sensitive to the credit risk of the underlying portfolio (it gives rise to higher capital requirements when the Risk Weights of the pool are higher). Moreover, in the case of the additional criterion D16 (Granularity of the pool), the SEC-IRBA already considers the granularity of the underlying pool as a risk factor in the case of wholesale portfolios. Concerning the criterion D17 (Relationship between the originator and the servicer of the securitised assets), we do not see its rationale in terms of producing any structural or credit benefit, particularly given the existing requirement of criterion C3·(Fiduciary and contractual responsibilities) in relation to services. Moreover, it should be also be considered that risk retention is already included (criterion B12) to make sure that the originator has skin in the game. Accordingly, we consider that no additional criteria should be required to grant a preferential treatment to STC securitisation as it would unnecessarily fragment the STC market between qualifying and non-qualifying STC transactions.

As mentioned above, therefore while we support introducing STC criteria into the capital framework, we do not believe it is necessary or appropriate to include the proposed additional criteria.

However, the EBF would like to provide some comments on the original criteria 1-14 as well as the additional criteria, in case the committee ultimately decides to retain them:

Criterion A1. Nature of assets

Criterion A1 requires that in STC securitisations, the assets underlying the securitisation should be credit claims or receivables that are homogeneous. Furthermore, the BCBS provides additional guidance for capital purposes.

The homogeneity is an important criterion to reduce the complexity of securitisations. In principle we support the idea of limiting the assets within a securitisation transaction on the level of the asset type. But splitting one asset type into further categories (as the additional guidance seems to require) should be avoided. As we understand, the additional guidance would not allow a securitisation of commercial and retail exposures in one transaction (as, for example, is currently the case for many auto loan and lease transactions). But this is the current market practice and didn´t lead to any difficulties in calculating the risk of the securitisation transaction. As we point out above, this distinction is in conflict with the corresponding STS Proposals on homogeneity.

A further subdivision of one asset type would make it necessary to split these current securitised portfolios into several portfolios. Each of these split portfolios would have to be securitised separately. It would mean that all regulatory and market driven requirements would have to be fulfilled for each transaction. For example, the assessments of rating agencies would be necessary for each transaction. Each transaction would need derivative counterparties to hedge interest rate risks. For each transaction a prospectus would have to be prepared and a cash flow model to be delivered etc. In addition, the portfolio size would shrink significantly, which would impede the marketability due to decreasing liquidity of small securitisations. In the end, if the criterion of homogeneity is interpreted too strictly by supervisory authorities it could make the securitisation uneconomic.

Taking into account recital 18 of the Proposed STS Regulation, it is clarified what the European Commission understands by a pool of assets that are homogenous in asset types. In our view, the distinction between these asset types is adequate to ensure that investors perform robust due diligence and to facilitate the assessment of underlying risks.

For these reasons, it should be clarified that the pool of underlying assets shall consist of one asset type. The additional guidance should be deleted.

Furthermore, criterion A1 requires “periodic payment streams”. For real economy purposes. In the case of auto loans, it is current practice in many loans that contractually agreed payment streams include a final payment that is higher than the monthly payments and that is secured by an asset. For clarification purposes this important kind of financing should not be excluded.

Additionally, in the last sentence this criterion states that "Any referenced interest payments or discount rates should be based on commonly encountered market interest rates…". The restriction to those "based on commonly encountered market interest rates" is problematic as it may be interpreted in a way that excludes banks' standard variable rates, which are very common in mortgage lending, which we do not believe is the legislative intent. This criterion should therefore also include an option for sectoral rates reflective of a lender's cost of funds.

Criterion A2. Asset performance history

This additional requirement provides that the performance history should ideally cover at least one complete economic cycle.

In our opinion, it can be very difficult to assess the length of a complete economic business cycle and different parties may have different opinions about the length of the complete economic business cycle. To avoid uncertainty about this requirement, the additional requirement should provide a clear statement about the period of history performance, including a maximum of [5] years. Therefore, the wording "ideally cover at least one complete economic cycle" should be deleted.

