Consultation response

EBA Discussion Paper: Draft Report on STS Framework for Synthetic Securitisation

Response on behalf of AFME Members

November 2019

5.1 Introduction

Question 1: Do you have any comments on this introductory section of the Discussion Paper?

AFME members broadly agree with the observations made in the introductory section of the Discussion Paper. In particular, we agree that it is appropriate to differentiate between "arbitrage" synthetic securitisation and "balance-sheet" synthetic securitisations, and that any proposed STS framework for synthetic securitisation should be limited to balance-sheet transactions.

We acknowledge that the Basel III Framework does not contemplate that synthetic securitisation should be included within the scope of "STC" securitisation. We also note, however, that for many years, balance-sheet synthetic securitisation has been much more widely used by EU banks than by banks in other jurisdictions, and the topic is therefore of much more direct relevance to the EU than it may be in those other jurisdictions. As was the case when a limited version of the existing STS framework was extended to certain SME synthetic securitisation via Article 270 of the CRR, we are therefore of the view that, given the special importance of synthetic securitisation to the EU financial system, if the EBA does ultimately agree with our view that synthetic securitisation is both a valuable and prudent capital management tool, the fact that the Basel Committee has not included synthetic securitisation from the "STC" regime should not stand in the way of the EBA recommending that synthetic securitisations which satisfy the relevant criteria should be eligible to be accorded "STS" treatment under EU securitisation regulations. The EU took the lead in developing the STS framework for traditional securitisation, which the Basel Committee then followed with the international standards on STC securitisation, and we would hope that by demonstrating the viability of a STS framework for balance-sheet synthetic securitisation, the EU can again demonstrate the benefits of such a regime at the Basel level.

We assume that the second step in the "two-stage approach" referred to in paragraph 10 of the Discussion Paper is a reference to the requirements set out in Article 243(2) of the CRR. There is not, however, any further analysis in the Discussion Paper as to whether these requirements are appropriate for synthetic STS securitisations. This is presumably a consequence of the fact that the Discussion Paper does not currently contain any conclusions as to whether or not synthetic STS securitisations should be eligible for preferred capital treatment. However, if such requirements are to apply, AFME members would welcome the opportunity to discuss this point further with the EBA.

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In particular, AFME members note that the 2% cap on aggregate exposures to a single obligor in Article 243(2)(a) of the CRR would be unworkable for some of the main types of exposures which are regularly securitised using balance-sheet synthetic securitisation, such as large corporate loans, asset finance and project finance portfolios which, as the EBA has itself noted, are much more prevalent in synthetic securitisations than traditional securitisations (see paragraphs 37 to 40 and 46 of the Discussion Paper). Indeed, some of these larger asset classes are difficult if not impossible to securitise via traditional securitisation techniques. While members acknowledge the importance of maintaining level playing field between traditional and synthetic securitisation where possible, we would propose that a differential exposure caps be set for different types of exposures, which takes into account the typical size of such exposures relative to the total portfolio size for a viable securitisation. As a starting point, a number of AFME members have indicated that a concentration limit of 3-4% would be more workable for many of these asset classes.

AFME members acknowledge that, given the private and largely unrated nature of synthetic securitisation markets, there is less information publicly available to assess the performance of balance-sheet synthetic securitisations, or to compare that performance against that of true sale securitisations. Against this backdrop, AFME members remain ready to assist the EBA in its analysis by providing additional data on the structure and performance of their existing synthetic securitisations. We also note that the introduction of the new disclosure templates under the EU Securitisation Regulation will facilitate further monitoring of synthetic securitisations moving forward.

5.2 Market developments and trends

Question 2: Do you agree with the analysis on the market developments? Please provide any additional relevant information to complement the analysis.

In general, AFME members agree with the observations made in Section 5.2.1 of the Discussion Paper. In this regard, we also make the following observations.

Volume and size of the market

We agree with the observation that, in the years following the financial crisis, issuance volumes for synthetic securitisation declined considerably, although a handful of banks continued to execute synthetic securitisations throughout this period. Since around 2012, however, the market has grown significantly, with many more originators utilising synthetic securitisation as part of their credit risk and capital management activities. This has been the case across the EU, with transactions being executed in many jurisdictions. While many of the larger transactions have been concentrated in a handful of jurisdictions (in particular, the UK, Germany, Spain, France and Italy), transactions have also been seen across many other EU member states, particularly as a result of the activities of the EIF. In total, it is estimated that more than 40 banks are currently using synthetic securitisation in one form or another.

Until the introduction of the new Securitisation Framework in 2019, most synthetic securitisations were executed by banks using the IRB Approach. However, with the introduction of the new SEC-SA risk weight formula, synthetic securitisation has now become more viable for banks using the Standardised Approach as well, and we are starting to see more Standardised banks executing transactions. It is not, therefore, the case that synthetic securitisation is a tool used only by a handful of large banks.

There has also been a broadening of the types of exposures which are the subject of synthetic securitisation. While large corporate loans continue to make up the largest share of the market (measured by portfolio size), other exposure types, including SME, trade finance, commercial real estate, project finance and leveraged loans have also seen significant issuance. More recently, we have started to see some retail asset classes, such as auto loans, being the subject of synthetic securitisation.

Accordingly, synthetic securitisation has emerged as an essential tool for a large number of banks right across the EU in their credit risk and capital management activities. For many of these banks, there are few other tools which are available to them which enable them to transfer credit risk to the private capital markets efficiently so as to free up both capital and lending limits and allow them to continue supporting the broader European economy. In this regard, synthetic securitisation serves a very different purpose from traditional securitisation, which is far more commonly used as a funding tool rather than a credit risk management tool. Far from being a product which increases risk across the financial markets, when used appropriately, as has invariably been the case across the EU since 2008, synthetic securitisation plays a positive role in transferring risk out of the banking sector and into private capital markets.

We agree with the observation that arbitrage synthetic securitisations have largely disappeared from the market since the financial crisis, and the importance of this change cannot be overstated. Even during the financial crisis, as is borne out in the analysis in Section 5.2.3 of the Discussion Paper, balance-sheet synthetic securitisation performed extremely well, with virtually no losses suffered in the higher-ranking tranches. Almost all the undesirable consequences of synthetic securitisation for the financial markets came from arbitrage synthetic securitisations. AFME members wholeheartedly agree that any inclusion of synthetic securitisation within the STS framework should be limited to balance-sheet synthetic securitisations, and should exclude arbitrage synthetic securitisations entirely. At the same time, when deciding on the appropriate policy and capital treatment for balance-sheet synthetic securitisations, the poor experience of arbitrage synthetic securitisation should not be used as a reason not to extend the STS framework to balance-sheet transactions.

Public/private transactions

The synthetic securitisation market has remained a largely private one, with the vast majority of transactions being placed with a small number of sophisticated investors. In addition, because most synthetic securitisations are primarily executed for credit risk and/or capital management purposes, it is the first loss and/or junior mezzanine tranches which are invariably placed with investors. In the case of first loss tranches and many junior mezzanine tranches, it would either not be possible to obtain a credit rating, or the rating would be very low, and thus not be seen as a useful exercise, particularly given the level of due diligence that investors invariably conduct on the underlying portfolio in these transactions. One consequence of this is that, unlike for traditional securitisations where it is common to for the senior tranches to be externally rated by the credit rating agencies, there is very little use made of credit ratings in the structuring, marketing and sale of synthetic securitisations.

In addition, feedback from members has been that it is often difficult to obtain the required two ratings for a transaction. For example, some rating agencies have told originators that they are unable to rate blind pools. In cases where a rating is possible, the rating agencies often impose additional structuring criteria which are not required by investors, make the transaction less efficient for the originator, and generally make the transaction more complex.

Therefore, except where a credit rating has been required by the originator for capital purposes (eg., when applying the SEC-ERBA approach, or as a result of a local regulatory requirements, such as the UK PRA's requirement under the old securitisation framework for originators to obtain an external credit rating to support their commensurate risk transfer analysis), it is rare for a synthetic securitisations to be publicly rated, as this would entail significant additional cost for originators and place additional constraints on portfolio composition and transaction structures without providing any benefit for either the originator or investors. We acknowledge that one outcome of this has been that there is less publicly available information about the performance of synthetic securitisations compared with traditional securitisations.

However, AFME members are firmly of the view that the lack of publicly available information about synthetic securitisations should not be taken to imply that they are riskier, or that less rigour or due diligence is applied by the parties in their execution that is the case for publicly-rated traditional securitisations. On the contrary, given the intensive investor due diligence process ensures that transactions are appropriately structured and properly executed, as indeed we submit is borne out the analysis in Section 5.2.3 of the Discussion Paper. For many years now, originators have also been required to notify their regulator when executing a synthetic securitisation for significant risk transfer purposes, and provide detailed information about the transaction, so that information should also be available to regulators when assessing the risk associated with synthetic securitisation more generally. Nevertheless, to assist the EBA in overcoming the difficulties from the lack of publicly available information, members reiterate their offer above to engage further with the EBA in relation to the structure and performance of their existing transactions.

Geographical distribution of exposures

The most significant difference between synthetic securitisation and traditional securitisation is the fact that there is no true sale of the securitised exposures in a synthetic securitisation. One consequence of this is that it is much more straightforward in a synthetic securitisation to include exposures from different jurisdictions and/or different lenders with the originator's corporate group in a synthetic securitisation, as there is no need to analyse separately the true sale requirements for each such jurisdiction or entity type. For some types of portfolios, having exposures from a range of jurisdictions is seen by investors as beneficial, by reducing the risk that economic difficulties in any one geographic region could adversely affect the performance of the transaction.

Nevertheless, it is still the case that the securitised portfolio for many synthetic securitisations is concentrated by jurisdiction in a similar way to traditional securitisations. One significant exception to this, however, is for the larger EU banks with global operations. Many of these institutions use synthetic securitisation to securitise portfolios held in a wide range of jurisdictions not just in Europe, but also across Asia, North America and South America where traditional securitisation would be either impossible or inefficient for various reasons. This is particularly the case for large corporate and trade finance exposures.

Accordingly, AFME members are strongly of the view that there should be no geographic limitation on the types of exposures which are eligible to be included in a synthetic STS securitisation and that, provided that the STS criteria can be satisfied, it should be possible to include loans from multiple jurisdictions in a single transaction.

Changed characteristics compared to pre-crisis period

In relation to the statement in paragraph 42(c) of the Discussion Paper, the main reason why originators no longer place the super senior tranches of synthetic securitisations is a consequence of the changes introduced in the Basel II Framework (before the financial crisis), which allowed the originator to risk-weight the retained super senior tranche for a synthetic securitisation which achieves significant risk transfer. Accordingly, this change was beginning to take effect across synthetic securitisation markets prior to the financial crisis, and does not really represent a change of approach as a consequence of the financial crisis.

Question 3: Do you agree with the analysis of the historical performance? Please provide any additional relevant information to complement the analysis.

AFME members agree with the analysis of the historical performance of synthetic securitisations set out in Section 5.2.3 of the Discussion Paper.

We also wish to emphasise the analysis in relation to the performance of the senior tranches of synthetic securitisations set out in paragraph 55 of the Discussion Paper, which can be seen to have performed no worse than, and in many cases *better* than, traditional securitisations. This is particularly relevant to the consideration of whether it is appropriate to extend the preferential capital treatment for traditional STS securitisations to synthetic STS securitisations. Synthetic securitisation invariably involves placing the first loss and/or lower mezzanine tranches of the securitisation with investors outside the banking system, and with the exception of transactions in which an insurance company acts as the protection seller, these investors do not have prudential capital requirements under EU regulation. In contrast, the originator invariably retains the senior tranche(s) of the securitisation, and these are therefore the tranches for which the risk weights are most relevant.

While AFME members continue to believe that the risk weights of securitisation positions under the CRR are not properly calibrated to the actual risk associated with those positions, we acknowledge that from a policy perspective, the EBA does not want to make it more attractive for banks to invest in the first loss and junior mezzanine positions of other banks' securitisations. However, given that there have been virtually zero losses to the senior tranches of synthetic securitisations, we do not think the risk weights which currently apply to those tranches under the CRR are a fair reflection of the risks associated with those tranches, nor do we think that there is any reason to apply a different approach to those risk weights from that which is applied to traditional securitisations. Indeed, the risk weights for traditional and synthetic non-STS securitisations are the same, and there is no reason why this should not also be the case for both traditional and synthetic STS securitisations.

We acknowledge that it is sometimes difficult to compare the performance of synthetic and traditional securitisations, given that the underlying portfolios tend to be different for the two types of transactions. Nevertheless, we submit that the data on the performance of balance sheet synthetic securitisations, even viewed in isolation, shows that these transactions perform well and are not inherently risky. Again, this is even more clearly the case for the senior tranche(s) of synthetic securitisations.

