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Finance for Europe

Association for Financial Markets in Europe

Consultation response

EBA consultation on draft technical standards on homogeneity of underlying exposures in simple, transparent and standardised securitisations

25 October 2022

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the EBA's consultation on draft technical standards on homogeneity of underlying exposures in simple, transparent and standardised securitisation which was published on 28 July 2022.

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

Executive Summary

AFME members have significant concerns in relation to the proposed RTS, in terms of both (i) the substantive homogeneity requirements envisaged for corporate exposure securitisations, and (ii) the time-limited grandfathering envisaged for existing on-balance-sheet securitisations. AFME members further consider that project finance securitisations should be specifically provided for in the proposed RTS. We appreciate, however, the EBA's recognition that the "type of obligor" homogeneity factor is of critical importance in the context of securitisations of corporate exposures, given their multi-jurisdictional nature.

Substantive homogeneity requirements for corporate exposure securitisations

The homogeneity requirement is a "simplicity" rather than a "standardisation" requirement, purposively facilitating investor due diligence. Neither the Securitisation Regulation Level 1 text, nor the Basel STC regime, requires the imposition of one-size-fits-all requirements in relation to the size of corporate exposures that can be offered together in an STS securitisation, or, indeed, requires any subdivision of corporate exposures between SMEs, large corporates, or other types of corporate obligor.

Imposition of any **regulatory** definition distinguishing between "large corporates" and other corporate exposures (as proposed in the RTS) will lead to the arbitrary sub-division of homogeneous portfolios, structured in line with internal underwriting policies, on **both** sides of the proposed boundary. It will not further guarantee homogeneity and will subdivide portfolios that are homogenous. Difficulties in securitising their exposures will create issues in accessing credit for affected corporates and potentially impact on the pricing of credit where obtained.

The CRR3 "large corporate" definition, which the proposed RTS replicates, will not be in force in the EU until (on current expectations) 2025. It is therefore not a metric in use by originators. In contrast to its use in the CRR AIRB mechanics, the use of the "large corporate" definition in the proposed RTS will, in effect, dictate the underwriting policies of banks and the shape of the corporate securitisation market in a way that is this is not the purpose, as we understand it, of the homogeneity requirements, and is not proportionate.

For the reasons articulated above, a regulatory definition distinguishing between “large corporates” and other corporate exposures should not be imposed for homogeneity purposes. Any distinction drawn between different types of obligor should be based on originators’ internal underwriting processes. This would be in line with the approach taken generally in the proposed RTS and, in particular, with the proposed changes in relation to lending to enterprises that are underwritten as individuals/consumer lending.

However, as discussed further below, we note that **any** distinction drawn between “large corporates” and other corporates in the proposed RTS – even if based on originators’ internal underwriting processes – will create significant issues for the corporate securitisation market in terms of transaction granularity/concentration, and have a dampening effect on the market as a whole. It is also unnecessary: the risks associated with large corporates and mid-corporates are very much the same, and a pool of such exposures originated on a consistent basis is homogeneous – segregating these exposures in no way makes it easier to model or to understand the associated risks via diligence.

The measures that the EBA is proposing in the name of homogeneity undermine another, critical, objective: ensuring sufficient portfolio granularity/the absence of dangerous concentration risk. Although the CRR contains certain constraints on concentration and incentives to granularity, these target extreme levels of concentration. They do not ensure the higher levels of granularity that JSTs require in practice, and which are desirable, for diversified and predictable securitisations. The more granular a portfolio, the safer it is. The homogeneity proposals for corporate exposures will lead to smaller, less granular portfolios, many of which may not be viable, at all, given the granularity expectations of ECB JSTs (and, indeed, of originators as prudent investors in senior tranches). This will not be an advantage for investors compared to the status quo.

In addition to granularity impacts, the proposals for corporate exposures will constrain the effectiveness of securitisations as a balance sheet management tool facilitating lending to corporates. This will deprive the Union of a potentially powerful tool to assist in (amongst other things) recovery from the Covid 19 economic crisis and the economic consequences of Russian hostilities. The proposed changes also represent a backwards step from the flexibility to combine SME loans with other assets facilitated by the former Article 270 CRR

For the reasons articulated above, AFME members believe that the appropriate treatment of corporate exposures within the homogeneity criteria would be to permit such exposures (like consumer lending and trade finance exposures) to qualify as homogeneous based on asset class and consistency of underwriting and servicing policies (as is already provided for in the RTS) without the imposition of further homogeneity factors. Securitisation of a mixed pool of SMEs, mid-corporates, and large corporates should be permitted, as long as homogeneous principles of underwriting and risk management apply to the entire portfolio. Certain alternative approaches are discussed below, as fall backs if (for reasons that remain opaque in light of the legislative context of its mandate) the EBA does not feel able to accept this approach.

