Annex: French Banking Federation Comments to EBA consultation on securitisation retention rules (EBA/CP/2013/14)

- As per articles 410(2) and 410(3) of regulation 575/2013, EBA shall develop and submit to the Commission in order to ensure uniform application of interest alignment for securitisation:
    - draft regulatory technical standards on the retention of net economic interest and other requirements related to transferred credit risk ;
    - draft implementing technical standards for convergence of implementation of additional risk weight.
- French Banking Federation (FBF) welcomes this opportunity to share its views on the proposed standards and fully supports the objective to devise a consistent framework implementation of interest alignment criteria and penalties.
- Please find hereby our responses to your questions. As a summary, French banks believe that :
    - the current CEBS guidelines to articles 122a of CRD2 remain very useful : EBA should build on this existing base and amend it where it is deemed necessary;
    - the ITS should bring further clarity upon consistent implementation of the penalty calculation across jurisdictions.

Key comments

1. Lack of protection for existing transactions (need for grandfathering provisions)
2. Removal of the flexibility regarding the holder of the retention (retention by other specific entities). Impact of the new sponsor definition. The managed CLOs issue.
3. Holding of the retention within the consolidated group: need for clarification

- **Lack of protection for existing transactions (need for grandfathering provisions)**

The RTS & ITS draft proposals do not provide guidance relative to the transactions that have been structured in good faith, accordingly to the current CRD2 art. 122 a) requirements and that will, in some cases, no longer comply with the present provisions.

Moreover, the current proposals do not consider any grandfathering clause in the context of the retention requirements. This will put at risk existing transactions and will consequently penalize existing investors: without grandfathering, investors in existing transactions will be negatively impacted due to reduced liquidity in their investments.

In addition, the very short term horizon of the RTS & ITS implementation process will amplify the aforementioned negative consequences.

- **Removal of the flexibility regarding the holder of the retention (retention by other specific entities). Impact of the new sponsor definition. The managed CLO issue.**

The guidelines and the Q&A allow the collateral manager or an involved subordinated investor to satisfy the retention requirement.

The RTS draft proposal departs from the current guidance which provides flexibility for an entity other than the originator, sponsor or original lender to satisfy the retention requirements in certain circumstances.

According to the article 4(1) of the draft RTS the retention must be fulfilled in full by either the originator, the sponsor or the original lender, with no exceptions. Therefore, an involved subordinated investor (such as a third party investor in a CLO, under some specific cases) will no longer satisfy the retention requirement and only collateral managers subject to the requirements of the MIFID can satisfy the retention requirement.

Article 4(14) of the CRR stipulates that a sponsor is either a credit institution or an investment firm (compliant with the MiFID definition), "other than an originator institution that establishes and manages an asset-backed commercial paper programme or other securitisation scheme that purchases exposures from third party entities". The new reference to investment firms in the sponsor definition does not provide the expected flexibility in the identification of an eligible retaining entity in some specific cases (including the context of managed CLOs) because of the MiFID investment firm's definition technical constraints. For example, while the definition of "investment firm" picks up MIFID regulated asset managers, it excludes MIFID firms not authorised to undertake certain services and which are not allowed to hold client monies. Further, EU alternative asset managers authorised under the Alternative Investment Fund Managers Directive (AIFMD) do not fall within the definition of "investment firm". Many collateral managers currently regulated under MIFID will be obliged to be re-authorised under AIMFD in July 2013 and, consequently, will cease to be regulated under MIFID (a firm is not permitted to hold both authorisations).

In addition, the definition of "investment firm" does not expressly include non-EU asset managers or US CLO, therefore these counterparts cannot be a retainer. In the meantime the RTS proposal states that the retention requirement is relevant not only for EU CLOs but also to US CLOs looking for investors in the EU. Typically, the third party used to satisfy retention requirements in US CLOs falls into the following categories: the collateral manager or a consolidated affiliate, or an independent equity investor who was involved in structuring the deal and in selecting the exposures. The lack of flexibility provided by the RTS draft (compared with the current Guidelines and Q&A provisions) will force the EU banks that operate in the US CLO market to exit or significantly marginalise their presence in the US.

In addition, such standards will create significant disincentives for some categories of investors to participate in securitisation positions. This would have a significant impact on the financing of the EU economy through securitisation which seems contradictory to the European Commission's objectives.