5.3 Rationale

Question 4: Do you agree with the analysis of the rationale for the creation of the STS synthetic instrument? How useful and necessary is synthetic securitisation for the originator and the investor? What are the possible hurdles for further development of the market?

AFME members strongly agree with the view expressed in paragraph 68 of the Discussion Paper that the changes in securitisation markets in recent years mean that the time is now ripe to extend the STS framework to include synthetic securitisation.

We also submit that, despite assertions which are sometimes raised to the contrary, there is already a high degree of standardisation in synthetic securitisation transactions, across both EU jurisdictions and asset classes. In some ways, this is a consequence of the fact that synthetic securitisations are usually structurally much simpler than traditional securitisations, and the lack of a need to effect a true sale of the underlying exposures means that there is very little variation in the legal structure as a result of changes to jurisdiction or exposure type. Further, while there are still some significant differences between transactions, these tend to be driven by the different approaches taken by regulators to the analysis of significant risk transfer under Article 245 of the CRR, and AFME members strongly support the EBA's continued efforts to increase the harmonisation of approach in this regard, which overlaps in many places with the STS considerations. The prescriptive requirements of the CRR, the post-crisis implementation of retention requirements and the guidance provided by the EBA on subjects such as implicit support have all contributed to the standardisation and strengthening of structures.

While it is true that there are a number of different structures in the market for synthetic securitisations (eg., bilateral financial guarantees, credit default swaps, originator issued credit-linked notes or "full" synthetic securitisations involving a SSPE as the protection provider), most of these different structures can be applied equally to transactions in different jurisdictions or for different exposure types. This standardisation is also reflected in the fact that there is significant commonality of the investor base across transactions, both in terms of jurisdictions and asset types.

There is, therefore, no reason why it is not possible to formalise that standardisation through the creation of an STS regime for synthetic securitisation.

Further, formalising such standardisation by means of a "best practice" STS label would assist in further broadening synthetic securitisation markets both by making it easier for new originators to enter the market (with the comfort that they would be executing transactions which are comparable in structure to those of other originators) and by overcoming one of the downsides of the current limited publicly available information about synthetic securitisations which can act as a barrier to entry for new investors (by giving them confidence that the transaction was indeed consistent with market best practice). The STS label would also act as a catalyst for promoting the adoption of best practice as a “race to the top”, and to allow investors and regulators to detect any slippage in standards over time.

At the same time, AFME members would reiterate the observation at the end of paragraph 66 of the Discussion Paper, that it is important to ensure that any criteria specified for synthetic securitisation are workable and effective, for both originators and investors across the market, and our responses to the specific criteria proposed in the Discussion Paper are made in that spirit.

Although there are important differences between synthetic and traditional securitisations, it is nevertheless the case that, with a few obvious exceptions such as the lack of a true sale, most of the existing criteria for traditional STS securitisations can be applied to synthetic STS securitisations. Extending the STS framework to synthetic securitisation will, therefore, help to create and maintain a level playing field in terms of what is seen as "best practice" across both types of securitisations.

For the same reason, AFME members broadly acknowledge the logic of the approach to developing criteria for synthetic STS securitisation set out in Section 5.4.1 of the Discussion Paper.

One area where there is, however, an important difference between synthetic and traditional securitisation is that, as set out in paragraphs 69ff and paragraph 97 of the Discussion Paper, the originator of a synthetic securitisation retains ongoing risk in relation to the placed tranches of the transaction in a way which is not the case for a traditional securitisation. This is most evident in the case of an unfunded tranche, where the originator retains credit exposure to the protection provider, but is also the case in a funded transaction, where, unless the collateral is held as cash on deposit with the originator, the originator is exposed to the collateral provided by the protection provider. In addition, the originator is exposed to legal and operational risks associated with its ability to make a claim for protection following the default of underlying exposures in a way which is different from in a traditional securitisation where the originator's ongoing risk is generally limited to misrepresentations in respect of those underlying exposures. While AFME members are of the view that these risks are already appropriately taken into account in the CRR rules relating to significant risk transfer and credit risk mitigation, given that in almost all cases, the originator of a synthetic STS securitisation will retain the senior tranche(s) of that securitisation, we acknowledge that it is also appropriate to address these risk issues in the STS criteria. We would, however, note that as there are now virtually no synthetic securitisations where a credit institution acts as the protection seller, the concern expressed at the end of paragraph 71 of the Discussion Paper is unlikely to arise in practice.

A two stage approach?

We note the discussion in Section 5.3.3 of the Discussion paper in relation to the "two stage" approach to applying the STS framework to synthetic securitisations. While we agree that there are indeed two separate questions to be considered, AFME members are firmly of the view that both these questions must be considered at the same time. As was the case for traditional STS securitisation, the primary purpose of having the STS framework is to create a "best practice" securitisation product which should ensure that Europe in general, and securitisation markets in particular, avoid the negative outcomes experienced in 2008-09 in the event of a future economic downturn.

At the same time, it must be acknowledged that there are costs, both economic and operational, associated with adopting a "best practice" approach, particularly in terms of the restrictions which it places on portfolio composition and, in the case of the proposed criteria for synthetic STS securitisations, in relation to collateral requirements. AFME members acknowledge the rationale behind these additional costs, but strongly submit that in light of the clear risk reduction achieved by these features, it is appropriate to recognise that reduction through applying the same preferential capital treatment to synthetic STS securitisations as currently applies to traditional STS securitisations. To put it another way, if one purpose of the STS criteria is to determine what are and what are not appropriate features for a securitisation which is eligible for preferential capital treatment, the right time to make that decision is when the criteria are being developed, as was the case for traditional STS securitisation. This, of course, means that the additional requirements which apply to STS securitisations under Article 243(2) of the CRR should also be considered as part of the decision on criteria for synthetic STS securitisations.

The introduction of a STS framework for synthetic securitisation will, even without the preferential capital treatment, have some benefits for synthetic securitisation markets through increasing and formalising the standardisation of transaction features. However, that benefit will be many times greater if originators are able to mitigate the increased costs associated with the STS framework

through the reduced risk weights which are applied to the retained senior tranche(s). We return to this point further below.

Pros and cons of the development of STS synthetic product

AFME members strongly agree with the "pros" set out it paragraphs 80 to 85 of the Discussion Paper.

We also wish to note the following additional benefits of synthetic securitisation. First, synthetic securitisation is a very effective tool for transferring the risk associated with a portfolio of exposures without grossing up the originator's balance sheet at the solo level by needing to issue and retain the senior, low-risk tranches. This cannot be achieved via traditional securitisation which, by virtue of the true sale mechanics, requires the SSPE to issue tranches matching the total portfolio size.

Secondly, synthetic securitisation facilitates the securitisation of various types of exposures which, by their nature, are not suitable for traditional securitisation. This includes exposures which include undrawn commitments (such as working capital facilities), loans with transfer restrictions (such as are often found in larger corporate loans) and loans to borrowers in jurisdictions where it is impossible to achieve an effective true sale, or where the effect of doing so would have adverse tax or accounting implications. Without synthetic securitisation, banks have less ability to manage the credit risk associated with these types of exposures, and thus facilitate lending to the broader economy.

In relation to the "cons" set out in paragraphs 86 and 87 of the Discussion Paper, we have the following observations. In relation to the comment that extending the STS framework to synthetic securitisation would involve a divergence from the Basel framework, we reiterate our observations in relation to Question 1, above. As noted in the Discussion Paper, the EU capital rules already deviate from the Basel framework in a number of ways which have been determined to be appropriate in the EU context, and AFME members submit that this is clearly such a case given the much greater importance of synthetic securitisation to EU banks than to banks in other jurisdictions. EU capital rules need to take into account the reality of how the EU financial system operates, and recognise where there are differences between the EU and other jurisdictions in that regard.

In relation to the concern about creating a two-layer structure for synthetic securitisation, we submit that the current rules, which exclude synthetic securitisations from the STS framework, is already creating just such a two-layer structure, where one type of securitisation (ie, traditional securitisation) is being treated differently from synthetic securitisation, despite the fact that, as demonstrated in the Discussion Paper, there is no difference in the performance of the two types of securitisation to justify that different treatment. We also note that the observed reality with traditional STS securitisation is that, despite the continued uncertainties resulting from delays in the finalisation of the various Level 2 regulations, the traditional securitisation market is rapidly becoming a "STS market". There is no reason to suspect that this would not also be the case for a synthetic STS product, particularly if the introduction of an STS framework for synthetic securitisation was accompanied by the same preferred capital treatment as applies for traditional STS securitisation.

The concerns expressed in paragraph 87 of the Discussion Paper in relation to increased moral hazard and that the STS label could be interpreted as meaning a high quality product apply equally to traditional STS securitisation, but clearly were not ultimately considered to be a reason not to proceed with the STS framework in that case. In relation to the concern that allowing synthetic STS securitisations could lead to reduced issuance of traditional STS securitisation, AFME members'

view is that this is unlikely given that the motivations for executing the two types of securitisation tend to be quite different. Traditional securitisation is used primarily by banks as a funding tool, whereas synthetic securitisation is used for credit risk and capital management purposes, and not for funding purposes (in this regard we note that the reference to an "alternative funding channel" in paragraph 85(b) of the Discussion Paper appears to be an error). When securitisations are used for funding purposes, the primary objective of issuers is to sell the senior tranches, in order to maximise the amount of funding at the lowest cost of funding. In order to achieve lower cost, investors demand true sale, rated tranches which are discountable or eligible for Repo purposes. Synthetic securitisations do not meet these requirements, and therefore, there is no intrinsic reason to believe that the level of traditional securitisation issuance will diminish. In any case, we submit that given the comparable performance of synthetic and traditional securitisation, there is no reason to favour traditional securitisation in this way.

Finally, we view the potential for a NPL STS securitisations to be a completely separate question from synthetic STS securitisation. As noted in the Discussion Paper, synthetic securitisations are invariably executed in relation to performing exposures (as are traditional STS securitisations). There is no reason why extending the STS framework to synthetic securitisation should have any bearing on future policy changes in relation to NPL securitisations.

How useful and necessary is synthetic securitisation for originators and investors?

Please see our comments in relation to "Volume and size of the market" in response to Question 2, above. Synthetic securitisation is an essential tool for many banks in their credit risk and capital management, so as to facilitate continued lending right across the economy. It also provides an important asset class for investors seeking to gain exposure to high quality performing bank assets without having to build an origination or servicing platform. The experience to date is that synthetic securitisations continues to be a cost effective source of capital when compared with other instruments such as issuing shares.

Possible hurdles for further development of the market

Please see our response to Question 5, below.

Question 5: Do you agree with the assessment of the reasons that could eventually support a preferential capital treatment?

Pros

AFME members strongly agree with the "pros" set out in paragraphs 88 to 92 of the Discussion Paper. In particular, just as is the case for traditional STS securitisation, given that the criteria for synthetic STS securitisation will result in a simpler, more standardised and more transparent product, the preferential capital treatment is justified. This is particularly the case in light of the analysis of the historical performance of existing synthetic securitisations, even without the additional protections that would be offered by the STS framework.

Under the current Securitisation Framework for synthetic securitisations, the same risk weights apply to a simple balance-sheet synthetic securitisation with no complex features as apply to a highly complex, arbitrage synthetic securitisation. While the complexity and uncertainty associated with arbitrage synthetic securitisations may justify the significantly increased risk weights over those which applied under the old securitisation framework, in the same way it is not appropriate to treat traditional STS securitisations similarly to traditional securitisations of US sub-prime loans,

it is also not appropriate to treat all synthetic securitisations as if they were the riskiest arbitrage transactions. The STS criteria are the appropriate way of drawing the distinction between those synthetic securitisations for which the conservative risk weights should apply, and those which should benefit from more favourable risk weights.

Furthermore, we agree with the EBA assessment that the regulatory recognition of synthetic STS securitisation, and expected increase in demand and issuance, would further support banks' lending capacity as more capital would be able to be freed up for further lending to the wider economy and more risk would be transferred to be spread across the financial system. This would indirectly support the new sustainability and green EU agenda items by enhancing banks' lending capacity.

We also note that this distinction is already drawn under Article 270 of the CRR for certain SME synthetic securitisations, even though they do not need to comply with all of the proposed criteria for synthetic STS securitisation. It is, therefore, difficult to see why the introduction of a proper, tailored STS framework for synthetic securitisation would not permit the same preferential capital treatment as would currently apply to an SME securitisation which did not necessarily satisfy all those synthetic STS securitisation criteria, particularly as we also assume that if a framework for synthetic STS securitisation is introduced, it would replace the existing Article 270 framework. In this regard, members would hope that grandfathering would be provided for existing transactions structured to meet the requirements of Article 270.