Time-limited grandfathering for existing on-balance-sheet STS securitisations

Temporary/time-limited grandfathering for OBS STS securitisations (in effect, in terms of general principles of EU law, ‘retroactive’ application of new secondary legislation, undermining ‘legal certainty’ and market participants’ ‘legitimate expectations’, and inconsistent with the principle of ‘proportionality’) is wholly unworkable in the context of these SRT transactions. It unfairly penalises on-balance-sheet relative to traditional securitisations for no good reason, and – among originators – penalises early adopters of this regulatory-led initiative. Market participants must be free to transact based on Level 1 provisions of the Securitisation Regulation pending development of RTS, without fear of their transactions being overturned.

Otherwise – given the time taken for RTS to be enacted (the risk retention RTS, for example, remains outstanding nearly four years following entry into force of the Securitisation Regulation) – the regime would be entirely dysfunctional. Exercise of regulatory calls is a last resort and adverse to the interests of the investors the STS regime exists to protect, as well as to originators and their regulators. The current proposals would be likely to lead to the exercise of a large number of regulatory calls in a short space of time.

We believe that explicit, permanent grandfathering can, and should, be provided for existing OBS securitisations. If the EBA feels that it can provide only for a time-limited period before the provisions of the proposed RTS enter into force for OBS securitisations, that period must be sufficiently long to ensure that transactions in the market are not impacted.

Provision for project finance securitisations

Project finance exposures are not suitable for securitisation in traditional STS format, but are suitable for on-balance-sheet STS securitisation. Since these deals are often multi-jurisdictional and can involve obligors/underlying obligors that are SMEs as well as larger corporates, there would be merit in establishing a stand-alone asset class for project finance without further homogeneity factors, on the basis that the category is already considered sufficiently homogeneous and the application of additional requirements would lead to excessive concentrations in securitised portfolios. However, this will not be necessary if changes are made to homogeneity requirements for the corporate exposure class in line with AFME members' primary suggestion above.

Last, but not least, AFME members note that the cumulative impact of current initiatives affecting on-balance-sheet STS securitisations: the RTS on homogeneity under consultation, the recently finalised RTS on pro rata amortisation triggers and the proposed Delegated Act on significant risk transfer (the proposed commensurate risk transfer test which, in practice, penalises STS transactions) are to create additional layers of cost, conservatism and procedure that, taken together, strongly disincentivise use of the STS label for on-balance-sheet transactions.

Questions

Q1. *Do you agree with the proposed amendment to the asset category in Article 1 with respect to the addition of "credit facilities provided to enterprises, where the originator applies the same credit risk assessment approach as for individuals not covered under points (i), (ii) and (iv) to (viii)"? Please elaborate on the practical relevance.*

We agree with the proposed amendment in Article 1(a)(iii) of the RTS. The proposed drafting appropriately aligns the identification of enterprises treated as individuals/consumer lending with the originator's internal underwriting process.

Q2. *Do you agree with the proposed amendment in Article 1 to the "type of obligor" for credit facilities, including loans and leases, provided to any type of enterprise or corporation?*

We appreciate the EBA's recognition that flexibility in relation to the "type of obligor" homogeneity factor is of critical importance in the context of securitisations of corporate exposures, given their multi-jurisdictional nature. This issue has not arisen under the Existing RTS due to the lack of securitisations of corporate exposures undertaken in cash format. The available homogeneity factors for the asset type "*credit facilities, including loans and leases, provided to any type of enterprise or corporation*" – at least one of which must be satisfied – are