- **Holding of the retention within the consolidated group: need for clarification**

Article 394 (2) contemplates compliance with retention requirement on a consolidated basis only by entities acting as originator or sponsor which are subject to consolidated supervision and this ability is available only where "exposures from several credit institutions, investment firms or other financial institutions which are included in the scope of supervision on a consolidated basis" are securitised:

"*Where an EU parent credit institution, an EU financial holding company, an EU mixed financial holding company or one of its subsidiaries, as an originator or a sponsor, securitises exposures from several credit institutions, investment firms or other financial institutions which are included in the scope of supervision on a consolidated basis, the requirement referred to in paragraph 1 may be satisfied on the basis of the consolidated situation of the related EU parent credit institution, EU financial holding company, or EU mixed financial holding company*."

According to both CRR and CRD art. 122a texts, the definition of "originator" encompasses the use of other group entities, including "related entities" involved in the creation of assets while it is not specified that such entities need to be in the scope of relevant entities.

Paragraph 21 of the Q&A seems to provide some flexibility for collateral managers as it seems to imply that the retention requirement could be met by a parent or an affiliate consolidated within the accounting group of a CLO manager rather than within its regulatory capital group (considering that many asset managers may have the benefit of waivers from the CRD consolidation requirements).

The removal of the Guidelines and the Q&A leads to a situation where only those institutions in a group whose regulatory capital requirements are supervised on a consolidated basis may satisfy requirements on a consolidated basis. The Guidelines and the Q&A allow the retention requirement to be met by the parent/ affiliate of the collateral manager. The draft RTS is silent on this issue, while, in our view, it requires clarification.

Therefore, there is a concern that satisfying the retention requirement on a consolidated rather than solo basis may be granted to entities under regulatory capital supervision and to assets sourced from entities under regulatory capital supervision on a consolidated basis. This conservative approach would put the group assessment option at risk by limiting the scope for cases where all the exposures are originated by a single group, potentially limiting its application to balance sheet securitisations.

We point out that the Article 394(2) is not explicitly mentioned in the RTS (other than in relation to a retention holder leaving the group) and is not the subject of a question from the EBA.

French Banking Federation responses to question relating to Draft RTS on the retention of net economic interest and other requirements related to exposures to transferred credit risk (Articles 394,395, 397 and 398) of Regulation (EU) No [xx/2013]

Q1. The EBA would like to know to what extent securitisations rely on paragraphs 25-26 of the CEBS Guidelines in order to achieve the retention commitment and would also like to understand if these transactions could also meet the requirements set out in Article 394(1) of the CRR without applying the criteria provided in Paragraphs 25 and 26 of the CEBS Guidelines on Articles 122a of Directive 2006/48/EC taking into account the definition of securitisation according to Article 4(37) of the CRR and the respective definitions of originator, sponsor or original lender

We understand that EBA's intent is to ensure implementation of the guidelines across jurisdictions (rather than to have them use as general guidance), in particular as far as CLOs are concerned.

First, we would like to stress that Draft RTS seems contradictory with Accompanying Document:

- Page 9, point 5: "The term original lender should be understood to refer to an entity which, either itself or through related entities, directly or indirectly, originally created the obligation or potential obligations of the debtor or potential debtor giving rise to the exposure being securitised and which is not the originator"
- Page 41, point 29: "It must be acknowledged that, taking into account the existing structure of the market, the identification of the retainer with the CLO asset manager may lead to a number of CLO managers facing capital constraints in fulfilling the 5% retention requirement. Feedback received from preliminary consultation of European market participants, as well as available evidence from consultation of US CLOs managers regarding similar retention requirements, indicates that most managers of CLOs are structured so as to operate with relatively small balance sheets and, therefore, are likely to struggle to provide the resources necessary to fulfill retention requirements. This could potentially translate in the long term into a modification of the currently existing managed CLO model.

Indeed the Accompanying Document seems to narrow eligible retainer definition to CLO managers only, whereas the definition of originator is much less restrictive and would allow any group of investors to fulfil the requirement as long as they control the manager.

For this matter, we find that paragraphs 25 and 26 of the EBA Guidelines clarify the retention requirement where it is not possible to identify any party that fits any of the originator, sponsor or original lender roles, or where the retainer is not originator, sponsor or original lender but is the entity whose interest are most optimally aligned with those of investors. The RTS should include the substance of Para 25- 26 and of the answers in Q&A Section II.C. The RTS should at least retain the notions of "retention by whatever party would most appropriately fulfill this role" and "retention ultimately met by an entity with which alignment of interest is optimally achieved".

By removing the Guidelines, EBA would deprive us of supervisory references for more specific internal governance.

