Association for Financial Markets in Europe
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***Submitted via E-mail to [CP-2012-7@eba.europa.eu](mailto:CP-2012-7@eba.europa.eu)***

European Banking Authority
Tower 42, Level 18
25 Old Broad Street
London EC2N 1HQ

Dear Sir or Madam,

**Consultation Paper:**

**Draft Regulatory Technical Standards ("DRTS") on Gain on Sale – EBA/CP/2012/07**

The Association for Financial Markets in Europe ("AFME")[1] is pleased to submit these comments regarding the above Consultation Paper (the "Consultation") issued by the European Banking Authority (the "EBA") on 12th June 2012.

The EBA website page on which the Consultation was published said "The concept of gain on sale is mainly relevant for financial institutions using the US GAAP as [sic.] accounting standard." However under current GAAP (post-FAS 166 and 167), as under IFRS, we understand that it is, generally speaking, difficult to achieve de-recognition where the originator retains an interest in the securitisation going forward, whether through a retained tranche of credit enhancement, entitlement to ongoing excess spread or both.[2] Both of these features are important at present for European securitisation business models and structures. Further, since the implementation of Article 122a of the Capital Requirements Directive in January 2011, in many cases credit institutions face another obstacle to achieving de-recognition because if any credit institutions (or, eventually, other types of EU-regulated investors) will invest in or acquire credit exposure to the transaction, the originators/sponsors/original lenders will be required to retain a tranche of risk.[3]

Therefore we would tentatively agree that the practical impact of this issue is limited: as there is rarely (if ever) a sale in accounting terms under IASB rules, the concept of a gain on such sale does not arise. Even if it did, no change in current regulatory capital treatment is being proposed.

[1] http://www.afme.eu/

[2] There are anecdotal reports of a very few European trade receivables securitizations in which corporate sellers (not banks) achieved IFRS accounting sale treatment by selling receivables to a bank, conduit or non-consolidated SPE, with credit protection being provided by a third party credit insurer or other protection provider.

[3] Technically, of course, the regulatory burden falls on the investor and not directly on the originator/sponsor/original lender. Also, a pari-passu retained interest (vertical slice, transferor interest (in revolving transactions) or random similar exposures) could be consistent with whole or partial de-recognition of non-retained portions.

Specific issues

Specifically, the EBA has sought comment in response to three questions as follows.

*Q1. In your view does future margin income being* [sic.] *correspond to future excess spread defined in Article 237 of in the draft CRR as "finance charge collections and other fee income received in respect of the securitised exposures net of costs and expenses? Do you consider alternative definitions for future margin income as more appropriate? Please provide the reasoning behind your responses to the above questions and details of the alternative(s) you would propose.*

As a practical observation, the definition of "excess spread" in Article 237 of the CRR seems to us to be unobjectionable. Perhaps it might be clearer in the DRTS simply to refer to "excess spread" (as so defined), and achieve consistency of definition, rather than use a separate term such as "future margin income". The latter is rather unclear as it begs the question of whether it is income gross or net of costs. We believe the intention is for it to mean net of costs. This ambiguity could be reduced by using the term "excess spread" or "future excess spread" instead.

Generally speaking we believe that greater clarity is needed from the EBA for us better to understand both the scope of this proposal and some of the key terms used.

For example, assume a simple group of loans with a carrying amount of 100, which have been securitised and for which de-recognition is achieved. Assume that loans with a carrying amount of 100 were sold for total consideration of 103. As the document points out, under IFRS then a profit of 3 would be recognised (as prescribed in steps 1 and 2 on page 12 of the Consultation). If you assume further that the consideration received consisted of cash of 100 and a new financial instrument, say an interest-only strip (assume that the interest-only strip did not itself prevent de-recognition of the loans) for which the fair value was determined to be 3 at the date of the securitisation, then would the "finance charge collections" be related to the future revenue arising from the interest-only strip, or does the finance charge comprise the portion of the gain on sale attributable to the "ongoing involvement" in the loans? Further, once the ongoing involvement ceases and all cash flows are received, would it, only at that point, be appropriate to then add back the future margin income so defined at that point?

In order for institutions to appropriately identify and track the future margin income and exclude it from own funds, we believe there must be clarity about the definition. Therefore we recommend that a specific example be included in the paper to illustrate the application of the concepts of future margin income. The above example could be expanded on further, or alternatively, another one may be used. AFME and its members would be happy to discuss this in further detail with the EBA.

*Q2. In your view does Article 9 above capture and further specify the concept of gain of* [sic.] *sale? Do you agree that all relevant concepts have been included? Are there any irrelevant concepts included? Please provide the reasoning behind your responses to the above and details of alternative(s) you would propose.*

"Gain on sale" is an accounting concept. Article 9 refers to this and therefore seems unobjectionable in this context.

*Q3. In your view does Article 9 result in any incremental costs or benefits?*

We do not believe so. There is no change in regulatory capital treatment as a result of these new DRTS, and the practical impact is anyway limited, as stated above.

Having said that, there are important issues around transitional arrangements for which we respectfully seek clarification from the EBA.

In particular we seek clarification for the treatment of any future margin income as defined in the Consultation which has been recognised in the profit and loss statements during the periods prior to the proposed effective date for the new standards of 1st January 2013 (the "Effective Date"). It is clear that any new securitisations executed on or after the Effective Date would be subject to the ruling, but the position is less clear for those instances where the securitisation was executed prior to the Effective Date and for which the institution still has some ongoing involvement (reflecting the concept of revocability) as at the Effective Date. Upon the occurrence of the Effective Date, would an institution be required to deduct any previously booked future margin income from capital on that day?

If it is decided that any previously recognised future margin income is subject to the amended rules, we respectfully request that the EBA allow grandfathering of such existing transactions due to the short time left until the Effective Date. Implementing the new requirements in such a short timeframe will be difficult to achieve in any event but will also detract from efforts already underway regarding other important regulatory changes which are effective at the same date.

On the other hand, if no grandfathering is to be allowed, we respectfully request that, if within the power granted to the EBA, the effective date for the changes arising from this Consultation is changed to a date which would allow institutions appropriately to implement the necessary changes in their organisations. In this case we suggest an effective date of no earlier than 1st January 2014.

Thank you for soliciting our comments as part of your Consultation. As stated above, we would be pleased to assist the EBA further if required. In particular, if you have any questions or desire additional information regarding any of the comments set out above please do not hesitate to contact the undersigned on + 44 207 743 9375 or by email at richard.hopkin@afme.eu.

Yours sincerely,

Richard H. Hopkin

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