As noted in our response to Question 2, above, synthetic securitisation is an essential tool for banks in managing their credit risk and capital requirements. This has direct implications for the ability of banks to provide finance to the real economy. The introduction of the Basel III Capital Floor will see a significant increase in capital requirements across the EU banking sector which will reduce lending capacity. Against that backdrop, providing appropriate recognition for genuine risk reduction transactions is appropriate and necessary to maintaining the health of EU financial markets.

In relation to the concern expressed in paragraph 93 of the Discussion Paper that this would represent a further departure from the Basel Framework, we again refer to our comments in response to Questions 1 and 4, above.

In relation to the concern expressed in paragraph 94 of the Discussion Paper that allowing preferential capital treatment would encourage opportunistic behaviour by banks or increase the motivation for banks to engage in securitisation for capital purposes, AFME members do not think these concerns are justified. We note that, even if the risk weights that currently apply to traditional STS securitisations are applied to synthetic STS securitisations, these risk weights will still, in most cases, be significantly higher than the risk weights that applied under the old securitisation framework prior to 2019, but we do not believe that there is evidence that banks were engaging in opportunistic behaviour when executing balance-sheet synthetic securitisations under the previous regime. Further, the various regulations which now apply to all securitisations under the Securitisation Regulation (such as risk retention, the ban on resecuritisation, the criteria for credit-granting, the enhanced disclosure requirements and the prohibition on cherry-picking in portfolio selection) also limit the extent to which securitisation can now be used for opportunistic ends, regardless of whether or not it meets the requirements for STS.

Nevertheless, one way of mitigating this risk further would be to limit any preferential capital treatment to securitisation positions held by the originator itself. As noted above, in contrast to the position before 2008, there is currently virtually no practice of banks investing in synthetic securitisations originated by other banks. Thus, if only an originator was permitted to recognise a preferential risk weight in relation to positions in its own synthetic STS securitisation, this would not adversely impact the benefit of introducing an STS framework for synthetic securitisation.

While most transactions which adopt the SEC-IRBA approach will have only one senior tranche retained by the originator, where the SEC-ERBA methodology is used, it may be necessary to have one or more upper mezzanine tranches also retained by the originator in addition to the senior tranche. Therefore, to take this into account, the preferential risk weights should apply to all contiguous senior and upper mezzanine tranche(s) held by the originator, and not apply to more junior tranches which are subordinated to those placed with investors.

Question 6: Please provide any additional relevant information on potential impact of the creation of the STS synthetic securitisation on (STS) traditional securitisation, and any other information to complement the analysis.

No additional comments on this question.

5.4 Criteria for STS synthetic securitisation

Question 7: Do you agree with the criteria on simplicity? Please provide comments on their technical applicability and relevance for synthetic securitisation.

AFME members are generally in agreement with the proposed criteria on simplicity other than for a few technical clarifications as set out below. We also submit a mark-up of the draft criteria for STS Synthetic Secucritisation (please see Annex 1).

Criterion 1

AFME members disagree with the rationale behind limiting the originator to an EU-regulated undertaking Article 2(12)(a) to (g) of the Securitisation Regulation. This would exclude some members of banking groups (eg., auto loan lenders which are not themselves credit institutions). We submit that it should be sufficient for the originator to be an entity established in the EU which is a member of the same group as an EU-regulated institution.

Care also needs to be taken to ensure that there is no requirement for the protection buyer itself always to be the lender, as this can create tension with insurance regulations in many EU jurisdictions. To overcome these tensions, the approach taken in many synthetic securitisation markets is to require that the lender is in the same corporate group as the protection buyer, but not necessarily the same legal entity. Criterion 1(4) could therefore be expressed as "The underlying exposures should be held on the balance sheet of the protection buyer (or a member of the same corporate group as the protection buyer)[1] at or before the closing date". This is consistent with the risk retention approach permitted under Article 6(4) of the Securitisation Regulation, and is also the basis on which most synthetic securitisations satisfy the risk retention requirements.

From a practical perspective, we are also of the view that some flexibility should be permitted to allow an originator to remedy an inadvertent breach of these requirements. For example, if an exposure is accidentally also hedged via a CDS, which is then unwound upon the error being identified by the originator.

Criterion 2

Again, it is important to ensure that the protection buyer itself need not be the lender, and therefore the language "the protection buyer has full right, good and valid title to the underlying

exposures" should be replaced with "the protection buyer (or a member of the same corporate group as the protection buyer) has full right, good and valid title to the underlying exposures".

We also submit that the protection buyer should not need to make representations in relation to the securitised exposures. This is on the basis that if the exposure does not meet the eligibility criteria it would not be eligible for protection, and thus investors would not be disadvantaged. This is one of the ways in which synthetic securitisations differ from traditional securitisations.

Criterion 3 – No active portfolio management

We would suggest that removal of an exposure which has been sold by the originator should also not constitute active portfolio management. This is to deal with circumstances where a bank may, as part of its general business, syndicate, participate out or otherwise dispose of loans or portfolios of loans which have been securitised. This is not an unusual occurrence, and to maintain alignment of the securitisation and the bank's balance sheet such loans would generally be removed from a synthetic securitisation. The separate regulations prohibiting originators from providing implicit support to securitisation transactions will ensure that such sales are not being done to prevent investors from taking losses.

Criterion 4 – Homogeneity

While AFME members would expect that the homogeneity criteria for synthetic STS securitisations broadly to conform to those which apply to traditional STS securitisations, we submit that the existing regulatory technical standards would need to be revised for this purpose to take into account the types of exposures which are more commonly securitised using synthetic securitisation, as well as to reflect the structural differences between traditional and synthetic securitisation (for example, Article 1(c) in its present form does not work for synthetic securitisations).

Although the appropriateness of the existing RTS would need to be considered for all asset classes, we would in particular seek clarity that an underlying portfolio of trade finance exposures (as distinct from trade receivables) would be considered homogeneous on the basis that trade finance is a single asset class consisting of financing exposures to corporates or financial intermediaries that are involved in an underlying trade transaction. Trade finance represents the financial instruments and products that are used to facilitate international trade and commerce and although there are a variety of trade finance instruments or products (depending on whether the financing is made to the importers/buyers, exporters/sellers or the facilitating financial intermediaries), they serve the common purpose of making it possible and easier for the parties to carry out a trade transaction. Given the global nature of trade, trade finance exposures are typically geographically diversified across multiple jurisdictions. However, transactions are typically booked and managed by the originating bank on a common global transaction platform/system such that the bank's policies and processes relating to trade operations can be carried out with consistency across jurisdictions and products.

Trade finance is governed by contractual financing agreements but there are also well established standard market practices and rules (such as the Uniform Customs and Practices for Documentary Credits (UCP 600) developed by the International Chamber of Commerce (ICC) Banking Commission) to ensure uniformity and standardisation. The UCP was established to create a set of contractual rules that would establish uniformity in practice, and address the issues with

conflicting national regulations. UCP has gained universal acceptance by trade practitioners in countries with widely divergent economic and judicial systems.

Trade finance exposures share the common characteristics of having very short maturities (3-6 months on the average) and low default/loss rates (as shown by studies such as the ICC Global Trade Finance Survey conducted by the ICC Banking Commission). It has been recognised that SMEs are of vital importance to global economy and equally, trade finance is critical for the sustenance of SMEs and international trade is core to global economic development. However, according to recent World Trade Organisation and Asian Development Bank reports on trade finance gaps, the availability of trade finance is often cited by businesses around the world, particularly SMEs, as a major barrier to their capacity to trade. The inclusion of trade finance as an eligible asset class for STS securitisation will ultimately contribute to address the needs of SMEs, whether directly or indirectly, and promote international trade and global economic development.
In addition, we consider that further clarity is required in relation to corporate exposures more generally as they tend to include, by their very nature, more diversity that is usually seen in more traditional securitisation asset classes such as residential mortgages and auto loans. On its face, the homogeneity factor in Article 3(a)(ii) of the RTS would appear to encompass portfolios of large corporate loans to borrowers in different jurisdictions and/or industry sectors, but given the predominance of this type of portfolio in synthetic securitisation, further clarity would be helpful in this regard.

The above is a non-exhaustive exposition of some of the issues which would need to be considered in relation to homogeneity. AFME members look forward to a more detailed discussion of this important point as the EBA's thinking of criteria for synthetic STS criteria continue to evolve.

Criterion 7

AFME Members disagree with the prohibition on loans made to special purpose entities. In the wholesale lending market, it is common for SPE borrowers to be used for a variety of purposes which do not of themselves indicate that the loans are inherently risky or more complicated for investors to assess than similar loans to non-SPE borrowers. This is particularly the case for some exposure types such as project finance, where the risk profile of the exposure can be enhanced by the use of a SPE borrower which holds the project assets and is a separate legal entity from the commercial sponsor of the project. Given that proposed Criterion 13 already excludes exposures that were underwritten on the basis that their repayment is predominantly reliant on refinancing or asset sales, there is no reason for also excluding SPE borrowers.

We also note that this was a point which was specifically considered in the context of the criteria for traditional STS securitisation, and that the final criteria did not exclude SPE borrowers. In the interests of maintaining a level playing field, the same approach should be taken for synthetic STS securitisation.

Question 8: Do you agree with the criteria on standardisation? Please provide comments on their technical applicability and relevance for synthetic securitisation.

AFME members' primary concern in relation to the criteria on standardisation relate to the requirement that the protection buyer should bear no currency or interest rate risk. In addition, we have a number of technical observations in relation to exactly how some of these criteria would apply in the context of synthetic securitisation. Our detailed comments follow.

Criterion 15 – Currency and interest rate risk

The proposal that the protection buyer should bear no currency or interest rate risk in relation to the underlying exposures is at odds with virtually every synthetic securitisation in the market.

Currency risk

It is standard practice for the credit protection and the collateral to be denominated in the same currency, so this requirement is not of concern. However, it is also quite common for portfolios to contain exposures denominated in multiple currencies, or denominated in a currency which is different from the protection currency. In the latter case, this is particularly important in the context of non-EUR exposures, where it may be difficult to place tranches in the market if the protection is denominated in the underlying loan currency.

In most synthetic securitisations, currency mismatch is dealt with by specifying a fixed exchange rate in the credit protection contract to apply to each underlying exposure. This exchange rate may be updated from time to time (subject to various conditions). Upon the occurrence of a credit event, the loss is calculated by converting the loss in the underlying currency into the protection currency at that fixed exchange rate. Thus, the protection buyer bears the risk of loss or gain as a result of movements in the exchange rate between the date on which it was fixed and the date on which the loss is determined. To ensure that the effect of this currency mismatch is reflected in the bank's capital calculations, when determining the amount of the underlying exposure which has been securitised, and thus which should be excluded from the bank's calculation of risk-weighted amounts under Article 151(1) and 153 of the CRR, the bank applies a haircut to the amount of protection in a manner consistent with the haircut that would be applied to unfunded credit protection under Article 233 of the CRR. Thus, a portion of the exposure will continue to be treated as if it had not been securitised. Many banks also hedge their currency risk at the macro level, thus reducing the degree to which they are exposed to currency movements affecting the securitised exposures.

It would be very difficult for banks to hedge this currency risk effectively within the securitisation itself given that the securitisation does not pass through the cashflows on the underlying exposures in the same way as in a traditional securitisation. That is, the only circumstances in which a payment would be required under such a currency hedge would be where a credit event has occurred and the resulting loss will be borne by the placed tranche(s), as opposed to the case of a currency swap for a traditional securitisation which has scheduled payments aligned to the scheduled payments on the underlying exposures. As this would be a highly contingent swap, AFME members are of the view that it would either be impossible or very expensive for any entity other than the originator itself to provide such a swap to the securitisation, and if it is provided by the originator then it would result in essentially the same effect as the current approach described in the preceding paragraph.

The only other alternative would be to pass the currency risk to investors. However, this is not possible without that also causing the portfolio and tranche sizes to fluctuate in line with those currency movements. This would result in (i) the investors potentially being liable for increased amounts as a result of currency movements and (ii) in the case of funded transactions, leave the protection buyer exposed to the risk that the protection seller does not provide additional collateral for such increased exposure. Providing such increased collateral would also not be possible in a transaction where the protection takes the form of credit-linked notes issued by either the protection buyer or a SSPE and held in the clearing systems, as it is not possible to impose an obligation on noteholders to make additional payments in these circumstances.

Accordingly, AFME members submit that the existing approach to taking currency mismatch into account is appropriate, and the STS criteria should not require any additional hedging of currency risk.