We also think that limiting the possibility to act as retainer to the CLO manager is too restrictive. An originator SPV, a third party involved in structuring the transaction and selecting the exposures, a third party responsible for the prospectus – not limitative examples - should also be possible eligible retainers.

Q2. The EBA would also like to understand if, for new securitisations there are transactions that are likely not to be able to meet the retention requirements following the CRR and associated draft RTS.

Yes, there will be new transactions that are likely not to be able to meet these requirements whereas the same would have been able to do so if they have been able to rely on Para 25 – 26 + Q&A Section II C. Especially, as mentioned in Para 29 of part 5.2 "Cost benefits" of the RTS, some CLO managers will not be able to act as retainer just because they will not be in the capacity to satisfy to the rule stating that the retained interest must not be a significant asset.

Q3. To the extent securitisations have relied on Paragraph 48 in the CEBS Guidelines on Article 122a of Directive 2006/48/EC to meet the retention requirements, would there be any material impact (be it economic, operational, etc.) to now complying with retention option (a) of Article 394(1) of the Regulation (EU) No xxxx/2013 rather than relying on the provisions of Paragraph 48 in the CEBS Guidelines on Article 122a of Directive 2006/48/EC in order to meet the retention requirements?

The paragraph 48 of the CEBS Guidelines provides guidance for use of the originator interest holding option in the context of revolving securitisations of non-revolving exposures: as such, the originator interest the option (b) may be used in the context of revolving securitisations of non-revolving exposures.

This current guidance is not replicated within the RTS which will generate in this context compliance uncertainty. We recommend that EBA includes the existing guidance (retention through an originator interest (i.e. option (b)) remains available for revolving securitisations of non-revolving exposures.

Q4. Do you consider that this way to comply with the retention requirement under option (a) should be explicitly mentioned in the RTS?

For sake of clarity and consistency, we recommend that EBA maintains this option (i.e. that the vertical slice holding option may be held in the form of a liquidity facility in the context of ABCP programmes subject to compliance with some conditions).

Q5. Do you consider that the conditions enumerated in Article 6.1(b) are correct and sufficient? If not, which conditions would you add/change/remove? Why?

Since the conditions enumerated in Article 6(1)(b) are the same as those that are listed in section 47 of current EBA guidelines, we consider they are correct.

Nevertheless we want to remind the EBA, that the situation described in article 6.1(b) should not constitute a new securitisation exposure. Indeed, in ABCP conduit structures, the existence of full support liquidity lines provided by the sponsor to underlying exposure means that all the credit risk of the securitisation tranche held in the conduit is borne by the institution providing the liquidity facility as a consequence, there is no need for program wide letter of credit creating an additional tranching at the level of the conduit.

In this situation, the conduit doesn't create a re-securitisation structure and thus no retention should be required at the level of the conduit if the retention has been performed at the level of each underlying securitisation exposure by the original lender (i.e. : the seller for the securitisation of purchased receivables for instance). If an institution providing a full support liquidity line to a securitisation tranche held on a conduit could constitute a form of retention, we insist on the fact that this retention is not necessary if the retention is performed by the originator/original lender of the securitisation structure.

We suggest EBA to mention that this form of retention would not be required if the retention has been performed by the original retainer of the securitisation structure of which the securitisation tranche is issued and held by the ABCP conduit.

In the situation where the retention is achieved only by the liquidity facility provider (the sponsor bank) according to Article 6.1.b., we think that if the liquidity facility is drawn, in the way that securitisation positions are held directly on the balance sheet of the sponsor bank[1], the retention is still achieved. Indeed in such situation the bank should not be considered as an investor but more as playing its role of sponsor.

Q6. Do you consider that the retention option (d) under Article 8.1(b) via the provision of a liquidity facility should be explicitly mentioned in the RTS? Please also specify reasons why this provision should explicitly remain in the RTS?

It is possible that certain securitisation vehicles do not require liquidity facilities covering 100% of the credit risk and therefore do not fulfill the conditions under Article 6.1 (b). In that case the obligations of retention shall be fulfilled by the provision of a letter of credit with the criteria listed in Article 8.1 (a), or a liquidity facility with the criteria listed in Article 8.1 (b). Both instruments may, in certain circumstances (and this would generally be the case for ABCP conduits), constitute a second-loss exposure at the securitisation program-wide level, as a first-loss exposure at the transaction-specific level underlying this program-wide level is assumed by the originators or original lenders of the underlying exposures. Accordingly, the 5% of the credit risk of the exposures covered by the retention should be measured on the total securitisation exposure, excluding the first-loss exposure assumed by the originators or original lenders.