Criterion A3. Payment status

The reference to the credit-impairment of borrowers as defined is very problematic. It is current market practice to exclude defaulted or delinquent receivables. However, the proposed non-credit-impairment requirements do not consider commonly well-established ABS. Accordingly this criterion should be narrowed down to reflect the current market practice.

The criterion requires that credit claims or receivables being transferred to the securitisation may not, at the time of inclusion in the pool, include obligations that are in default. It should be noted that the impairment criteria can only be checked at the time of selection for inclusion in the securitisation. However, it takes some time until the selected exposures can be legally transferred and assigned, respectively. During this short period, it cannot be avoided that exposures get into default or become credit-impaired. Thus, the exclusion of defaulted exposures should refer to the time of selection if the underlying exposures will be transferred and assigned, respectively without undue delay. In practice, it is often required that the time between portfolio selection and the inclusion into securitisation does not need to exceed three months.

The criterion includes the requirement to measure and determine a material increase in expected loss. From our point of view, this could be difficult for the following reasons. The calculation of expected losses requires the parameters PD, LGD and EAD. However, such parameters are typically calculated by IRB banks and would exclude banks that use the Standardised Approach for credit risk. Beyond such practical issues, we doubt whether an increase in the expected losses is an appropriate criterion at all. We would understand such a requirement if the aim were to avoid an originator mainly selecting receivables where he

expects a significant increase in expected losses. However, this could be better addressed by the requirement that the selection of the receivables has to be carried out randomly, and that no adverse selection of receivables is permitted which could hinder the performance comparison between the non-securitised portfolio and the expected performance of the securitised loans. The phrase "for which the transferor or parties to the securitisation are aware of evidence indicating a material increase in expected losses" should therefore be deleted.

The additional guidance describes that if the obligor has been the subject of an insolvency or debt restructuring process due to financial difficulties within three years prior to the date of origination, the obligor will be deemed as credit-impaired. In practice, also seasoned exposures are securitised. This requirement would mean that for contracts that were originated, for instance five years ago, the originator has to look back eight years even if the credit quality for such loans has not been in doubt for five years. The credit acceptance process is based on an acceptancy policy, that is the same for the securitised exposures and the non-securitised exposures, and which is usually supported by scorecards for retail customers and rating procedures for corporate customers being validated continuously. To warrant a simple assessment of the securitised exposures and to give investors additional comfort, all exposures that are delinquent at the time of selection are excluded from the securitisation of high quality ABS. In addition, the exposures to be securitised are selected randomly from the target portfolio. Thus, it is ensured that the quality of the securitised portfolio is comparable but typically slightly better than the quality of the non-securitised portfolio. We are of the opinion that such arrangements should suffice for STC-securitisations and advocate to delete the requirements.

Criterion A4. Consistency of underwriting

Not-deteriorating has to be defined properly. Underwriting criteria can become less stringent, depending on where we are in the macro-economic cycle. We suggest replacing non-deteriorating by "pursuant to underwriting standards that are not less stringent than those applied **at the time of origination**".

Criterion A5. Asset selection and transfer

Material re-characterisation or clawback risk should be further clarified, with reference to periods, national legislation etc.

Criterion A6. Initial and ongoing data

With regard to cut-off dates being in line with the data used in investor reports, this is currently not market practice, although the ECB is pushing originators to adapt their systems to allow this alignment. Therefore, the BCBS / IOSCO should provide for a grandfathering period necessary for the market participants to adapt their systems.

With regard to the requirement that an initial portfolio should be reviewed by an "appropriate legally accountable and independent third party", it should be clarified that the report does not need to be made available to investors at all (the note to the criterion states

that the report "need not be provided but its results, including any material exceptions, should be disclosed in the initial offering documentation"), as is common market practice because of confidentiality and liability issues relating to the terms on which such reports can be provided by the third party authors, and has been accepted in the STS Proposals (per Article 244(4)(h) of the CRR Amendment Regulation).

