EUROPEAN BANKING AUTHORITY

BANKING STAKEHOLDER GROUP

CONSULTATION ON EBA/DP/2014/02 ON
"SIMPLE, STANDARD AND TRANSPARENT SECURITISATIONS"

General Comments and Replies to Questions

BY THE EBA BANKING STAKEHOLDER GROUP

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Foreword

The EBA Banking Stakeholder Group ("BSG") welcomes the opportunity to comment on the Discussion Paper DP/EBA//CP/2014/02 on simple, standard and transparent securitisations, on the basis of the Commission's call for advice of December 2013 related to the merits of, and potential ways of, promoting a safe and stable securitisation market. The Discussion Paper is the EBA's response to the European Commission's call for advice on identifying a prudentially sound securitisation market and its regulatory treatment, aimed at widening long-term funding opportunities for the European economy. The BSG regards this as an important issue as, for various reasons some of which may be associated with regulation, banks may be more credit constrained in the future than in the past which means that there would be an economic advantage in fostering alternative sources of funding of loans to the real economy.

For the real economy it is also an advantage to have the possibility for borrowers to ask banks to arrange securitisation programmes as an alternative to ordinary bank funding. This is normal for bank customers with large assets in, for example, product financing or accounts receivable where the diversification of the portfolio risk is normally large (car industry, telecom, electricity, gas etc.). Securitisation can be a tool which in a single operation reduces balance sheet strains in banks (loans to customers) and the burden for, for example, utility services to have the credit risk and funding need to provide credit to consumers (account receivables). Securitisation programmes can therefore contribute to mitigating risk from the balance sheet of banks and their customers to an active short-term commercial paper market or a long term bond market.

As an important overall principle, the underlying risk in securitised assets must always be transparent and understandable for the investor.

As in the past, the BSG supports initiatives that aim at harmonizing supervisory rules and practices across Europe, in order to ensure fair conditions of competition between institutions and more efficiency for cross-border groups. The BSG also supports a revitalisation of an active securitisation market in Europe based on sound business principles. The BSG also expects these initiatives to facilitate data sharing between European supervisors and avoid reporting duplications for banks. However, the BSG identifies a number of issues which, unless properly addressed, could lead to unintended results.

This response has been prepared on the basis of comments circulated and shared among the BSG members and members of the BSG's Technical Working Groups on Capital and Risk Analysis and Recovery, Resolution and Systemic Issues. The response outlines some general comments by the BSG, as well as our detailed answers to some questions indicated in the Consultation Paper.

The European Market for Asset Backed Securities (ABS) almost closed after the 2007/2008 crisis. The market came into disrepute as it was held to be responsible for the financial crisis as the risks associated with subprime loans were spread by securitisation: the initiators (largely housing loan companies in the US) offloaded (transferred) them into SPVs which then sold structured bonds to a variety of end investors. The subprime meltdown, and the network externalities associated with it, caused a complete drying up of liquidity in the market in the US and spread over to the European ABS market, although this market did not show entirely the same characteristics.

As a consequence, vigorous regulatory action was taken at an early stage: CRD II and Basel 2.5 (CRDIII) addressed the issue by introducing a risk retention requirement and higher risk weights (RWA). Securitisation was treated conservatively in a number of other post-2009 regulations such as Solvency II, AIFM, UCITS and EMIR, adding also higher due diligence requirements. These regulatory actions contributed to the significant reduction in the issuance of ABS in Europe and to a reduction of the investor base: since 2008, the vast majority of European securitisation issuance has been retained by the issuers themselves instead of being placed with end-investors.

However, as this EBA consultation paper shows, defaults and losses associated with securitisation positions vary significantly across regions and asset classes. The securitisation market in Europe did not follow the trend of the US: default rates of EU securitisations were much lower - in the AAA asset class for residential real estate loans, default rates between 2007 and 2009 approached 16% in the US and almost zero in the EU[1].