For the avoidance of doubt, we consider that the retention obligation may be fulfilled independently by:

- the original lender (seller) via the provision of a first loss exposure at the transaction-specific level under option (d), as described in article 6.1(a) ;
- the sponsor via the provision of a liquidity facility under option (a), as described in article 6.1(b) ;
- the sponsor via the provision of a letter of credit under option (d), as described in article 8.1(a) ;
- the sponsor via the provision of a liquidity facility under option (d), as described in article 8.1 (b).

[1] when the liquidity line is a Liquidity Asset Purchase Agreement ('LAPA')

Q7. Do you consider that the conditions referenced in Article 8.1(b) are correct and sufficient? If not, which conditions would you add/change/remove? Why?

Yes, we consider that the proposed conditions are correct.

Q8: Are there other ways to comply with the retention options set out in Art 394 of the CRR which should be included in this RTS? Please be specific in your description of any additional ways to comply.

There are 5 options in the CRR to fulfill the 5% retention requirement.

- Retention may be achieved at the tranche level :
  - vertically through option (a) : 5% of the nominal value of each tranche ;
  - horizontally through option (d) : first loss tranche representing at least 5% ;
- Retention can also be achieved directly on the securitized exposures :
  - randomly through option (c), subject to a minimum of 100 securitized exposures ;
  - vertically through option (b) : 5% of the originator's interest in the securitized exposures (for revolving exposures) ;
  - horizontally through option (e) : 5% first loss of each securitized exposure.

Article 6.1 (a) of the current RTS consultation paper indicates that Option (a) may be achieved by retaining at least 5% of the credit risk of each of the securitized exposures, provided this credit risk ranks at least pari passu with the credit risk securitized for the same exposures. This is an easy way to ensure that the 5% retention requirement will be fulfilled at any time.

In Option (c), securitized exposures selected randomly could experience different prepayment rates and/or different default rates than retained exposures. In this case, retention requirements may not been fulfilled at all times. The current RTS could be modified to allow the originator to fulfill Option (c) requirements by retaining a separate pool that exhibits the same characteristics as the securitized assets (for example in terms of type of loan, guarantee, interest rate and Basel rating) and does represent at any time more than 5% of the securitized exposures.

Q9. Is the qualification "securitisation positions in the correlation trading portfolio containing only reference instruments satisfying the criterion in Article 327(1b)(ii) of Regulation (EU) No xxxx/201y" introduced in Article 13(1) correct/necessary? Should this qualification be removed? If not, why?

The current guidance clarifies the exemption and confirms it concerns all positions that are encompassed by the correlation trading portfolio as defined in CRD 3:
"The exemptions provided under Paragraph 3 where "transactions [are] based on a clear, transparent and accessible index […] or are other tradable securities other than securitisation positions" are assumed to constitute a scope that equates with the definition of a "correlation trading portfolio" as described under the Directive 2010/76/EU amendments to Directive 2006/49/EC ("CRD 3"). The exemptions provided in Paragraph 3 extend to all positions that are encompassed by the correlation trading activities as described in the above amendments."

In contrast, the draft RTS (article 13) refers only to a portion of the correlation trading portfolio definition, i.e. those based on commonly traded indices (i.e.Art.327 (1b) (ii)) :
"1. The exemption in Article 394(4) of Regulation (EU) No xxxx/201y ***shall include securitisation positions in the correlation trading portfolio containing only***

reference instruments satisfying the criterion in Article 327(1b)(ii) *of Regulation (EU) No xxxx/2013. The exemption shall also apply to any securitisation position which is eligible for inclusion in such part of the correlation trading portfolio but has not been assigned thereto for risk management or similar reasons."*

In conclusion, trades on bespoke baskets (as described in article 338 (1) (b) (i), meaning "single-name instruments, including single name credit derivatives, for which a liquid two-way market exists") seem not to be included into the scope of the exemption, which would be not adequate.

With regards to the retention requirement there is no justification for providing distinct regulatory approaches. Therefore we request EBA to maintain the exemption provided by the current Guidelines. We propose therefore to modify the related RTS provision as follows:

"1. The exemption in Article 394(4) of Regulation (EU) No xxxx/201y ***shall include securitisation positions in the correlation trading portfolio containing only reference instruments satisfying the criterion in Article 327(1b)*** ~~***(ii)***~~ *of Regulation (EU) No xxxx/2013. The exemption shall also apply to any securitisation position which is eligible for inclusion in such part of the correlation trading portfolio but has not been assigned thereto for risk management or similar reasons."*

Q10. Is the inclusion in the exemption of the cases that are eligible to be included in that part of the correlation trading portfolio but that do not pertain to it adequate? If not, why?