Criterion B7. Redemption cash flows

Please include the word 'predominant" before "reliance on the sale or refinancing…"

Criterion B8. Currency and interest rate asset and liability mismatches

In this case we would prefer to see some of the wording of the additional language ("the term "appropriately mitigated" should be understood as not necessarily requiring a completely perfect hedge") being added to the wording of the criterion.

Criterion B9. Payment priorities and observability

Information in an Investor Report about the ability of a breach (of a trigger) to be reversed adds speculative elements to an otherwise factual report. In our view this is undesirable. Liability cash flow models will usually not be made available by the originator/sponsor, but procured by the originator/sponsor to be made available by a specialized party (Bloomberg, Intex etc.).

Criterion B11. Documentation disclosure and legal review

We consider that compliance should be subject to protection of confidentiality, especially with regard to commercial information.

Criterion B12. Alignment of interest

We consider it necessary that a clarification is provided with respect to the retention to ensure that a new compliance standard is not retrospectively applied. This criterion needs to work with local regulation in various jurisdictions (including the risk retention rules in Europe per the STS Proposals and the corresponding regulations in the U.S.).

Criterion C13. Fiduciary and contractual responsibilities

We fully agree that the remuneration of those with a fiduciary responsibility should such that they are incentivised and able to meet their obligations, but how this criterion can ever be checked is not clear to us at all.

Criterion D15. Credit risk of underlying exposures

It is a strong position of the EBF that the risk weight of assets should not come into play, since the credit enhancement for each deal will reflect the riskiness of the underlying assets. Plus the language seems contradictory. In the first paragraph it says to take into account any credit

risk mitigation, whereas in the second paragraph, it says not to take into consideration any credit risk mitigation.

This criterion requires that the underlying exposures have to meet the conditions under the Standardised Approach for credit risk. In our opinion, this requirement is very problematic, because it means that corporate exposures would have to be excluded that are successfully securitised today, and many retail portfolios will struggle to meet the requirements of this criterion as well.

We are convinced that it is more important that investors are able to assess the quality of the underlying assets adequately and that such assessment is not complicated and challenging in terms of the level of uncertainty that is inherent to such assessment. The criterion of "simplicity" should thus rather refer to the simplicity of such assessments. An assessment is simple if the following prerequisites are met: The credit and business processes, especially the acceptance policy and underwriting standards, but also the collection and dunning process as well as the internal controls and internal audits are the same for the non-securitised and securitised portfolio, underwriting standards have been stable over time in substance and transparent information including vintage curves exist about the historical performance and the development of the non-securitised portfolio and former securitised portfolios. Based on such information and on these conditions, investors can easily compare the performance of securitised and non-securitised loans, so that it can be simply concluded from the quality and performance of such portfolios in the past, adjusted by macroeconomic forward-looking information if necessary, to that of the securitised portfolio. In addition, it is important that the loans to be securitised are selected randomly from a target portfolio to avoid assessment bias. Based on such random selection from a target portfolio it can be warranted that the quality of the underlying securitised exposures is comparable to the non-securitised portfolio, which is one main feature of "comparable" securitisations.

To simplify the assessment and to reduce uncertainty, it is reasonable to exclude loans that are in default according to Basel II or the CRR and that show evidence of impairment according to the applicable accounting standard with the need of specific allowances. Furthermore, to provide investors more comfort and to exclude loans that could indicate a significant increase in credit risk, it is common practice of existing high quality ABS to exclude – as of the cut-off date - delinquent loans and to require that at least one and in some instances even two payments have been made before securitisation. As a result, such securitisations are "simple" and "comparable".