Interest rate risk

In relation to interest rate risk, the approach taken in most synthetic securitisations does indeed ensure that the amount of the SSPE's liabilities in respect of interest payments to investors does not exceed the sum of the protection fees which it receives from the protection buyer and the income generated by the collateral. However, where, as is usually the case, the notes pay a coupon comprised of a base rate plus a spread, the protection buyer will usually also be liable to pay the SSPE any differential between the base rate and the income generated by the collateral. For example, where the notes pay EURIBOR + 10%, if the collateral yields EURIBOR *minus* 20bps, the protection buyer would pay 10.2% to the SSPE so as to ensure that the sum of the protection fee and the collateral income equals EURIBOR + 10%. This is consistent with what is proposed in Criterion 15. However, we note that in the rationale discussion for this criterion, it appears to suggest that the protection buyer should not be exposed to the mismatch between the base rate and the collateral yield, which would be a significant departure from current practice. We submit that the current approach described here does not undermine the goal of standardisation, and the text of Criterion 15 in relation to interest rate risk should apply. Given that the differential between the collateral yield and the note coupon is usually fixed (eg., the 20bps in the above example) the only alternative to the present approach would be for the SSPE to enter into an interest rate swap with the originator to cover that differential, which would result in exactly the same economic outcome but would add the complexity of additional documentation and additional cashflows to be factored into the transaction.

Finally, we submit that flooring any base rate used to calculate the coupon payable to investors at zero should not be considered to result in the protection buyer bearing interest rate risk in relation to the transaction.

Criterion 16

In contrast to the approach described in relation to interest rate risk in relation to Criterion 15, some synthetic securitisations pay a coupon to investors that is a straight pass-through of the collateral income plus the credit spread paid under the credit protection arrangement. That is, the note coupon is not based on a market rate such as EURIBOR, but will fluctuate depending on the actual collateral yield. This is primarily seen in transactions where the collateral is held in the form of securities (similar to what is described in Criterion 36 in the Discussion Paper). This is a relatively straightforward mechanic, and so is still consistent with the more general policy objective of avoiding complex formulae or derivatives. We would therefore propose that the interest payments should be based on *either* generally used market rates or the collateral yield.

We also submit that this criterion should not be interpreted as applying to the underlying exposures being securitised given that the cashflows generated by those exposures have no impact on the payments due to investors in the securitisation.

Criterion 17

Whether or not to enforce or accelerate following an enforcement or acceleration event should be at the discretion of the relevant non-defaulting party rather than being automatic. In this regard, we

also note that automatic acceleration was considered during the consultation process for the traditional STS securitisation, and was ultimately rejected as a requirement.

We also submit that the reference to sequential amortisation continuing as the underlying exposures amortise is not relevant in the context of a synthetic securitisation. If the transaction is unwound early, then the credit protection will cease to apply to any credit events which occur after that time. Accordingly, the collateral can be immediately returned to investors (in accordance with the order of seniority) without waiting for the underlying exposures to amortise.

The only exception to this is where there are defaulted exposures which are in the process of being worked out. To cover the potential losses resulting from these work-outs, a portion of the collateral will be withheld (determined in respect of each tranche in reverse order of seniority) until such time as the relevant losses have been worked out, at which point any collateral not used to make protection payments will be returned to investors in accordance with the order of seniority. It should therefore also be made clear that the SSPE and/or protection buyer (where there is no SSPE involved) may retain some of the collateral in these circumstances.

Criterion 18

We assume that the reference in the fourth paragraph of this criterion to the total outstanding amount of "all tranches" at any payment date being at least equivalent to the notional outstanding amount of the underlying exposures which have suffered a credit event should be a reference to "the remaining amount of credit protection". That is, the sum of *all* the tranches will always be equal to the sum of the notional outstanding amount of the underlying exposures, both those which have defaulted and those which have not. However, the point which is being addressed here is that the amount of protection which is still available to the originator (ie, the sum of the tranches placed with investors) is not less than the aggregate notional amount of the underlying exposures which have suffered a credit event which is still being worked out.

It would also be helpful if the EBA could clarify that "hybrid" amortisation structures are permitted, such as where sequential amortisation applies at the outset, but with the potential to switch to pro-rata amortisation at a later point if certain clearly defined conditions are satisfied. Another example would be where pro-rata amortisation is applied to the senior and mezzanine tranches, but not to the first loss tranche.

Criterion 19

The conflation of termination of the revolving period and triggers for early amortisation provisions in a synthetic securitisation is unnecessary, and not consistent with the practice generally seen in the market. In a synthetic securitisation, once the revolving period ends, the securitisation will always move into the amortisation phase, with the tranches being reduced on either a pro-rata or sequential basis as the underlying exposures amortise. In the case of a funded transaction, this will also result in the collateral being returned to investors as this amortisation occurs. This is because, unlike in a traditional securitisation, the payments to be made to investors do not depend on the cashflows from the underlying exposures, but rather on the payment of the protection fees by the protection buyer and the income generated by the collateral. Deterioration of the underlying exposures does not, therefore, indicate that investors will suffer a shortfall on the payments due to them, other than to the extent that it indicates that credit events are more likely to occur which is, of course, the primary purpose of the securitisation. The only way in which the amortisation provisions should be affected by the performance of the underlying exposures is to the extent that a

switch from pro-rata to sequential amortisation is justified, which is already covered in Criterion 18. Accordingly, the reference to early amortisation provisions in this criterion should be deleted.

We also submit that a failure to generate sufficient new exposures that meet the predetermined credit quality should not necessarily result in termination of the revolving period. Sometimes such a failure may only be temporary, and to require termination of the revolving period in these circumstances would deprive the protection buyer of a key benefit to it from the transaction, while also reducing the weighted average life of the investment from the investors' perspective. If such a trigger is to be included, the protection buyer should be allowed a sufficient grace period before the revolving period is terminated so as to provide time for any temporary shortage of eligible replenishment exposures to be overcome.

Criterion 22

While AFME members agree that it is important for the underlying exposures to be identified at all times via a reference register, we note that many synthetic securitisations are executed on a "blind pool" basis, such that the identity of the underlying borrowers is not disclosed to investors. In these cases, the underlying exposures are identified in the reference register by means of a unique identification code or number rather than by name. This is also consistent with the principle in Article 7(1) of the Securitisation Regulation that confidentiality obligations in respect of the securitised exposures are to be respected. It would, therefore, be helpful if it could be clarified in this criterion that the reference register may be maintained on an anonymous basis.

Further, there should be no requirement to disclose the total outstanding amount of each underlying exposure (as opposed to the protected amount included in the securitisation). This is particularly relevant in the context of the ongoing challenges of complying with the disclosure templates for securitisations of wholesale loans where disclosing the total size of the loan greatly increases the ability of investors to determine the identity of the borrower which may contravene the requirement in Article 7 of the Securitisation Regulation for confidentiality obligations to be respected when making the required disclosure. In any event, given the detailed disclosure requirements which apply under Article 7 in any case, we do not think that there is any need to prescribe the information which needs to be included in the reference register in this criterion.

Question 9: Do you agree with the criteria on transparency? Please provide comments on their technical applicability and relevance for synthetic securitisation.

We do not have any specific comments on these criteria. We do note, however, our comments in response to Question 12 below in relation to the continued challenges of complying with the disclosure templates under Article 7(1)(a) of the Securitisation Regulation.

Question 10: Do you agree with the specific criteria for synthetic securitisation?

As is perhaps to be expected, AFME members do have a number of comments on the proposed specific synthetic securitisation criteria.

Criterion 30

AFME members agree that the credit protection payment following a credit event should be based on the actual realised loss. However, consistent with the comments made in relation to Criteria 1 and 2, above, this should refer to the actual realised loss suffered by the relevant lender at the time

of the credit event rather than by the originator as such. Because of the need to comply with Criteria 1 and 2 (as we have proposed they be amended), as well as the risk retention requirements in Criteria 14 (and Article 6 of the Securitisation Regulation) this means that the loss will still have been suffered within the originator's banking group, but will avoid the risk that the arrangements could technically cut across insurance regulation.

It is also not clear what is meant in the penultimate paragraph of this criterion by the reference to the circumstances in which investors are required to make payments being limited in number. Generally, the protection buyer would only be permitted to make a single protection claim in relation to each underlying exposure, other than where the credit event is restructuring, where the protection buyer may be permitted to make a subsequent claim if the restructured exposure suffers a further credit event.

Criterion 31

It is not clear whether the reference to the "actual loss suffered by the originator" in this criterion is intended to refer to the accounting loss, and this would take into account any expected future recoveries, or whether it is referring to the gross loss less actual recoveries received by the end of the two year period. AFME members submit that this should be a reference to the accounting loss (ie, under IFRS 9) at this time.

AFME members also question whether a two year extension period is appropriate for all asset types. While we acknowledge that it is most common to see a two year extension period, there are some portfolio types for which a longer period is appropriate, particularly in relation to project finance or commercial real estate assets, or in the case of exposures in jurisdictions where it is common for workout periods to take longer. Given this, we submit that the purpose of this criterion should be to ensure that the documentation clearly sets out the length of any extension period (which should be finite) and how any residual losses are to be determined if the work out process is not completed by the end of that extension period rather than prescribing a specific length of such extension period.

Criterion 32

It is not clear what is meant by the requirement that the documentation should contain all relevant information that has been used to price the credit protection agreement. As is the case for a traditional STS securitisation, the pricing of a synthetic securitisation (ie, the protection fee payable by the protection buyer) will be determined through a market-based process and negotiations between the protection buyer (or an arranger on its behalf) and the initial investors. It is neither necessary nor appropriate for the protection buyer to be required to disclose to the investors all of the considerations which it takes into account in determining what pricing is acceptable from its perspective. Indeed, some of this information will be highly commercially sensitive and it would never be appropriate to disclose this information to investors, or to the market more generally. Further, as pricing involves an *agreement* between the protection buyer and the investors, as currently proposed, this criterion would also seem to require the documentation to set out the considerations which the investors have used to price the transaction, which will also be highly commercially sensitive and which they are unlikely to be willing to divulge.

An important distinction needs to be drawn between information which *all* parties need in order to price a transaction, and information which is only relevant for one party's pricing considerations. The former category would include objective information about the securitised exposures and how

they are serviced, as well as the transaction structure, all of which is already covered by the general disclosure requirements under Article 7(1) of the Securitisation Regulation.

The latter category is comprised of more subjective factors, which may or may not be relevant for different parties depending on their commercial objectives, or which by their nature involve a subjective determination that only that party can make. For example, an investor is likely to place significant emphasis on the originator's reputation, the investor's assessment of the historical performance of previous synthetic securitisations originated by the protection buyer, the investors' assessment of the credit risk of the originator, their own default and loss expectations for the securitised exposures, general market conditions, the timing of the transaction and what alternative investment opportunities are available to it at that time, none of which are factors which the originator can disclose. Similarly, the originator is likely to take into consideration factors such as the cost of the protection compared with the yield on the securitised exposures or with other regulatory capital instruments which could be issued by the originator, the originator's internal cost of capital, as well as its assessment of the desirability of the investor as a protection seller. We therefore submit that this criterion should not require disclosure of such information.

We also note that the rationale provided for this criterion does not refer to the method in which the pricing was determined. AFME members are therefore of the view that the rationale for this criterion suggests that the transaction documentation should clearly describe how the protection fee and any note coupons are calculated in respect of each payment date over the life of the securitisation, rather than the process which was used to determine what the pricing would be in the first place.

Criterion 34 – Regulatory calls

A regulatory capital call based on a regulatory event or an early redemption right due to a capital disqualification event is standard market practice for instruments that contribute towards a bank's regulatory capital and common equity tier 1 (CET1) ratios. This is especially true for longer dated instruments as it is suboptimal and potentially costly to pay the premium where there is either non recognition or limited recognition of the preferred regulatory capital treatment due to an unforeseeable regulatory policy, legislative, regulation or interpretative change.

However, we submit that the formulation of the regulatory call set out in this proposed criterion is not consistent with current market practice and may not work as currently drafted. It is important that a regulatory call (at par) can be triggered by the protection buyer if there is a change of law and/or regulation (or interpretation by a relevant regulator) which materially changes the impact of the transaction on the protection buyer's regulatory capital position (or that of its consolidated group) compared with what was anticipated by the protection buyer at the time of entering into the transaction, regardless of whether there is a change in the contractual relationship or a change to the allocation of the benefits between the parties to the transaction, which in itself is an ambiguous concept. It would also be helpful if express reference could be made to a regulatory call being permitted in circumstances where the relevant regulator notifies the originator that it may not, or may no longer, recognise the securitisation as achieving significant risk transfer, or if the originator is not permitted to apply the intended risk-weight methodology (for example, if the originator is precluded from using the SEC-IRBA methodology by its regulatory pursuant to Article 258(2) of the CRR.

In this regard, please see our proposed mark-up of this criterion.