This inclusion seems adequate.

Q11: Should the broad stress testing requirement that institutions have to undertake be part of the Internal Capital Adequacy Process, in accordance with Article 72 of CRD IV, or should it, where applicable, be in accordance with Article 173 of the CRR and follow the credit stress testing requirements for IRB banks?

We consider that stress tests should be incorporated into the ICAAP process, which permits, in a broader way, to appropriately identify measure and monitor the risks incurred by the institution. Whereas, as a potential investor in a securitisation position, an institution will never have sufficient information regarding the underlying exposures to follow the credit stress testing requirements of article 177 (formerly 173) of the CRR, which applies to its loan exposures measured under IRB approach.

Q12. Is the qualification "…securitisation positions … held in the correlation trading portfolio…as referred to in Article 327(1b)(ii) of Regulation (EU) No xxxx/201y" introduced in Article 20 correct/necessary? Should this qualification be removed? If not, why?

Please refer to the response to Q9 above. Accordingly, the exemption for the correlation trading portfolio should encompass both correlation trading activities based on both indices and bespoke baskets.

Q13. Is the consideration of the cases that are eligible to be included in that part of the correlation trading portfolio but that do not pertain to it adequate? If not, why?

Please refer to our answer to question 10.

Q14: For which type of underlying assets do you think that the information on a loan level basis is not necessary for complying with the due diligence requirements under Article 395 of the Regulation (EU) No xxxx/201y? What kind of information is required in those cases? Please specify by type of underlying asset

The information on a loan level basis should not be viewed as necessary for any kind of securitisation of retail exposures, among which: mortgage loans, consumer loans, credit cards, auto loans, etc. For those kinds of granular securitized exposures, it is sufficient for an investor, at least in senior tranches, to focus on semi-aggregated data.
Taking RMBS as an example, reports on the collateral are usually presented by buckets of LTV, buckets of arrears, size of loans, maturity, type of interest, etc.
The EBA Technical Standards should also keep in mind the securitisation vintage (pre or post crisis) when calibrating the due diligence requirements as obviously the standards of disclosure have evolved over that period, but mostly for new transactions.

Q15: Do you consider that the information in existing templates (e.g. ECB ABS loan-level data template or Bank of England ABS transparency requirements) meet the relevant due diligence and disclosure requirements under Article 395 and Article 398 of the Regulation (EU) No xxxx/201y, respectively? Please differentiate in your response in terms of the types of underlying assets, if applicable.

The ECB template is very extensive and contains too much information to become the new regulatory standard in terms of due diligence especially regarding investment in senior tranches of granular retail securitisations. The due diligence requirements should take into consideration the level of information available and disclosed by the originators.

Q16: Do you find the accessibility conditions (e.g. search, availability, costs) regarding the information provided in existing templates (e.g. ECB ABS loan-level data template or Bank of England ABS transparency requirements) adequate?

The information requested under existing ECB templates is currently available on the European Data Warehouse (ED) platform. The accessibility conditions on this platform are adequate in terms of cost and availability.

Questions relating to Draft ITS Relating to the convergence of supervisory practices with regard to the implementation of additional risk weights (Article 396 of Regulation (EU) No [xx/2013]

Q1. Does the formula in Article 2 result in reasonable additional risk weights?

The formula is the same as the formula recommended in the EBA Guidelines. As far as French banks are concerned, we have already implemented this formula and find the proportionality provision quite educational.

Q2. Would you suggest any changes to the formula that would lead to an improved framework for the application of additional risk weights? Do you believe the variable Article394Exemption$_{Pct}$ equal to 0.5 if the exemption in Article 394(3) applies is reasonable?

The formula includes a provision that allows the bank to reset the penalty to zero when the bank is able to sell and buy back the position. We do not find this is a good incentive. We do not have specific comment regarding the value of the above-mentioned variable.

Q3. Would you suggest an alternative approach for calculating additional risk weights?

French banks believe that the aim of this ITS is to ensure a consistent implementation of the formula. In particular, we consider that this is the bank responsibility to self-apply the penalty, upon internal control of the criteria, rather than to depend on external / supervisory authority to identify an issue and to impose a penalty. In short, we believe that the ITS should further require an ex ante calculation of the penalty.