If, however, major parts of the originated portfolio were excluded from securitisation that are linked with higher risk weights then we believe that the intended effects to boost the financing opportunities for SMEs to create growth and jobs will not be achieved. Due to the limited capital resources of credit institutions due to Basel III and increased capital requirements by the EBA and ECB to augment the resilience of credit institutions, capital is a scarce resource in credit institutions at the current time, which limits the expansion of the

lending business. Thus, many banks focus their lending on customers who absorb rather lower levels of capital. However, these companies generally do not experience problems in obtaining funding by means of, for example, loans. Hence, it seems more important that loans can be securitised and qualify as STC where they have been originated in the normal course of business based on transparent underwriting standards of the credit institution that must not be less strict than the underwriting standards that apply for the exposures that are not securitised. This would enable the transfer of credit risk and free up capital for new credit business and support the real economy.

We understand criteria A3 (payment status) and A4 (consistency of underwriting) to be intended as safe-guards against higher-risk underlying exposures. Criterion A4 requires that the exposures are originated in the ordinary course of the originator's business pursuant to underwriting standards that are not less stringent than those the originator applies to origination of similar exposures not securitised. In addition, according to criterion A3 at least one payment has to be made, and defaulted and credit-impaired exposures are excluded. Thus, we don't see the need to exclude further exposures. For these reasons, we propose to delete the criterion D15.

Criterion D16. Granularity of the pool

We agree that this threshold is appropriate for retail transactions. With respect to wholesale transactions we are of the opinion that the threshold is too low. In our view, a threshold of 5% is necessary. To allow for a sufficient diversification, we propose the following: a second aggregate threshold of 20% should be introduced where the concentration of a single group of connected clients may not exceed a proportion between 3% and 5% in relation to the securitised portfolio. For the other 80%, we propose a threshold of 3% to diversify the exposures in the less granular sub-portfolio.

Criterion D17. Relationship between the originator and the servicer of the securitised assets

Risk retention is implemented to make sure the originator has skin in the game. There are cases where the servicers are different from the originator, such as for certain trade receivables, and equipment leases, and in the case there is acquisition of a portfolio or a business by another company. There is no conflict or issue with simplicity or transparency, as in the latter case, the portfolio is static (the simplest and most transparent form) and not revolving.

Moreover, this constraint is contrary to the basic fundamentals and best practices in securitisations, which normally have provisions requiring a replacement servicer if the originator defaults in its servicing obligations or becomes insolvent, in order to insulate the securitisation from adverse credit events affecting the originator. We note that this requirement is not reflected in the approach taken in the STS Proposals and we would suggest that this criterion was deleted.

Q3. What are respondents' views on the compliance mechanism and the supervision of compliance presented in this consultative document?

We are concerned that the emphasis for verification remains with the Originator / Sponsor (self-certification), with very limited support from external sources. There appears to be no independent external verification prior to issuance, so the Originator / Sponsor will issue with a level of uncertainty. Moreover, in order to overcome the current stigma associated with securitisation, certainly in Europe, it is necessary that investors are able to rely on a binding certification issued by an independent third party. A binding nature of certification is crucial to ensure legal certainty for originators, sponsors, original lenders and SSPEs as well as to ensure the trust of investors. Thus the use of an external verification agent, or trade body, properly supervised, along the lines as proposed in the most recent STS Proposals, should be reconsidered if an active STC securitisation market is being sought.

If the originator, however, is subject to legal liability or regulatory action then, in return, the originator should at least have the right to request and obtain a binding confirmation of conformity, after the self-assessment of the criteria, that certain requested criteria under A to C are met. We believe that this would be necessary from a prudential perspective of the originator and as part of its legal risk management to reduce his regulatory risk that can incur in case of a different interpretation as to whether a certain criterion is fulfilled in a specific case. In distinction to a certification, such confirmation could not cause any moral hazard as indicated by the Consultation Document, because the originator would have to provide a self-assessment and to give reasons why in its opinion a certain criterion is met. Furthermore, the possibility of obtaining such confirmation would have the advantage of reducing reputational risks both for originators but also for the STC securitisation market because it would help avoid cases where a "supervisor [will] not be satisfied with a bank's determination" which would make market participants insecure and which would adversely impact the further development of the STC securitisation market.