Criterion 34 – Other originator calls

In addition to regulatory calls based on the capital treatment of a transaction, certain other changes of circumstances which cannot be anticipated or taken into account by the originator when structuring the transaction should also be permitted as early termination events, For example, for a transaction which applies the SEC-ERBA methodology, a change to the relevant rating agency methodology which results in retained tranches in the securitisation being downgraded has the same effect as a change of law or regulation from the protection buyer's perspective, and is equally outside of its control. In a similar vein, changes to applicable accounting rules may also have a significant impact on the commercial viability of a transaction or the protection buyer. For example, if a transaction was structured as a financial guarantee, but due to a subsequent change to the accounting rules it becomes necessary to reclassify it as a derivative, this could have a significant impact on the protection buyer's capital position which may also make it necessary to unwind the transaction. Similarly, the originator should be permitted to exercise a regulatory call for other regulatory changes which make it impossible to continue to comply with its obligations under the transaction (for example, changes to disclosure requirements which would require the originator to breach confidentiality obligations to borrowers), even though this may not cause the transaction technically to be illegal.

We agree, however, that changes that do not have a specific impact on the securitisation itself should not fall within the scope of the regulatory call. Thus, for example, a change in central bank collateral frameworks that would render a transaction no longer eligible collateral for these purposes does not actually affect the regulatory capital treatment of the transaction itself.

Criterion 34 – General

The introductory wording of this proposed criterion should be clarified to make it explicit that the protection provider is permitted to terminate the transaction early in the event of the failure to pay by the protection buyer. AFME members also submit that the protection seller should also be able to terminate the transaction early in the event of an illegality or change in tax law which results in payments to the protection provider or investors becoming subject to withholding tax. In the case of a funded transaction, the investors should also be permitted to terminate the transaction in the event of a collateral default. Given that such a default will generally undermine the effectiveness of the securitisation for the protection buyer anyway, allowing investors to terminate in these circumstances would not have an adverse impact on the protection buyer over and above the consequences it has already suffered as a result of the collateral default.

AFME members acknowledge the competing considerations set out in the rationale for this criterion in relation to whether investors should be permitted to terminate for the insolvency of the protection buyer.

Criterion 35 – Excess spread

AFME members disagree with the complete exclusion of excess spread for synthetic STS securitisation. Contrary to the views expressed in the Rationale for this prohibition in the Discussion Paper, we submit that incorporating excess spread into a synthetic securitisation is relatively straightforward, particularly where it is calculated as a fixed percentage of the portfolio in a given period, to be applied on a "use it or lose it" basis.

Given that we understand that the EBA will be proposing a revised framework for the use of excess spread for the purposes of the significant risk transfer rules, there is no reason to exclude all such transactions from the scope of the synthetic STS securitisation framework.

The availability of excess spread is also essential to facilitate the securitisation of some types of exposures, particularly those associated with consumer lending, which are, by their nature, entail both higher risk and, consequentially, higher yield. For such exposures, it is appropriate for investors to share some of the benefit of this higher yield in return for taking on the higher risk associated with these exposures.

We also note that there is no corresponding prohibition on the use of excess spread in traditional STS securitisation, despite the fact that the effect of such excess spread is no less complex in traditional securitisations. In the interests of ensuring a level playing field, the same approach should be adopted for synthetic STS securitisation.

Criterion 36

Please see our comments in response to Question 11, below.

Question 11: Do you agree with the criterion 36 on eligible credit protection agreement, counterparties and collateral? Please provide any relevant information on the type of credit protection and different collateral arrangements used in market practice and their pros and cons for the protection of the originator and the investor.

Eligible credit protection agreements

AFME members broadly agree with the types of credit protection agreements referred to in this proposed criterion, although we do not consider that it is necessary to limit items A and B to guarantees. Nevertheless, most transactions entered into by the entities referred to in items A and B do take the form of a guarantee.

However, we are also of the view that credit-linked notes issued by the protection buyer itself should be a permitted form of credit protection agreement provided that the credit protection embedded therein satisfies the other STS criteria. Credit-linked notes are, by their very nature, a form of funded credit protection. Credit-linked notes would not currently be captured within item C on the basis that they do not satisfy the requirements in the two subsequent bullet points in relation to the form of collateral. In this regard, however, please see our comments below in relation to collateral arrangements.

Eligible protection providers

AFME members disagree with the exclusion of unfunded credit protection provided by private sector investors from the synthetic STS framework. Such transactions are no more complicated than equivalent public sector transactions. While we acknowledge that there is a greater risk for the originator in the case of unfunded credit protection, it should not be the purpose of the STS framework to prevent parties from being exposed to risk. Rather the purpose of the framework should be to ensure that parties are able properly to assess those risks and make a fully informed decision as to whether or not the risk is one which they are able to accept. Further, from the perspective of the protection seller, providing unfunded protection enables it to avoid taking credit risk on the protection buyer entirely.

In this case, the CRR already provides a mechanism to ensure that the additional risk associated with unfunded credit protection provided by private sector entities is properly taken into account by the originator through the higher risk weights which apply to such protection. It is therefore not necessary for the STS criteria to exclude such transactions entirely.

Insurance companies are playing a growing role in synthetic securitisation markets, particularly in providing protection on the mezzanine tranches which are less attractive to investors which need to provide collateral to support the credit protection. The availability of such protection can be the difference between a transaction being unviable and being a cost-effective portfolio management for the originator. With the need to place thicker tranches with investors under the revised securitisation framework, particularly for banks under the Standardised Approach, the availability of unfunded protection in this way is crucial to their ability to use securitisation as part of their risk and capital management procedures.

There is a limit to the amount of funded credit protection which is available in the market, and as bank capital requirements are forecast to increase significantly in the coming years with the introduction of the Basel III Final framework, it would be unfortunate if at the same time, the options available to banks to meet those increased requirements were restructured unnecessarily. The insurance sector is well-positioned to assist in meeting this demand. In particular:

- The insurance industry is historically very effective at sharing risk among themselves, thus reducing the risk that losses on individual transactions would pose systemic risk to the insurance sector.
- The insurance and reinsurance industry follows a different cycle from the hedge fund sector, which currently provides the majority of funded credit protection for synthetic securitisation. The availability of unfunded protection from insurers therefore minimises the risk of disruption in the market should there be a reduction in available capacity from hedge funds.
- The insurance sector is large and long capital. For example, EIOPA has indicated that European insurers and reinsurers have aggregate own funds in the order of EUR 1 trillion, which is approximately twice the amount of capital required under the Solvency II framework.[2]

It should also be noted that where unfunded protection has to date been used for synthetic securitisation, the terms of that protection are very different from those seen in traditional credit insurance or monoline guarantees, and provide for much more robust credit protection for the protection buyer. This should help to ameliorate concerns that protection payments would not be met. The market is already developing ideas/thoughts on how to mitigate the counterparty credit risk present within unfunded credit protection, and potentially some of these could be incorporated within this framework. One such potential mitigant is the inclusion of downgrade triggers on the investors. Should an unfunded investor be downgraded below a certain trigger level (at least in line with CRR requirements on minimum rating levels for unfunded protection providers), then certain actions would need to be taken by the investor (e.g. full collateralisation, finding a replacement investor with the minimum required rating, etc).

Collateral arrangements

AFME members strongly disagree that the criteria should require that *both* the protection buyer and protection seller need to have recourse to high quality collateral where the credit protection is provided by a non-zero-risk weighted entity. The majority of synthetic securitisations currently involve the transaction being structured either with the collateral held on deposit with the protection buyer or in the form of an unsecured credit-linked note issued by the protection buyer. We also submit that these structures are much simpler than those which involve arrangements to mitigate the credit risk which the protection seller has to the protection buyer. Further, this is the structure which is *required* under the existing Article 270 regime for SME synthetic securitisations seeking to take advantage of the STS risk-weight on the senior retained tranche.

[2] See https://eiopa.europa.eu/Pages/Financial-stability-and-crisis-prevention/Insurance-Statistics.aspx.

These structures *do* ensure that the protection buyer has recourse to high quality collateral, but mean that the protection seller is exposed to the credit risk of the protection buyer for the return of the collateral. However, as is the case with our response in relation to the availability of unfunded credit protection, it should not be the purpose of the STS framework to prevent parties from being exposed to risk. Provided that the risk is properly disclosed, parties should be permitted to make their own decision as to whether they are comfortable to accept that risk.

Indeed, it is certainly the case that many investors are not comfortable to take fully uncollateralised credit risk on the protection buyer. Many transactions where the collateral is held on deposit with the bank include rating downgrade triggers, such that if the bank is downgraded below a specified rating threshold, it is required to move the collateral to a third party bank, or indeed to have the collateral held in the form of securities, along the lines of the collateral arrangements described in the draft criterion. Again, it should be open to the parties to agree what credit risk, or credit risk mitigants, are to be included in a transaction, provided that these arrangements are clearly and fully disclosed in the transaction documentation.

Notwithstanding our view that it should not be a requirement for the credit risk of both the protection buyer and the protection seller to be mitigated, we also wish to raise a number of technical issues in relation to the collateral proposals set out in the Discussion Paper.

It is currently unclear in this criterion whether it is possible for the collateral to be held as cash on deposit with the protection buyer. The wording following item C refers to both the originator and the protection seller needing to have recourse to high quality collateral in one of the two forms specified. This creates the following issues:

- In relation to the originator, it would appear to prevent the collateral being held as cash on deposit with the protection provider. However, both forms of collateral described in the bullet points which follow this requirement involve *more* credit risk for the protection buyer than cash on deposit, which by definition creates no counterparty credit risk for the protection buyer.
- In relation to the protection seller, it is unclear whether it is necessary for them to have recourse to the *same* collateral as the originator, or whether this requirement can be satisfied by the protection seller having recourse to different collateral from the originator.

Cash collateral

For the reasons which follow, AFME members strongly submit that: (i) the protection buyer should be permitted to have recourse to collateral in the form of cash held on deposit with the protection buyer or one of its affiliates and (ii) where the protection seller has recourse to securities collateral as described in the first bullet point in this criterion, that should not preclude the protection buyer continuing to have recourse to cash on deposit with the protection buyer as described below.

AFME members have serious concerns if this criterion would exclude the possibility for the collateral provided by the protection provider to be held on deposit with the protection buyer itself. This will have a significant impact on the economics of a synthetic securitisation, as holding the cash with a third party bank will require the protection buyer to reflect the risk weight of that third party bank when calculating the risk-weight of the protected tranche(s). Thus, while the protection buyer can recognise a zero per cent risk weight for the protected tranche(s) where the cash is held on deposit with the protection buyer, the risk weight applicable where the cash is held with a third party bank will be in the order of 20 per cent, thus significantly reducing the regulatory capital benefit of the transaction and, where the securitisation is not being executed for significant risk transfer purposes, actually *increasing* the protection buyer's capital costs as a result of executing the transaction.

To the extent that this requirement is intended to mitigate the credit risk of the investors in connection with the securitisation, it will also be only partially effective, as it will still result in the investors being exposed to the credit risk of the third party bank. Therefore, while this would reduce the correlation risk that exists were the cash is held with the protection buyer itself, it does not remove the credit risk entirely.

Where the protection seller does require that its credit exposure to the protection buyer is mitigated, that this can be achieved by alternative means. These tend to fall into one of two categories.

First, the most common approach is to provide that, where cash collateral is being held on deposit with the protection buyer or one of its affiliates, a minimum account bank rating applies, such that if the protection buyer ceases to satisfy that minimum rating requirement, it is required either to transfer the collateral to a third party bank which does have the minimum rating, or to invest the cash collateral into high quality securities held by a custodian (similar to the proposal set out in the first bullet point of this criterion).

Secondly, an alternative approach involves the protection buyer holding the cash on deposit, but then collateralising its obligation to repay the deposit with collateral securities held in a custody account. In this case, the collateral securities are owned by the protection buyer, which then grants security over those securities in favour of the investors, rather than the securities being owned by the protection seller (or by a SSPE where a SSPE is involved in the transaction), which grants security over those securities in favour of the protection buyer to secure the payment of credit protection claims.

The effect of these arrangements is that, if the protection buyer defaults on its obligation to repay the cash deposit, the investors have recourse to the collateral securities. This actually puts the investors in a *better* position than if the collateral is held in the form of securities held with a custodian, as the investors have the benefit of *both* the protection buyer's obligation to repay the deposit and the securities held with the custodian should the protection buyer fail to satisfy this obligation. In contrast, where the collateral takes the form of securities owned by the protection provider, the protection provider does not have the additional claim against the protection buyer for the repayment of the cash deposit.

This structure is also more beneficial for the protection buyer than where the securities collateral is owned by the protection provider, as it allows the protection buyer to continue to recognise a zero per cent risk weight in relation to the protected tranches, which for CRR purposes are being collateralised by the cash on deposit with the protection buyer. This avoids the need to take into account haircuts which would apply under Articles 224ff of the CRR even where the collateral securities are themselves zero-weighted.

Accordingly, while AFME members agree with the approach of requiring that the collateral arrangements contain features to mitigate the counterparty credit risk associated with cash held on deposit with the protection buyer, it should remain possible for the protection buyer to be the deposit bank.

