FINANCE
DENMARK

Response to EBA Discussion Paper on draft report on STS Framework for Synthetic Securitisation

Memo

November 25, 2019
Doc. no. FIDA-1344658213-687260-v1
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Finance Denmark[1] welcomes the opportunity to respond to the EBA Discussion Paper on STS Framework for Synthetic Securitisation published on 24 September with a deadline on 25 November 2019. The Discussion Paper has been developed in response to mandate assigned to the EBA in the Securities Regulation (Regulation (EU) 2014/2402)[2], which requires EBA (in close cooperation with ESMA and EIOPA) to develop a report on the feasibility of a framework for Simple, Transparent and Standardised ("STS") synthetic securitisation.

General remarks

This framework should be limited to balance sheet securitisations and should thus be clearly differentiated from arbitrage synthetic securitisations.

Article 270 of Regulation (EU) 575/2013 on Capital Requirements ("CRR") presents a STS framework for a limited scope of synthetic securitisations. This framework allows the originating credit institution to enjoy preferential treatment in terms of reduced risk-weights for retained senior tranches, where a significant credit risk has been transferred to 0 % risk-weighted supranational entities or through private investors through fully-collateralised guarantees.

Finance Denmark is of the firm view that a wider STS framework for synthetic securitisations, which provides incentives to originator credit institutions, is a highly beneficial measure to support the real economy through increased lending to micro businesses, SMEs, mid-cap and large-cap companies, as well as providing investors with sound investment opportunities.

[1] Finance Denmark is a business association for banks, mortgage institutions, asset management, securities trading and investment funds in Denmark.
EU Transparency Register – registration number 20705158207-35
[2] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R2402&from=en

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Specific remarks

In the following section, Finance Denmark's comments to the questions raised by EBA in the Discussion Paper are presented.

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

Finance Denmark supports the development of a STS framework for synthetic securitisation that goes beyond the current limited, limited to balance sheet securitisation and thus making a clear distinction to and excluding arbitrage synthetic securitisation.

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

No comments.

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

Synthetic securitisation has performed better than traditional securitisation historically. However, it would be interesting to see how many of the synthetic transactions have been actively managed compared to how many of the traditional securitisations that have been actively managed. Actively managed securitisations, where deteriorating exposures can be replaced with eligible performing exposures, could have an impact on the overall performance.

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?

Finance Denmark welcomes a STS framework for synthetic securitisations that offers further comfort not only for the investor, as in the case of traditional securitisations, but also for the originator institution.

Finance Denmark believes that synthetic securitisation is a highly useful tool for originator credit institutions in order to diversify their credit risk, manage their capital position and free up capacity on lenders' balance sheets, allowing for new lending that in turn supports the real economy. For investors, synthetic securitisations offer an additional investment opportunity that can generate returns through direct credit risk exposure to a wide range of asset classes.

Hurdles that might impede further development of the market are several ranging from factors such as increased reporting requirements by either investors and/or originators, stricter regulations, increased capital requirements to a downturn in the global economy.

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

Finance Denmark agrees with the assessment of reasons that supports a preferential capital treatment for STS synthetic securitisation.

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.

Finance Denmark believes that in order to simplify, increase transparency and standardisation for synthetic securitisations through the introduction of the proposed framework, originator credit institutions should be incentivised by preferential capital treatment. If no preferential treatment is given to the originator, there is a risk that the framework is not used, as the costs of complying with the additional requirements are likely higher than the benefits of doing so. Further, this would align the proposed framework with the current limited scope for STS synthetic securitisation as ruled out in the CRR.

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

Overall, Finance Denmark agrees with the criteria on simplicity as proposed in the Discussion Paper.

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

Overall, Finance Denmark agrees with the criteria on standardisation as proposed in the Discussion Paper.

As for Criterion 15 – Appropriate mitigation of interest rate and currency risks, Finance Denmark believes that the criterion to not allow for any currency risk within the transaction is penalising for originators that have operations and thereby assets in countries that do not use the most widely traded currencies such as EUR, GBP or USD, which notes to investors tend to be denominated in. The originator is already penalised by a currency mismatch, leading to additional capital requirements and therefore it seems as an additional penalty to not allow for any currency risk in order to satisfy the STS criteria.

As for Criterion 19 – Early amortisation provisions/triggers for termination of the revolving period, Finance Denmark believes that the suggested criterion would provide a weakened protection for the originator, as the suggested triggers would limit the protection obtained from the synthetic securitisation in case of events such as deteriorating credit quality or incurred losses. These are events that underpin the motivation for many originators to actually enter into synthetic securitisation transactions and thus seem counter-intuitive.

As for Criterion 22 – Reference register. The criterion states that the underlying exposures should at all times be identified through a reference register, which should clarify among others the reference obligor. Finance Denmark believes that this criterion would dramatically reduce the attractiveness of using the suggested framework, as many synthetic securitisation transactions are done on a blind pool, i.e. not revealing the reference obligors' names.

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

Finance Denmark overall agrees with the criteria on transparency.

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

The specific criteria for synthetic securitisation seem to be fair and well-argued: However, excess spread is normally seen as an extra investor protection during the lifetime of the transaction but is of course dependent upon documentation and the waterfall priorities.

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 investor.

The requirement of having cash collateral held with a third-party credit institution introduces additional credit risk. Finance Denmark believes that this to some extent goes against the other requirements for simplicity, transparency and standardisation and may potentially limit the attractiveness of this type of transactions for both originators and investors.

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.

Finance Denmark has no additional suggestions.

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?

Finance Denmark sees positively on an introduction of a differentiated regulatory treatment of STS synthetic securitisations. Finance Denmark believes that all STS compliant synthetic securitisations should get beneficial capital treatment, in line with what is currently permitted for a limited share of STS synthetic securitisation within the CRR, i.e. allowing for 10 % risk weights on the originator's retained senior tranches, rather than 15 %. Furthermore, Finance Denmark believes that the beneficial capital treatment should not be limited to retained senior tranches but should also include retained mezzanine tranches and possibly also retained junior tranches.

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

Finance Denmark believes that the impact of STS synthetic securitisation will be limited if no differentiated capital treatment is introduced, as the added costs of complying with the STS criteria are likely higher than the potential benefits. As a result, synthetic securitisations will likely remain highly bespoken and bilateral, without any significant increase in both the number of originator institutions buying credit protection and the size of the investor base.

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?

In Finance Denmark's view, a result of beneficial capital treatment may be that the STS synthetic securitisation will grow among not only originator institutions but also investors, which can have spill-over effects also on third countries where the STS framework has not been introduced. As the investor base grows and becomes more comfortable with synthetic securitisation, third countries will benefit too.

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

Yes, Finance Denmark believes that it is recommended that a beneficial treatment is introduced for STS synthetic securitisation.