Furthermore, we are concerned how the criteria will be assessed, as any subjectivity could lead to confusion on how the criteria should be applied. One such example is the consistency of underwriting. In some countries a homogeneous pool in certain asset classes can only be formed if origination over several years can be selected. As such, the underwriting standards cannot be uniform as small changes will be made over time. Therefore, the interpretation of the underwriting criteria will be critical if smaller institutions want to be able to issue a STC securitisation. Depending on the origination spectrum, one could imagine that different assets had been underwritten over different points of the cycle. Underwriting standards might have been both deteriorated and strengthened over such a time period so the subjectivity contained within the definition might prohibit smaller banks being able to satisfy this criterion.

We are also concerned that the criteria are subject to the interpretation of the various national supervisory authorities, leading to the risk of post-issuance changes in interpretation that could result in the loss of STC status and resulting liability on the part of originators/sponsors, investors and issuers, even where attestations were made in good faith at the time of issuance. Accordingly, and as referred to in our comments above in relation to the harmonisation of the STC criteria with other attempts in specific jurisdictions to provide a

framework for qualifying or STC securitisations (such as the STS Proposals in the EU) a mechanism for assuring consistent interpretation of the criteria across Europe and/or grandfathering provisions which protect STC designations from future interpretation changes are in both cases essential.

Q4. What are respondents' views on the alternative capital requirements for STC securitisation presented in this consultative document?

We consider that the alternative capital requirements present a step in the right direction but could still prove to be a barrier if calibration is not further adjusted to reflect the lower risks of STC transactions. The industry (and other respondents representing discrete parts of the finance and securitisation industries) has proved on many occasions the multiplication effect of the capital proposals applicable to securitisations as compared to the underlying pool or Whole Loan Portfolios or Covered Bonds. The STC proposal will reduce the overall effect slightly, so deal economics should be slightly enhanced as compared to non-STC transactions under the new framework. However, compared to the old framework risk weight, even for STC compliant transactions, the increase and the excessive non-neutrality as compared to Covered Bonds and/or Whole Loan Portfolios remains. Therefore, as a product, securitisation only has a limited use and will continue to be a niche product unless the p-factor and the floor will be further reduced.

The following numeric examples give a clear indication of the remaining non-neutrality, even for STC securitisations:

For a standard RMBS tranching (90% AAA, 7% BBB, 3% B), 8% capital,
p-factor 0.6, the proposed (ERBA) capital charges for non-STC (I yr: 4.8%, 5 yr: 5.7%) resp. STC (1 yr: 3.9%; 5yr: 4.7%) compare to 0.8% (AAA; SA) -1.6% (AA; SA) for covered bonds or 2.8% (SA) for a whole loan portfolio.

We expressively welcome favourable capital treatment of “simple, transparent and comparable” securitisations. We also welcome the proposed method to calculate the alternative treatment of exposure in STC securitisation in the way to rescale the p-parameter and rescaling the risk weights of the SEC-ERBA. In our view, this approach keeps the whole capital treatment for securitisation positions comparatively simple.

Although the structural risks of STC securitisations are significantly reduced compared to non-STC securitisations, the BCBS / IOSCO proposes a floor risk weight for STC securitisations for IRBA-institutions that is significantly higher than today. Thus, we strongly advocate to retain the floor risk weight of 7% for STC securitisation in the SEC-IRBA. Moreover, we consider that the range proposed for the re-scaled supervisory parameter (p) in both SEC-IRBA and SEC-SA is too high and a lower p should be considered to further adjust the surcharge over the capital requirements of the underlying pool. The capital surcharge in the securitisation framework is justified by the existence of the additional risks associated to the securitisation process (agency, structural and model risks) on top of risks of the underlying portfolio. Compliance with STC criteria ensures a substantial reduction in those risks and should be accompanied by a commensurate reduction in the capital surcharge. In this way, capital requirements of STC

compliant securitisation would be closer to those of the underlying pool, setting the right incentives to promote sound securitisation activity.