Where the credit protection takes the form of credit-linked notes issued by the protection buyer itself, the same effect can be achieved through the protection buyer being required to secure its obligation to repay the notes with securities collateral held by a custodian. Note, however, that where credit-linked notes are concerned, the protection buyer does not itself need to benefit from any security arrangements over collateral because, as recognised by Article 218 of the CRR, the issuer of the credit-linked note is by definition in the same position as a collateralised protection buyer.

Securities collateral

Returning to the requirements for securities collateral set out in the first bullet point of this criterion, AFME members have concerns at the suggestion that haircuts must be applied when determining the notional value of the securities. The only way this can be achieved in practice is if either the securitisation involves a SSPE which enters into a repurchase transaction with a repo counterparty (generally the protection buyer) where the market value of the securities required to be transferred by the repo counterparty to the SSPE from time to time takes into account the haircuts. Although this is a structure which is contemplated by many synthetic securitisations, in practice it has rarely been used because it creates negative carry for the repo counterparty/protection buyer. That is, it is required to apply more of its resources to provide the collateral for the transaction than the funds it receives from the protection seller upon entering into the transaction.

For technical reasons, it is not possible to use a repurchase transaction to collateralise a bilateral transaction (ie, one that does not involve a SSPE). Therefore, in a bilateral transaction, the protection provider would be the party which would need to bear the negative carry resulting from applying haircuts. This would also expose the protection buyer to the ongoing counterparty credit risk of the protection seller in relation to its obligation to post additional collateral if the market value of the collateral securities declines.

One way in which many synthetic securitisations have addressed these issues in recent years is to restrict the collateral securities to very short-dated securities, which are "rolled" on a quarterly basis in-line with the payment dates for the securitisation. Thus, immediately prior to each payment date, the collateral securities redeem into cash in an amount equal to the outstanding balance of the protected tranche(s). This cash is then use to pay any credit protection payments to the protection buyer and to make any amortisation payments to the protection seller which arise on that payment, with the remaining cash reinvested in new collateral securities to mature immediately prior to the next payment date. The effect of this is to isolate both the protection provider and the protections seller from the market risk associated with the collateral securities, meaning that the amount of collateral required is at all times equal to the outstanding balance of the protected tranche(s), without any additional amounts required as a result of applying a market haircut. We also submit that limiting eligible securities to those which are 0% risk-weighted is too restrictive, particularly if the entire synthetic STS securitisation market was required to move to a collateralised basis. While we agree that collateral securities should be high quality, it is not necessary that they be 0% risk-weighted. Investors are comfortable investing in traditional STS securitisation securities that are not 0% risk-weighted, and provided that the eligibility criteria are properly disclosed, there is no reason why similarly high-quality ABS or corporate securities could not be used for synthetic STS securitisation. AFME members submit that a rating threshold of "A-" would be an appropriate level.

AFME members submit that a structure along these lines, or other structures having equivalent effect, should be considered to satisfy the requirements of the first bullet point set out under this criterion on the basis that it does constitute a conservative approach to the collateral securities in order to mitigate appropriately the market and credit risk associated with those securities.

Question 12: Please provide suggestions for any other specific criteria that should be introduced as part of the STS framework for simple, transparent and standardised securitisation.

AFME members do not consider that any additional specific criteria are required in relation to synthetic STS securitisations.

We submit, however, that as part of the process of considering the eligibility of a STS framework for synthetic securitisation, consideration should be given to preparing a separate set of disclosure templates for the purposes of Articles 7(1)(a) and 7(1)(e) of the Securitisation Regulation. We acknowledge that this is not technically part of the EBA's mandate. However given that the disclosure templates have clearly been drafted primarily with traditional securitisation in mind, and that there are many difficulties associated with applying them to synthetic securitisations, it would be helpful to consider what modifications could be made to those templates to address those issues. There are two points that warrant specific consideration in this regard:

- First, given that investors in a synthetic are not dependent on the cashflows of the underlying exposures for payments under the securitisation, much of the detailed cashflow information required by the templates is not relevant for synthetic securitisations.
- Secondly, and more importantly, because synthetic securitisations often involve less granular portfolios and wholesale assets, it is very difficult to balance the obligation to disclose all of the required information in the templates with the originator's obligations to maintain customer confidentiality and to comply with data secrecy and market abuse regulations. Even where the disclosure is technically made on an anonymous basis, the level of information disclosed often means that it is possible for investors nevertheless to identify the relevant borrowers.

While both these issues apply to synthetic securitisation generally, and are not specifically "STS" issues, we would encourage regulators to take advantage of this opportunity to ensure that the regulations applicable to synthetic securitisations reflect the nature of the transactions being regulated.

5.5 Framework for a differentiated regulatory treatment of STS synthetic securitisation

Question 13: Do you see a justification for possible introduction of a differentiated regulatory treatment of STS synthetic securitisation? If yes, what should be the scope of such treatment and how should it be structured – for example only for senior tranche retained by the originator bank, or more limited/wider?

Yes. Please see our response to Questions 3, 4 and 5, above. We also agree wholeheartedly with the observations in paragraphs 106 to 112 of the Discussion Paper, which effectively summarise why introducing a differentiated regulatory consideration for synthetic STS securitisation both is appropriate and will contribute to the continued development of this important segment of EU financial markets. As we note in our response to Question 5, while there are benefits to the introduction of a STS framework for synthetic securitisation without the differentiated regulatory treatment, that framework will be far more successful in rapidly achieving its goals of ensuring greater simplicity, standardisation and transparency across synthetic securitisation transactions if the additional operational and economic burdens associated with complying with the STS requirements can be mitigated by the preferential risk weights that apply to traditional STS securitisation.

Ultimately, balance sheet synthetic securitisations which comply with the STS criteria are no riskier for either the protection buyer or the investors than traditional STS securitisations. They also provide a complementary tool for banks seeking to manage their credit risk and capital requirements which, for various reasons, generally cannot be achieved through the use of traditional securitisation.

As also noted in our response to Question 5, AFME members agree with the policy objective of not encouraging the transfer of credit risk between banks. To that end, we would support limiting any

preferential regulatory treatment for synthetic STS securitisations to positions held by the protection buyer and its affiliates which rank senior to the tranches placed with investors.

Question 14: What would be the impact if no differentiated regulatory treatment is introduced? In that case, is the introduction of the STS product without differentiated regulatory treatment relevant for the market?

Please see our responses to Questions 5 and 13, above.

Question 15: What would be the impact of potential differentiated regulatory treatment from level playing perspective with regard to third countries where STS framework has not been introduced?

As noted in our response to Questions 1 and 4, above, balance sheet synthetic securitisation is a tool which has been used by EU banks far more extensively than banks in other jurisdictions. As such, AFME members consider that any adverse impact on the "level playing field" resulting from providing for a preferential regulatory treatment for synthetic STS securitisation for EU banks would be relatively limited.

Accordingly, AFME members are strongly of the view that the fact that the Basel framework does not include synthetic securitisation within the scope of STC securitisation, and therefore by definition does not provide for a differentiated regulatory treatment for synthetic STC securitisation, should not be a barrier to EU regulation allowing properly structured synthetic securitisations to benefit from the same treatment as traditional STS securitisations.

Question 16: Should a separate explicit recommendation be included in the Recommendations section on whether or not such treatment should be introduced?

Yes. AFME members strongly support the inclusion of an explicit recommendation that the originator of a synthetic STS securitisation should be permitted to apply the same preferential risk weights to any retained positions which it holds in the securitisation as would apply to any positions which it holds in a traditional STS securitisation. For the reasons set out in our responses to the previous questions, we believe that such a recommendation is clearly justified by the historical performance of synthetic securitisations, and would be an appropriate way of recognising the additional protections that would derive from synthetic securitisations being structured to comply with the STS criteria.

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ANNEX 1

AFME Mark-up: 20 November 2019

STS for Synthetic Securitisation

Draft Criteria

Criterion 1:

General requirements for balance sheet securitisation:

In order to be considered a STS synthetic balance sheet securitisation the following requirements should be met:

1. The securitisation should be a **synthetic securitisation** as defined in Article 2(10) of the Securitisation Regulation.

2. The protection buyer under the credit protection arrangements establishing the synthetic securitisation is **an entity established in the EU** ~~**regulated undertaking** as defined under points (a) to (g) of Article 2(12) of the Securitisation Regulation~~, and is an **originator** with respect to the underlying exposures as defined in Article 2(3) of the Securitisation Regulation.

3. When the protection buyer is an originator with respect to the underlying exposures as defined in point (b) of Article 2(3) of the Securitisation Regulation i.e. the exposures underlying the synthetic securitisation have been purchased from a third party before they are securitised, the originator should apply to the purchased exposures credit and collection policies, workout policies and servicing policies that are no less stringent than those the originator applies to similar exposures that have not been purchased.

4. The underlying exposures are part of the **core lending or any other core business activity of the protection buyer.**

5. The underlying exposures should be **held on the balance sheet of the protection buyer** or another member of the same corporate group as the protection buyer, at or before the closing date.[1]

6. The protection buyer should undertake in the securitisation documentation ~~to~~ **not further to hedge** its exposure to the credit risk of the underlying exposures beyond the credit protection obtained through the synthetic securitisation in a manner that results in the double hedging of the same credit risk.

Credit risk mitigation rules:

The credit protection agreement establishing the synthetic securitisation [and any collateral provided by the protection seller] should comply with the credit risk mitigation rules laid down in Part Three, Title II, Chapter 4 of the Capital Requirements Regulation and, where ~~Article 249 of the amended CRR (including~~the protection seller is a SSPE, the requirements set out in Article 249(4) of the Capital Requirements Regulation shall apply.~~ the requirements on SSPE), or with equivalently robust requirements in case the protection buyer is not an institution regulated under the CRR~~.

Criterion 2:

The securitisation documentation should contain the ~~representations and warranties provided by the protection buyer that the~~ following requirements in respect of the underlying exposures ~~of a synthetic securitisation are met~~:[2]

[1] This change is to avoid the risk of the credit protection constituting insurance in some jurisdictions.

[2] It is not necessary for this to be a representation from the protection buyer because if these conditions are not met in respect of individual underlying exposures, the protection buyer will not be able to make a claim

- **Title to and accounting of the exposures**: Where the protection buyer is a credit institution or insurance company, either the protection buyer or a member of the same corporate group as the protection buyer[3] has full right, good and valid title to the underlying exposures and their associated ancillary rights and accounts for the credit risk of the underlying exposures in his regulatory balance sheet. Where the protection buyer is not a credit institution or insurance company, the protection buyer or a member of the same corporate group as the protection buyer has full right, good and valid title to the underlying exposures and their associated ancillary rights.
- **Compliance of the exposures with all eligibility criteria set out in the securitisation documentation**: On the date that it is included in the securitised portfolio, ~~Each~~ each underlying exposure ~~meets~~ complies with all eligibility criteria specified in the credit [credit protection agreement]/[transaction documentation]~~., representations and warranties and any other conditions, other than a credit event, for a protection payment in accordance with the credit protection agreement within the securitisation documentation.~~
- **Financing agreements' validity and enforceability**: The contractual agreement ~~underlying~~ for each underlying exposure ~~contains~~ constitutes the ~~a~~ legal, valid, ~~and~~ binding and enforceable obligations of the obligor~~, enforceable in accordance with its terms,~~ to pay the sums of money specified in it.
- **Underwriting standards**: The underlying exposures meet ~~the~~ standard underwriting criteria that are not less stringent than ~~those~~ the underwriting criteria~~,~~ which the originator applies to similar exposures that are not securitised.
- **No obligor default or other material breach**: To the ~~best~~ knowledge of the protection buyer, on the date on which it is included in the securitised portfolio, none of the obligors with respect to each ~~the~~ underlying exposure~~s is~~ are in material breach or default of any of their obligations ~~under any loan agreements~~in respect of that underlying exposure.
- **No untrue information**:[4] ~~There is no untrue information on the particulars of the underlying exposures contained in the securitisation documentation. As at the closing date, in relation to each underlying exposure, no contractual agreement between the obligor and the original lender has been subject to any variation, amendment, modification, waiver or exclusion of time of any kind which in any material way adversely affects the enforceability or collectability of the underlying exposure.~~

Criterion 3:

The underlying exposures should at all times be subject to predetermined, clear and well documented **criteria determining their eligibility** for protection under the credit protection agreement establishing the synthetic securitisation.

After the closing date the securitisation should not be characterised by **any active portfolio management** on a discretionary basis ~~including the sale of exposures being protected under the credit protection agreement~~.[5] The following should in principle not be considered an active portfolio management:

- Substitution of exposures that did not comply with the eligibility criteria.~~are in breach of representations and warranties~~

following a credit event. Therefore, investors will not be exposed to risk in relation to those underlying exposures. This is different from a traditional securitisation where a misrepresentation would give rise to a repurchase obligation by the originator to mitigate the loss to which investors would otherwise be exposed as a result of that misrepresentation.