In a public consultation issued in May last year, the ECB and the Bank of England[2] have jointly emphasised the need for prudently designed ABS. Other central banks have also supported the securitisation market: Banque de France[3] has supported a common initiative by a pool of French

[1] EBA/DP/2014/02, p. 13

[2] The case for a better functioning securitisation market in the European Union, BoE and ECB, May 2014

[3] In France, five banks (BNP Paribas, BPCE, Crédit Agricole, HSBC France and Société Générale) have issued EUR 2,65 bn euros based on SME credits in April 2014. The SPV, Euro Secured Notes Issuer (ESNI), has been created by industry initiative and is open to French and EU banks.

banks to create an SPV to structure SME loans. Banca d'Italia made a global reform in August, which enables SPVs and insurance companies to lend directly to corporates. Indeed, securitisation can be used as a tool to improve credit market conditions as an alternative to other central bank policy instruments such as LTRO and interest rate policy.

On October 10th, the Commission issued delegated acts under the Solvency II Directive and the CRR to promote high-quality securitisation. The rules aim at taking into account certain types of securitisations in the calculation of the Leverage Ratio and the Liquidity Coverage Ratio (LCR) and in the capital requirements of Solvency II. These acts are designated to stimulate investment in the economy.

In the meantime, the ECB has started a purchase programme of covered bonds and asset-backed securities, which fulfill the criteria established in the European collateral framework[4]. In addition, an IOSCO-BCBS group has been mandated to work on the definition of High Quality Securitisations. The conclusions are due in mid-2015.

General comments

The EBA Discussion Paper (EBA/DP/2014/02) which consults on the environment for EU securitisations in order to propose a framework for safe and sound securitisations and recommendation for a holistic review of the regulatory framework is a welcome initiative. The paper gives an informative statistical and regulatory overview of the securitisation market.

The BSG supports the statement that a single regulatory approach to securitisation is no longer appropriate and that a distinction should be made between different types of securitisations according to their quality, and which, as a consequence, should receive a different regulatory treatment. The proposal for a framework for ABS goes in the right direction and underpins the agenda of the Commission to develop European capital markets.

We have some initial, more general remarks concerning this framework:

1) Securitisation is an important topic as it concerns the transformation of a debt instrument into a capital market instrument that has the ability to raise cash in the financial markets. Therefore, it is a basis for developing the EU capital markets union. Since the beginning of last year, a number of initiatives have been taken by various institutions (see above) to

[4] http://www.ecb.europa.eu/press/pr/date/2014/html/pr141002_1.en.html

revitalize the securitisation market. Therefore, the topic should be coordinated with the other institutions' workstreams.

2) The investor base for ABS is varied and includes Monetary Financial Institutions (MFI), Money Market Funds (MMF), insurance companies, etc., which fall under different regulatory regimes. On a European basis, such a framework should therefore also be studied in the joint committee of the ESAs (if this is not already the case) in order to harmonise the different initiatives.
3) This Discussion Paper explicitly deals with transactions where the risk of transferred exposures is tranched. However, the advantages/disadvantages of tranching (i.e. classification of risk with the possibility of reaching different types of investors with one SVP) are not made sufficiently explicit in this paper.
4) As a corollary, transactions where the credit risk of the transferred exposures is not tranched are excluded, although they permit to reach certain classes of investors who cannot invest directly in loans under certain jurisdictions (i.e. insurance companies).
5) The creation of a separate category of securitisation is very much welcomed but should be focused solely on simplicity, standardisation and transparency, and not on risk. Introducing risk parameters in a label will create the false illusion that the label is granting a new institutionalised "AAA" rating with all the consequences observed during the crisis. The risk analysis should be made by the investor and the label should only be a guarantee that all necessary risk analysis elements are available to the investor.
6) Securitisation is a global term which encompasses several types of assets/cash flow-based transactions with no (or very limited) recourse to the sponsor. It may be categorized into (i) short-term financing of assets such as trade receivables, or (ii) medium- or long-term financing of structured ABS which securitise auto loans, leases or consumer loans. The present Discussion Paper focusses only on the latter and excludes explicitly asset-backed commercial paper (ABCP), although they qualify as securitization under CRR[5]. This will exclude a short-term financing source of the economy and may be detrimental to this market.