In addition, the risk weights for STC securitisations in the SEC-ERBA should not be higher than today for IRBA-institutions. This is essential, because we believe that many IRBA-institutions, when they invest in securitisations issued by third parties, will not be ready to develop specified IRB-models that would be necessary for the different securitisation segments, such as RMBS, Auto-ABS etc. due to the high development and maintenance costs for such models on the one hand and the problem that the required data for such developments will not be sufficiently rich to reliably build and calibrate such models on a statistical basis. Thus, only very few big credit institutions that have sufficiently rich data will be able to develop such IRB-models and achieve the required economies of scale. All other credit institutions will mainly have to use the SEC-ERBA. Because there is no reason to differentiate the risk weights for IRBA-institutions and CSA-institutions that both use the external ratings for the determination of risk weights, the current risk weights of Basel II under the rating based method for IRBA-institutions should also apply for CSA-credit institutions. Thus, we see an urgent need to revise the proposed risk weights for STC securitisation.

The SEC-ERBA will be used by most European market participants because of the proposed hierarchy of methods and the constraints linked to the use of the SEC-IRBA (notably costs to implement internal ratings model, and the impossibility in Europe of using proxies to determine the SEC-IRBA parameters for banks as investors). The increase in capital requirements shown above would therefore mechanically result in higher funding costs for European companies and/or in the failure to relaunch the securitisation market in Europe.

More specifically, on the hierarchy of methods, we welcome the proposals to modify the Basel framework so that investors are given the flexibility to choose the standardised approach (SEC-SA) instead of the SEC-ERBA, where the risk-weighted exposure amount resulting from the application of the SEC-ERBA is not commensurate to the credit risk embedded in the underlying exposures. Each national supervisor, however, may interpret differently the term “non-commensurate”. To reduce this prudential risk and allow the market to function, we would recommend following the European Council’s agreed approach in the STS Proposals whereby, in cases where the application of the SEC-ERBA would lead to exceeding the risk-weighted exposure amounts by more than 25%, banks should be allowed to apply the SEC-SA instead. In addition, we would recommend going further and extending this flexibility also to mezzanine tranches of both STC and non-STC securitisations. The issue of the sovereign cap is not specific to the European Union (see non-EU originated securitisations) and many mezzanine securitisations present very little risk and as such their current risk weights are disproportionate to the underlying exposures’ credit risk.

We also advocate better access to IRBA, if only for non-originating investing banks. Therefore we welcome the Basel proposals to use top-down IRBA parameters and allow reliance on external historical data (ensuring that they remain consistent with the purchased exposures) and encourage developing this approach in a global framework through both the BCBS / IOSCO STC criteria as well as in the STS Proposals in the European regulation.

European Banking Federation

It is also important that the use of proxy information is permitted in the context of the internal ratings based approach in order to facilitate its use by a wider investor base in Europe and beyond, as is the case for example in the U.S., where external ratings have been removed from regulation and proxies to determine IRBA parameters have been permitted. Regulators / supervisors in Europe and other jurisdictions should be encouraged to follow a similar path.

Finally, as referred to in our comments above with respect to the divergence between the STC criteria and the STS Proposals, we consider that third country equivalence of STC / mutual recognition of preferential treatment for STC should be included in the framework for internationally active banks to facilitate the use of common capital standards in home and host jurisdictions.

For more information please contact:

Gonzalo Gasos
G.Gasos@ebf-fbe.eu

Daniele De Gennaro
D.DeGennaro@ebf-fbe.eu

Blazej Blasikiewicz
B.Blasikiewicz@ebf-fbe.eu