[3] See footnote 1, above.

[4] See footnote 2, above.

[5] As the protection buyer retains ownership of the underlying exposures, it is not necessary to refer to a sale of exposures here.

- *Where the securitisation includes a replenishment period, the addition of exposures that meet clearly defined replenishment conditions.*

In any case, any exposure added to the securitisation after the closing date should meet eligibility criteria that are **no less strict** than those applied in the initial selection of underlying exposures at the closing date.

An underlying exposure may only be **removed** from the securitisation where it:

- has been repaid or otherwise matured;
- has been disposed of by the lender of record in the ordinary course of its business, where such removal would not constitute implicit support for the purposes of Article 250 of the Capital Requirements Regulation;
- ~~the underlying exposure~~ is subject to a refinancing, restructuring or similar amendment that is not credit driven, and which occurs in the ordinary course of servicing such exposure (such as, for example, maturity extension);
- ~~where due to an error the underlying exposures~~ did not meet the eligibility criteria at the time it was included in the securitisation.

Criterion 4:

The underlying exposures should meet the following criteria:

- The synthetic securitisation should be backed by a pool of underlying exposures that are homogeneous in terms of asset type, *subject to conditions clearly defined and specified in the transaction documentation.*
- The underlying exposures should ~~contain~~ comprise obligations of the debtors and, where applicable guarantors, *to pay the sums of money specified in the terms that are contractually binding and enforceable* ~~*in accordance with such terms*~~*,* with full recourse to debtors and, where applicable, guarantors.
- The underlying exposures should have defined periodic payment streams, the instalments of which may differ in their amounts, relating to rental, principal, ~~or~~ interest payments or commitment fees, or to any other right to receive income from assets supporting such payments.
- The underlying exposures may also generate proceeds from the sale of any financed or leased assets.

Criterion 5:

The underlying exposures should not include transferable securities, as defined in point (44) of Article 4(1) of Directive 2014/65/EU, other than corporate bonds that are not listed on a trading venue.

Criterion 6:

The underlying exposures should not include any securitisation position.

Criterion 7:

The underwriting standards pursuant to which the underlying exposures are originated and any material changes from prior underwriting standards should be fully disclosed to potential investors without undue delay.

~~The underlying exposures are underwritten with full recourse to an obligor *who is an individual, an SME or a corporate and who is not a special purpose entity.*~~

No broker intermediary or similar party was involved in the credit or underwriting decisions relating to the underlying exposures.

Criterion 8:

In the case of securitisations where the underlying exposures are residential loans, the pool of loans should not include any loan that was marketed and underwritten on the premise that the loan applicant was made aware that the information provided might not be verified by the lender.

Criterion 9:

The assessment of the borrower's creditworthiness should meet the requirements set out in Article 8 of Directive 2008/48/EC or paragraphs 1 to 4, point (a) of paragraph 5, and paragraph 6 of Article 18 of Directive 2014/17/EU or, where applicable, equivalent requirements in third countries, *to the extent that such standards would, according to their terms, apply to the individual underlying exposures.*

Criterion 10:

The originator or original lender should have expertise in originating exposures of a similar nature to those securitised.

Criterion 11:

The underlying exposures should not include, at the time of selection:

- exposures in default within the meaning of Article 178(1) of Regulation (EU) No 575/2013, or
- exposures to a credit-impaired debtor or guarantor, who, to the best of the originator's or original lender's knowledge:
    - has been declared insolvent or had a court grant his creditors a final non-appealable right of enforcement or material damages as a result of a missed payment within three years prior to the date of origination of the underlying exposure or has undergone a debt-restructuring process with regard to his non-performing exposures within three years prior to the date of selection of the underlying exposures, except if:
        - a restructured underlying exposure has not presented new arrears since the date of the restructuring, which must have taken place at least one year prior to the date of selection of the underlying exposures; and
        - the information provided by the originator in accordance with points (a) and (e)(i) of the first subparagraph of Article 7(1) of the Securitisation Regulation explicitly sets out the proportion of restructured underlying exposures, the time and details of the restructuring as well as their performance since the date of the restructuring;
    - was, at the time of origination of the underlying exposure, where applicable, on a public credit registry of persons with adverse credit history or, where there is no such public credit registry, another credit registry that is available to the originator or original lender; or
    - has a credit assessment or a credit score indicating that the risk of contractually agreed payments not being made is significantly higher than for comparable exposures held by

the originator which are not securitised*, provided that*, this requirement shall not prevent the securitised portfolio being comprised of underlying exposures having different credit assessments or credit scores, as set out in the transaction documentation and disclosed by the originator in accordance with points (a) and (e)(i) of the first subparagraph of Article 7(1) of the Securitisation Regulation.

Criterion 12:

The debtors should, *at the time of inclusion of the respective exposures in the securitisation*, have made at least one payment, except in the case of revolving securitisations where the underlying exposures are ~~. This is with exception of revolving securitisations backed by exposures~~ payable in a single instalment or having a maturity of less than one year[, including without limitation monthly payments on revolving credits].[6] This criterion does not apply to an exposure which represents the refinancing of a pre-existing exposure already included in the securitisation.

Criterion 13:

The underlying exposures *should have been underwritten* on the basis that their repayment was not intended to be predominantly reliant on the refinancing of such underlying exposures or on the re-sale value of the assets that are being financed by those underlying exposures. For the avoidance of doubt, this does not exclude loans where there is a commercial expectation at origination that they will be refinanced prior to or on their scheduled maturity.

Criterion 14:

The originator or original lender should satisfy the risk-retention requirement in accordance with Article 6 of the Securitisation Regulation.

Criterion 15:

Currency risk: The transaction documentation shall clearly describe how any currency risk ~~Currency risk~~ arising in the synthetic securitisation will impact on payments to the protection buyer and the investors.~~should be appropriately mitigated and measures taken to that effect should be disclosed.~~

Where applicable, any collateral securing the obligations of the protection seller under the credit protection agreement shall be denominated in the same currency as the credit protection.

~~*The protection buyer should bear no currency risk in relation to the credit protection it receives. This may be done in either of the following ways:*~~

- ~~*the guarantee or derivative contract and, where applicable, the collateral securing the credit protection obligation should be denominated in the same currency as the underlying exposures, or*~~
- ~~*through other appropriate arrangements, which ensure that the protection buyer does not bear any currency risk in relation to the credit protection it receives.*~~

Interest rate risk: The transaction documentation shall clearly describe how any ~~Interest~~ interest rate risk associated with the synthetic securitisation will be dealt with and/or impact on payments to the protection buyer and the investors. ~~should be mitigated and measures taken to that effect should be disclosed. *The protection buyer should bear no interest rate risk in relation to the credit protection it*~~

[6] This is less relevant for synthetic securitisation than for traditional securitisation, as generally the revolving credit itself would be referenced as the underlying exposure rather than individual monthly instalments thereunder.

~~*receives.*~~[7] *In the case of a synthetic securitisation involving an SSPE, the amount of the SSPE's liabilities in terms of interest payments to investors at any payment date should be equal to or less than the amount of its income from the protection buyer and any collateral arrangements at such payment date.*

The underlying exposures should not include derivatives, *other than derivatives entered into for currency or interest-rate hedging purposes in connection with the underlying exposures or the credit protection agreement*. Those derivatives should be underwritten and documented according to common standards in international finance.

Criterion 16:

Any referenced interest payments in relation to the securitisation ~~under the securitisation assets and liabilities~~ should be based on either (i) generally used market interest rates, or generally used sectoral rates reflective of the cost of funds, and should not reference complex formulae or derivatives or (ii) income generated by the collateral securing the protection seller's obligations under the credit protection agreement.

Criterion 17:

Following the occurrence of an enforcement or ~~acceleration~~ termination event[8] in respect of the protection buyer, the protection seller should be permitted to take enforcement action and/or ~~acceleration~~ terminate the credit protection agreement. In the case of funded credit protection, upon such termination, collateral should be returned to investors ~~should be initiated immediately and sequential amortisation should continue to apply to all tranches *so that, as the underlying exposures amortise, the outstanding amount of all tranches is reduced*~~ *in order of their seniority.*

Where an SSPE is used within a synthetic securitisation, following an enforcement or ~~acceleration~~ termination ~~notice~~ of the credit protection agreement, no amount of cash should be trapped in the SSPE beyond what is necessary to ensure the operational functioning of the SSPE, the payment of protection payments in respect of defaulted underlying exposures which are still being worked out at the time of such termination or the orderly repayment of investors in accordance with the contractual terms of the securitisation.

Criterion 18:

Allocation of losses: *The allocation of losses to holders of a securitisation position in a synthetic STS securitisation should always proceed in order of seniority of tranches, from the most junior tranche to the most senior tranche in the transaction.*

Amortisation of size of tranches: Pro-rata or hybrid (that is, comprising a combination of pro-rata and sequential amortisation) amortisation may only be applied to determine the outstanding amount of some or all tranches where clearly specified triggers relating to the performance of the underlying exposures ensure the switch of the amortisation scheme to sequential amortisation. Such performance-related triggers should include at least the deterioration in the credit quality of the underlying exposures below a predetermined threshold.

[7] It is not clear what this requirement is trying to achieve, as the protection buyer would not generally receive any payments linked to interest rates.

[8] In the context of synthetic securitisation, it is more meaningful to talk of termination of the credit protection agreement as the trigger that would lead to early unwind of the securitisation.

Where this is not the case, sequential amortisation should apply to all tranches in order to determine the outstanding amount of the tranches at the respective payment dates i.e. as the underlying exposures amortise, such amortisation should be applied first to reduce the most senior tranches and only once these most senior tranches have fully amortised to reduce more junior tranches in accordance with the order of seniority as agreed in the transaction documentation.

As tranches amortise, where investors have provided collateral for those tranches ~~as part of the credit protection agreement establishing the synthetic securitisation~~, an amount of that collateral equal to the amount of amortisation on such tranches should be returned to investors. In case of underlying exposures in relation to which a credit event has occurred and the workout process has not been completed, the ~~sequential~~ amortisation ~~scheme~~ provisions should ensure the total outstanding amount of all tranches at any payment date is at least equivalent to the notional outstanding amount of such underlying exposures after consideration of the amount of any interim payments that have already been ~~effected~~ made on such underlying exposures in relation to the respective credit events. All amortisation arrangements ~~agreements, applicable before and after the occurrence of an enforcement or acceleration notice,~~ should be clearly documented.

Criterion 19:

The transaction documentation should include appropriate triggers for termination of the revolving period where the securitisation is a revolving securitisation, ~~or early amortisation provisions *where an SSPE is used within a synthetic securitisation to issue notes placed with investors,*~~ including at least the following:

- A deterioration in the credit quality of the underlying exposures to or below a predetermined threshold;
- *Losses rise above a predetermined threshold, or losses over a predefined period rise above a predetermined threshold;*
- A failure to generate sufficient new underlying exposures that meet the predetermined credit quality over a specified period of time.

Criterion 20:

The transaction documentation should clearly specify:

- the contractual obligations, duties and responsibilities of, as applicable, *the verification agent,* the servicer of the underlying exposures, the trustee (if any) ~~i.e. an 'identified person' with fiduciary responsibilities who acts in the best interest of investors in the securitisation transaction~~, and other ancillary service providers;
- upon default, insolvency and other specified events, where applicable, provisions to ensure the replacement of relevant counterparties (other than the protection buyer and the investors) ~~for~~ in cases where the respective services for the benefit of the securitisation are not provided by the originator itself;
- the processes and responsibilities necessary to ensure that, where servicing is not provided by the originator itself, the default or insolvency of the current servicer does not result in a termination of servicing, such as contractual provisions which enable the replacement of the servicer in such cases;
- *the servicing procedures that apply to the underlying exposures at the closing date and thereafter and the circumstances under which these procedures may be modified;*
- *the servicing standards the servicer will have to adhere to in servicing the underlying exposures within the entire maturity of the synthetic securitisation.*

Criterion 21:

The servicer should have expertise in servicing exposures of a similar nature to those securitised, supported by a management team with extensive industry experience.

The servicer should have well-documented and adequate policies, procedures and risk management controls relating to the servicing of exposures.

The servicer should apply servicing procedures to the underlying exposures that are at least as stringent as the servicing procedures applied by the originator for similar exposures~~,~~ which are not securitised.