   Asset Backed Commercial Paper (ABCP) conduits play an important role in the financing of businesses. ABCP conduits are platforms that predominantly purchase trade or leasing receivables from corporations or leasing companies. The purchase is funded by issuing short-term commercial paper (ABCP). The sponsor bank which is running the conduit provides liquidity lines that can be drawn if the ABCP cannot be sold to the market or

[5] EBA/DP/2014/02, Box2, p. 69

losses in the securitised receivables occur. Often ABCP are "fully supported": meaning that any losses of the investors are borne by the provider of the liquidity facility. The promotion and active support of such a tool, in addition to term securitisations such as ABS, would therefore be welcomed by most market participants[6] .

With the revision of the Basel framework for securitisations, there is a risk that ABCP will be negatively affected. In this context two roles have to be distinguished that banks can play in an ABCP multi-seller conduit: investor and sponsor banks. The fact that ABCP are not issued without a sponsor bank that provides the liquidity facility the treatment of these facilities in the capital requirements regime is of utmost importance. There is a risk that capital requirements for liquidity banks multiply 3-4 times compared to the current framework and exceed the risk weights for senior unsecured corporate loans. Thus ABCP financing will become unattractive for sponsors and very expensive for sellers.

Therefore, ABCP as well as the corresponding liquidity facilities should be recognised as "simple standard and transparent securitisations" and should be rewarded with a special regulatory treatment.

In this respect, the BSG welcomes the EBA recommendation 1 in the present DP for a holistic, cross-product and sector review for securitisations (long-and short term, i.e. ABS and ABCP) and other investment products (i.e. covered bonds).

Replies to Questions

Question 1: Do you agree with identified impediments to the securitisation market?

Other forms of alternative financing than covered bonds come into competition with ABS, as mentioned in the discussion paper under paragraph (3.c).

1) The ABCP market is one example. ABCPs are commercial papers with a maturity of less than one year, generally sourced in the same sector (credit cards, customer receivables, etc.) with recourse to both the underlying asset and the sponsor (the bank) which provides a liquidity line. In this respect, ABPC are comparable to a short-term covered bond. This market is very active and helps in the financing of the economy.

[6]While the volume of the conduit business market shrunk significantly due to the exit of arbitrage conduits and structured investment vehicles (SIVs) after the financial crisis, the share of multi seller conduits in all conduit issuances has risen considerably. According to Moody's multi-seller conduits in Europe securitised trade or leasing receivables of an amount of 63.3 billion EUR in 2014 and thereby accounted for 82 Percent of the ABCP market. Multi-seller ABCP have experienced a stable and sound development also through the 2007/2008 crisis and subsequent years. In Germany, for example, no ABCP investor in a multi-seller conduit has ever suffered a loss.

2) For corporates in general and SMEs in particular, factoring, forfaiting and invoice finance could be mentioned as alternative forms of funding. These techniques are usual forms of raising cash from receivables [7]. For SMEs in particular, securitisation programmes are often too expensive because of the incompressible costs of initiating a programme. Currently, banks are looking at ways to realise securitisation finance for SME receivables. Different solutions are envisaged: private placement of securitised receivables, thus avoiding rating costs, or pooling of several SME programmes via specialised vehicles. The minimum amount for a financially viable securitisation (versus forfaiting/factoring) is considered to be EUR 50 million[8].

Concerning regulatory uncertainty (paragraph 3.f), some of the items quoted are of utmost importance in order to create secure securitisations and are therefore more a factor of quality than an impediment, such as for instance the retention rules, which oblige the originators to keep an interest in the financing, as opposed to an “originate to distribute” model.

Question 2: Should synthetic securitisations be excluded from the framework for simple standard and transparent securitisations? If not, under which conditions/criteria could they be considered simple standard and transparent?