Criterion 22:

The underlying exposures should be identified at all times via a ***reference register.*** *The reference register should clearly identify, at all times, ~~the reference obligors,~~ the reference obligations from which the underlying exposures arise~~,~~ and the outstanding ~~notional~~ protected amount of each underlying exposure~~, and the protected notional amount for each underlying exposure~~. Reference obligors may be identified in the reference register on an anonymous basis by reference to a unique identifier.*

Criterion 23:

The transaction documentation should include clear provisions that facilitate the timely resolution of conflicts between different classes of investors. *Where an SSPE is used within a synthetic securitisation to issue notes placed with investors,* voting rights should be clearly defined and allocated to noteholders and the responsibilities of the trustee and other entities with fiduciary duties to investors should be clearly identified.

Criterion 24:

The originator should make available data on static and dynamic historical default and loss performance, such as delinquency and default data, for substantially similar exposures to those being securitised, and the sources of those data and the basis for claiming similarity, to potential investors *before pricing.* Those data should cover a period of at least five years.

Criterion 25:

A sample of the underlying exposures should be subject to external verification prior *to closing* by an appropriate and independent party, *including verification that the underlying exposures meet the criteria determining eligibility for the credit protection under the credit protection agreement.*

Criterion 26:

The originator should, before the pricing of the securitisation, make available to potential investors a liability cash flow model which precisely represents the ~~contractual~~ relationship[9] between the underlying exposures and the payments flowing between the originator, investors, other third parties and, where applicable, the SSPE, and ~~should~~shall, after pricing, make that model available to investors on an ongoing basis and to potential investors upon request.

[9] Unlike for a traditional securitisation, there is no *contractual* relationship between the underlying exposures themselves and the payments to the parties to the securitisation.

Criterion 27:

In the case of a securitisation where the underlying exposures are residential loans or auto loans or leases, the originator should publish the available information related to the environmental performance of the assets financed by such residential loans or auto loans or leases, as part of the information disclosed pursuant to point (a) of the first subparagraph of Article 7(1) of the Securitisation Regulation.

Criterion 28:

The originator should be responsible for compliance with Article 7 of the Securitisation Regulation. The information required by point (a) of the first subparagraph of Article 7(1) should be made available to potential investors before pricing upon request. The information required by points (b) to (d) of the first subparagraph of Article 7(1) should be made available before pricing at least in draft or initial form. The final documentation should be made available to investors at the latest 15 days after closing of the transaction.

Criterion 29:

The credit protection agreement establishing the synthetic securitisation should cover, **at least, the following credit events:**

- Failure to pay of the underlying obligor, defined to encompass at a minimum the circumstances defined in Article 178 (1)(b) of the CRR;
- Bankruptcy of the underlying obligor, defined to encompass at a minimum the circumstances defined in Article 178 (3)(e) and (f) of the CRR;
- Restructuring of the underlying exposure, defined to encompass at a minimum the circumstances defined in Article 178(3) (d) of the CRR.

The requirement to include at least these three events should not prevent the parties from agreeing on additional and/or stricter credit events. All credit events that are to apply, and their precise definitions, should be **clearly documented.**

Forbearance measures, as defined in Annex V Section 30 paragraphs 163 to 183 of Commission Implementing Regulation (EU) 2015/227 amending Implementing Regulation (EU) No 680/2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013, applied to underlying exposures shall not preclude the trigger of eligible credit events.

Criterion 30:

The credit protection payment following the occurrence of a credit event should be calculated based on the **actual realised loss** suffered by the originator, as worked out in accordance with its standard recovery policies and procedures for the relevant exposure types and as recorded by the originator in its financial statements at the time the payment is made.

The final credit protection payment should be payable within a specified period following the end of the workout process for the relevant underlying exposure.

Transactions should provide that an **interim credit protection payment** is to be made, at the latest, 6 months after the credit event has occurred in cases~~,~~ where the workout of the losses for the relevant underlying exposure has not been finalised by that time. The interim credit protection payment should

be, at least, the maximum of the impairment considered by the originator in its financial statements, in accordance with the applicable accounting framework, at the time the interim payment is made and, if applicable, the LGD determined in accordance with Part Three Title II Chapter 3 CRR that has to be applied to the corresponding underlying exposures in order to determine the IRB capital requirements on the originator for such underlying exposure according to the CRR. Where an interim credit protection payment is made, a final credit protection payment should be made in order to adjust the interim settlement of losses to the actual realised loss, in accordance with the first paragraph of this criterion.

Where the protected amount is less than the outstanding notional amount of the corresponding underlying exposure, the credit protection payment should be in the same proportion to the protected amount as the protection buyer's realised loss bears the outstanding notional amount of the underling exposure~~, subject only to the rule on interim payments~~.

The method by which interim and final credit protection payments are calculated should be clearly specified in the credit protection agreement.

The rights of the protection buyer to receive protection payments under the synthetic securitisation should be enforceable. The amounts payable by investors under the securitisation are clearly defined, capable of calculation in all circumstances and limited in amount.

The circumstances in which investors are required to make payments under the credit protection agreement should be clearly defined ~~objective or subject to a determination by the verification agent, and limited in number~~.

The credit protection amount should be broken down to the level of individual underlying exposures.

Criterion 31:

With regard to underlying exposures for which a credit event has occurred and the workout process has not been completed upon the scheduled maturity or early termination of the credit protection agreement, the credit protection agreement shall clearly specify the maximum extension period that shall apply to the workout process for those exposures. If the workout process is not completed by the end of that extension period, ~~2 years after the scheduled legal maturity or early unwinding of a transaction (the final reference date),~~ a final credit protection payment should be made on the basis of the ~~actual~~ final estimated loss expected to be suffered by the originator and recorded by the originator in its financial statements at that time.

Following any termination of the credit protection by investors, the workout process should continue in respect of any outstanding credit events, which occurred prior to such termination in the same way as described in the first paragraph.

Criterion 32:

The credit protection premiums paid under the credit protection agreement establishing the synthetic securitisation should be structured as contingent premiums: no guaranteed premiums, upfront premium payments, rebate mechanisms or other mechanisms that may avoid or reduce the actual allocation of losses to the investors or return part of the paid premiums to the originator after the maturity of the transaction, should be stipulated in the credit protection agreement.

~~The documentation should contain all relevant information that has been used to price the credit protection agreement, including, as applicable, information on the market benchmarks and other market variables taken into account, by the originator, for the pricing.~~

Criterion 33:

A third party verification agent should be appointed by the originator at the outset of the transaction, in order to verify, at a minimum, the following points for each of the underlying exposures in relation to which a credit event notice was given:

- that the credit event in the credit event notice occurred in accordance with terms of the credit protection agreement;
- that the underlying exposure was included in the ~~securitisation~~ securitised portfolio at the time of the occurrence of the relevant credit event;
- to the extent that verification is possible, that the underlying exposure met the eligibility criteria~~,~~ at the time of its inclusion in the reference portfolio;
- that where an underlying exposure has been added as result of a replenishment, such replenishment complied with the replenishment conditions;
- the ~~accuracy~~ calculation of the final loss amount ~~work out procedure, also in relation to the losses registered in the profit and loss statement by the originator~~;
- that at the time where the final protection payment is made, the allocation of losses to investors in relation to the underlying exposures has been conducted correctly.

The verification agent should be independent of the originator and, where an SSPE is used within a synthetic securitisation, of the SSPE, and should have been appointed, and its appointment accepted, on or before the closing date.

Such verification by the verification agent may be performed on a sample basis rather than for each individual underlying exposure for which a protection payment is sought ~~but in all cases, any investor must have the right that the eligibility of a particular underling exposures is subject to verification including in case if it is not satisfied with the sample verification~~.

The originator should undertake in the securitisation documentation that it should provide to the verification agent all the necessary information to verify the requirements set out in the first paragraph.

Criterion 34:

Other than as a result of insolvency of the protection provider, or a failure to pay (in respect of any premium or other amounts payable by the originator to investors under the synthetic securitisation), or breach of a material contractual obligation by the protection provider, the originator should only be permitted to terminate a transaction prior to its scheduled maturity when ~~either~~ any of the following occurs:

- relevant regulatory events which should:
  - include changes in ~~all~~ any relevant law and/or regulation (or official interpretation of that law and/or regulation by competent authorities) or the tax or accounting treatment of the transaction which has a material adverse effect on the amount of capital which the protection buyer is required to hold in connection with the securitisation or the underlying exposures, in each case compared with that which it anticipated at the time of entering into the transaction~~directly affecting the contractual relationship defining the transaction and/or materially affecting the allocation of benefits among the parties of the transaction. In this regard, relevant law/regulation should include relevant taxation and accounting provisions~~;~~.~~
  - include a determination by a competent authority that the protection buyer (or any affiliate of the protection buyer) is not or is no longer permitted to recognise significant risk transfer in respect of the securitisation in accordance with Article 245 of the Capital Requirements Regulation; and

- exclude other factors affecting the economic efficiency of the transaction that are not enshrined in law or regulation, such as ~~credit rating agencies' methodologies or~~ a central bank's collateral framework;~~.~~

- other changed circumstances, including:
  - where the protection buyer applies the SEC-ERBA methodology, a change to the relevant rating agency methodology which results in the retained risk weights for any tranches in the securitisation retained by the protection buyer increasing (other than as a result as deterioration in the quality of the underlying exposures); and
  - other changes of law or regulation which would pervert the protection buyer from complying with its obligations under the securitisation;

- a time call~~ is exercised, at a point in time, where the time period measured from the securitisation's closing date is equal to or higher than the weighted average life of the initial reference portfolio at closing]~~. The time call should not be structured to avoid allocating losses to credit enhancement positions or other positions held by investors and should not be otherwise structured to provide credit enhancement; and~~.~~
- a call as per Article 245(4)(f) of the amended CRR is exercised [clean-up call].

If any of these call rights are included in a transaction, they should be clearly specified in the documentation.

Any other originator calls should not be allowed under the terms of the synthetic transaction.

Criterion 35:

~~The protection buyer should not commit to any amount of excess spread available for the investors.~~

Criterion 36:[10]

Only the following credit protection arrangements establishing the synthetic securitisation should be allowed:

A. a guarantee meeting the requirements set out in Chapter 4 of Part Three Title II of the CRR, by which the credit risk is transferred to any of the entities listed under Article 214 (2) (a) to (d) of the CRR, provided that the exposures to the protection provider qualify for a 0% risk weight under Chapter Two of Part Three Title II of the CRR, or;

B. a guarantee meeting the requirements set out in Chapter 4 of Part Three Title II of the CRR which benefits from a counter-guarantee of any of the entities referred to in point (i); or

C. other credit protection in the form of guarantees, ~~or~~ credit derivatives or credit-linked notes not referred to under the previous two points that is meeting the requirements set out in Sub-Section 2 of Section 3, Chapter 4 of Part Three Title II of the CRR as amended by Article 249 of the CRR, provided that the obligations of the protection seller are subject to the following collateral requirements.

[10] Note: In our response to the consultation, we have proposed that (i) it should be possible for unfunded credit protection to be provided by entities which do not qualify for a 0% risk weight and (ii) that there should be no requirement for the parties to have recourse to segregated collateral. Accordingly, our proposal is that this criterion should be deleted. The mark-up set out herein is provided only as a fall-back should our initial proposals not be accepted.

When the collateral is provided in accordance with the point C, both the originator and the protection seller need to have recourse to high quality collateral, in ~~either~~ one of the following forms:

- collateral ~~is~~ in the form of ~~0% risk weighted~~ debt securities~~,~~ held by a custodian which is independent of the protection buyer and the protection seller~~in a trust or entity set up for the sole purpose of holding securities whose notional value takes into account clearly determined and conservative haircuts to appropriately mitigate market and other risks, and which have a short remaining maturity of maximum 3 months, and under robust custody arrangements,~~ ; ~~or~~
- in the case of the protection buyer, collateral held in the form cash on deposit with the protection buyer (which such requirement will be deemed to be satisfied in the case of credit-linked notes in accordance with Article 218 of the Capital Requirements Regulation); or
- in the case of the protection seller, collateral in the form of cash held with a third party credit institution with a sufficient credit quality standing.

- For the avoidance of doubt, the protection buyer and protection seller may have recourse to different collateral in these circumstances.

In addition, the following requirements should apply to the collateral:

- The rights of the ~~originator~~ protection buyer to use the collateral to meet protection payment obligations of the ~~investors~~ protection seller should be enforceable. Security arrangements should be provided to ensure such right of the protection buyer.
- The rights of the investors to the return of collateral as the tranches amortise or when the securitisation is unwound ~~when the synthetic securitisation is no longer outstanding to the return of any collateral that has not been used to meet protection payments~~ should be enforceable.
- Where collateral is invested in securities, the securitisation documentation should set out the eligibility criteria and custody arrangement for such securities. Where the investors remain exposed to the credit risk of the originator, this must be clearly disclosed in the securitisation documentation.

The originator should obtain an opinion from a qualified legal counsel confirming the enforceability of the credit protection in all relevant jurisdictions.