The difference between a cash and synthetic securitisation, as defined in article 242 (10) and (11) of the CRR, lies in the fact that in a cash securitisation, ownership of the assets is transferred into an SPV whereas in the case of a synthetic securitisation, insurance is purchased against a defined portfolio of loans, for example by way of a total return swap (TRS). In a TRS, the receiver of the total return will receive the return of the underlying asset (usually an index on shares or bonds), i.e. the income plus any appreciation or depreciation of its value, against a set payment (i.e. Libor + margin). It enables the receiver to get exposure to an asset without having to own, and thus to finance it. This is why this type of instrument is popular with hedge funds.

Synthetic securitisations are usually more complex. Therefore, careful differentiation should be made between a synthetic securitization that is used to create an arbitrage, or allow hedge funds to create short positions on specific asset classes such as the Abacus transactions during the crisis; and a “non-true sale” transaction that is created because there is no simple or efficient way to actually transfer the legal ownership of assets. Furthermore, for some banking institutions it is the only way to participate in risk transfer transactions without the need of selling loans of clients. If this

[7] Birouk O. , Cassan L., La titrisation en France, Bulletin BdF N° 190, 4ème trimestre 2012, Encadré 2
[8] Une titrisation moins coûteuse pour les PME ; Option Finance N° 1290 ; 27 october 2014.

distinction is not made, these institutions will gain no advantages from this two-class system as their client policy and given words of not selling performing loans to external investors will prevent it. In addition, synthetic securitisations are generally not public: for example, the "mezzanine" tranche is generally sold to very sophisticated investors, such as hedge funds, that clearly understand the structures.
Therefore, synthetic securitisations should also be included in the framework.

Question 3: Do you believe the default definition proposed under Criterion 5 (ii) above is appropriate? Would the default definition as per Article 178 of the CRR be more appropriate?

The use of Article 178 of the CRR would be more appropriate because the definition of default is more complete and therefore avoids approximations and different definitions of default. It includes specific types of credits, such as credit cards, which are likely to be underlying assets for securities and indications of unlikeliness to pay.

Question 4: Do you believe that, for the purposes of standardisation, there should be limits imposed on the type of jurisdiction (such as EEA only, EEA and non-EEA G10 countries, etc.): i) the underlying assets are originated and/or ii) governing the acquisition process of the SSPE (Securitisation Special Purpose Entity) of the underlying assets is regulated and/or iii) where the originator or intermediary (if applicable) is established and/or iv) where the issuer/sponsor is established?

The EBA Discussion Paper rightly points out the higher general quality of European securitisations. However, securitisation is a global business. Limits imposed on the type of jurisdiction could seriously impede the market and also generate reactions from those jurisdictions which are left out. The criteria should be based on credit and reducing major non-credit risk-related factors such as enumerated in recommendation 3, p.61 of the Discussion Paper.

However, the use of European level directives such as the Financial Collateral Arrangements Directive to ensure a homogeneous granting of security over assets should be encouraged. This Directive and its various transcriptions into local laws is an example of Europe-wide initiatives that have helped the development of secured funding transactions including covered bonds. In the case of securitisation, the use of this existing framework should be encouraged as a way to mitigate counterparty risk.

Question 5: Does the distribution of voting rights to the most senior tranches in the securitisation conflict with any national provision? Would this distribution deter investors in non-senior tranches and obstacle the structuring of transactions?

There is no reason to grant voting rights exclusively to the senior tranche given the level of conflicts of interest it would create. For example, fundamental matters such as varying the capital structure, maturities, coupons etc. should obviously be voted by the majority of all classes. A vast majority of securitisations give the controlling rights to the most senior tranche, therefore allowing such tranche to direct the acceleration of the securitisation post event of defaults. However, these provisions are now in conflict with the Dodd Frank rules and can sometimes reduce access to the US market for such securitisations.

Question 6: Do you believe that, for the purposes of transparency, a specific timing of the disclosure of underlying transaction documentation should be required? Should this documentation be disclosed prior to issuance?

Yes, absolutely. The main problem in securitisation (and the origin of the subprime crisis) is the lack of disclosures on the underlying assets. The USA retention rules intend to be a mechanism to avoid bad quality securitisations, as long as the issuer keeps some interest in the new financial asset created. For this reason it is important to have a good rating process and, over all, enough information about the securitisation to assess the convenience to purchase the securities created.

Question 7: Do you agree that granularity is a relevant factor determining the credit risk of the underlying?

Granularity of credit is one important aspect because of the inherent distribution of risk. However, it is not the only aspect, as in times of systemic risk, granularity may be overruled by macro-economic factors: i.e. in times of a financial crisis underlying assets will have a higher default rate in general statistical terms, despite a high degree of granularity (i.e. consumer credits, mortgage loans). On the contrary, according to an S&P study[9], senior tranches of CLOs have a minimal loss rate for the past 20 years and were not really granular.

Does the threshold value proposed under Criterion B pose an obstacle to the structuring of securitisation transactions in any specific asset class? Would another threshold value be more appropriate?

The criterion is not appropriate for ABCP transactions for the following reasons:

[9] Twenty Years Strong : A Look Back At US CLO Ratings Performance From 1994 Through 2014, Ratings Direct, Standard & Poors, January 31, 2014.

Within the trade receivables pools of multi-seller ABCP-programs the exposure to a single debtor is subject to the business policy and customer base of the corporate originator (e.g. automotive suppliers with naturally only have few customers whereby trading companies may have thousands). It would not be appropriate to declare a whole ABCP-program as not eligible as a simple standard and transparent securitisation because of single transactions with higher concentrations. This holds especially true if the portfolio (or the whole ABCP program) is covered by commercial credit insurance or a fully supported liquidity line.

Furthermore, in the case of leasing transactions with (predetermined) residual values, the manufacturer or an affiliate usually covers the credit risk of the residual value. This should not be regarded as an obligor but as a seller-related risk. For the securitisation of leasing receivables any residual values shall not be counted as an obligor for the purpose of fulfilling this granularity criterion.

Therefore, this criterion is not relevant for the securitisation of trade or leasing receivables if the receivables pool is fully covered by a third party (e.g. by a credit insurance) or by a fully supported liquidity facility within an ABCP-program

Question 8: Do you agree with the proposed criteria defining simple standard and transparent securitisations? Do you agree with the proposed credit risk criteria? Should any other criteria be considered?

We fully agree that exposures should be originated according to sound lending criteria. In addition, credit origination criteria should also be taken into account: it should be ensured that sufficient documentation on the borrower exists.

For ABCP multi-seller conduits, some adjustments of the proposed criteria would be necessary in order to better reflect their special features:

1. In criterion 4, the EBA is proposing that the securitisation should be backed by exposures that are homogeneous in terms of asset type, currency and legal system. In the case of an ABCP program this criterion should not apply to the securitised assets but to the risk protection scheme or the risk taker : as long as the credit risk of the securitised assets is fully covered by a third party (e.g. by a credit insurance or by a fully supported liquidity facility within an ABCP-program) it should be sufficient that the obligors of trade or lease receivable securitisations fulfill the criteria i. to iii as the investor is exposed primarily to the risk of the sponsor bank. This adds enormous simplicity to the analyses of the

investment. Similarly, the stress testing requirements according to the European Commission Delegated Regulation 625/2014 only relate to the sponsor bank and not the portfolio.

2. From the perspective of the liquidity bank (which does not benefit from the full support) the homogeneity criterion for trade and leasing pools of real economy originators should be met if the asset type is uniform and if any material risks arising from currency mismatches or different legal systems are covered by adequate measures (FX-hedging, credit insurance resp. legal opinions). This would enable the real economy to use ABCP-structures in a most efficient manner, especially when the trade receivables derive from cross border delivery of goods and services.
3. In addition, with respect to the disclosure of transaction documents (criterion 17) concerning trade and lease receivable transactions of real economy originators must not - even if legally possible - interfere with the protection of business secrets of such originators (e.g. term of trade, customer relations etc.). This is even more relevant if the securitisation is fully supported by a liquidity facility or by other means which cover all risks (e.g. credit insurance). Investors should therefore only be entitled to request documentation that is materially relevant for understanding their risk position and which they may reasonably request without harming business secrets of any of the counterparties involved. This being said, originators or sponsors should not be forced to disclose all documentation.
4. Criterion 19 states that the transaction should be subject to mandatory external verification on a sample of underlying assets (confidence level of at least 95%) at issuance, by an appropriate and independent party or parties, other than a credit rating agency. From the point of view of an ABCP sponsor bank, this requirement should not be applied to investors in ABCP that are fully supported. For the sponsor bank, a yearly due diligence based on a representative sample should be sufficient. In addition, it is not clear what is meant by the proposed confidence level: a more detailed explanation on the choice of the threshold would be welcome.

Question 9: Do you envisage any potential adverse market consequences of introducing a qualifying securitisation framework for regulatory purposes?

This may be detrimental for other types of securitisations, such as shorter paper (ABPC) in case they are not labeled as “qualifying”.

The introduction of a label can have adverse effects: as with ratings before the crisis, investors might rely solely on the label of "qualified security" and might omit to undertake a thorough risk analysis of their own. This may have an adverse effect on the credibility of the label.

Moreover, the criteria for qualifying securitisations should apply throughout all sectors (i.e. banks, markets and insurance companies) in order to avoid regulatory distortion.

Question 10: How should capital requirements reflect the partition between qualifying and non-qualifying?

For non-bank investors, (such as insurance companies) there should clearly be an incentive to buy qualifying securitisation. This will have to be dealt with by the other European Supervisory Authorities as this is not necessarily within the scope of the EBA

For bank investors, there could be some incentive, to invest in qualified securitisations:

1. Banks that originate, structure and retain all or a part of the assets should be treated as if they were holding qualifying securitisation: for themselves the assets are "transparent" and "simple". There is hence no reason why they should be less well treated than the ones sold to the public.
2. A good way to incentivise banks to invest in qualifying securities would be to grant them lower thresholds / RWAs. This would also encourage them to start market making activities, which would help to build an efficient qualifying securitisations market.

Question 11: What is a reasonable calibration across tranches and credit quality steps for qualifying securitisations? Would re-allocating across tranches the overall capital applicable to a given transaction by reducing the requirement for the more junior tranche and increasing it for the more senior tranches other than the most senior tranche be a feasible solution?

In general terms, it is important in the RWA methodology that allocations reflect credit risk and structuring risk. If securitisation positions are weighted higher than an unsecured loan for the same client, the transaction may not be viable on an economic basis.

In addition, a securitized position should be homogeneous throughout the different types of regulation (Solvency, Basel, etc).

Question 12: Considering that rating ceilings affect securitisations from certain countries, how should the calibration of capital requirements on qualifying and non-qualifying securitisations be undertaken, while also addressing this issue?

Country limits are only effective under the existence of an exchange rate control, i.e. for currencies outside the euro. For the Eurozone countries, when the ECB decides to purchase securitisations, it implicitly guarantees them: it is the decision of the ECB to purchase certain securities which affects the rating and not the rating which determines the ECB decision. In this respect, country limits become ineffective in Eurozone countries.

In addition, because of the Banking Union, banks in Eurozone countries automatically have access to refinancing of the ECB. This is also a factor which makes country limits ineffective and fights fragmentation. Therefore, when refinancing securitisations, the ECB ensures that the finance goes to the economy (instead of the banking sector).

Two factors are to be considered when determining the risk of an asset: the probability of default and the probability of loss. The calibration of the riskiness of a securitisation should therefore be determined by the haircut which is applied to the underlying securities. And the haircut should depend on the credit quality of the underlying asset.

For countries outside the Eurozone, rating ceilings should still be effective. This would also state a difference between Eurozone securitisations and the others.

Submitted on behalf of the EBA Banking Stakeholder Group

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