"type of obligor" and "jurisdiction" (see Art 1(a)(iv) and Art 2(3) of the existing cash STS homogeneity criteria (the **Existing RTS**) and of the proposed RTS). However, securitisations of corporate exposures are, for technical reasons including contractual transferability restrictions, typically undertaken in on-balance-sheet (**OBS**) format. Of the transactions analysed by the EBA in its May 2020 report on OBS STS (the **Report**), as the EBA noted, only 40% contained exposures located in a single jurisdiction. This is because, as the EBA noted in the Report, the ability to combine diverse portfolios and, in particular, geographically diverse portfolios, is a significant strength of the OBS securitisation format, which minimises legal complexities associated with the true sale/transfer of assets subject to different legal regimes, client confidentiality issues, partially drawn facilities, and other factors. This enables OBS securitisation to access portfolios that are inaccessible to traditional securitisation. Given the likely difficulties for market participants in establishing homogeneity based on "jurisdiction", flexibility in relation to the "type of obligor" homogeneity factor is of critical importance. We appreciate the EBA's recognition of this issue in its emphasis on the "type of obligor" homogeneity factor for securitisations of corporate exposures.

The homogeneity requirement is a "simplicity" rather than a "standardisation" requirement, purposively facilitating investor due diligence. Neither the Securitisation Regulation Level 1 text, nor the Basel STC regime requires the imposition of one-size-fits-all requirements as to the size of corporate exposures that can be offered together in an STS securitisation, or indeed requires any subdivision of corporate exposures between SMEs, large corporates, or other types of corporate obligor. The requirement for homogeneity in Article 26b(8) of the Securitisation Regulation forms part of the STS "requirements relating to simplicity" and not the Article 26c "requirements relating to standardisation". The EBA's mandate (in close cooperation with ESMA and EIOPA) in Article 26b(13) of the Securitisation Regulation to develop draft regulatory technical standards further specifying which underlying exposures are deemed to be homogeneous must be understood in this light. Purposively, the objective of the homogeneity requirement is to facilitate investor due diligence. As articulated in the Basel STC requirements: "*[t]he nature of assets should be such that investors would not need to analyse and assess materially different legal and/or credit risk factors and risk profiles when carrying out risk analysis and due diligence checks*". The Securitisation Regulation Level 1 text simply requires STS securitisations to be backed by "*a pool of underlying exposures that are homogeneous in terms of asset type, taking into account the specific characteristics relating to the cash flows of the asset type including their contractual, credit-risk and prepayment characteristics*" and comprising only one asset type. The equivalent provisions at Basel level relating to "simple, transparent and comparable" securitisations[1], similarly, indicate that homogeneity should "*be assessed on the basis of common risk drivers, including similar risk factors and risk profiles*". None of this requires the imposition of one-size-fits-all requirements as to the size of corporate exposures that can be offered together in an STS securitisation, or indeed any subdivision of corporate exposures between SMEs and large corporates, or other types of corporate obligor.

*Imposition of any regulatory definition distinguishing between "large corporates" and other corporate exposures (as proposed in the RTS) will lead to the arbitrary sub-division of homogenous portfolios, structured in line with internal underwriting policies, on **both** sides of the proposed boundary. It will not further guarantee homogeneity and will subdivide portfolios that are homogeneous. The risks associated with large corporates and mid-corporates are very much the same – segregating these exposures in no way makes it easier to model or to understand the associated risks via diligence. Difficulties in securitising their exposures will create issues in accessing credit for affected corporates and potentially impact on the pricing of credit where obtained.* The imposition of a regulatory bright-line between large corporates (on the one hand) and other types of corporates (on the other) will force banks to sub-divide portfolios that have been underwritten homogenously in line with internal definitions and underwriting limits for the purpose of STS securitisation. An originator

[1] See Basel CRE 40.73 (incl 40.73(1)(a)), 40.100 and 40.101.

whose internal underwriting process divides exposures either side of, for example, a EUR 300 million turnover threshold, will need to split its internally defined portfolio of EUR 300 million+ turnover exposures on either side of the proposed EUR 500 million turnover threshold in order to securitise them in an STS transaction. Similarly, given the group-wide basis of the proposed turnover threshold, an originator whose internal underwriting process extends credit to subsidiaries within wider corporate groups on a stand-alone basis (i.e. without, or without reflecting, recourse to the wider group) will be forced, by the proposed definition, to exclude those corporates from its non-"large corporate" portfolio. (The reverse issue would apply for subsidiaries to which credit is extended, taking into account group financial strength, if a regulatory definition was imposed based on solo corporate turnover.) Although the high turnover threshold for "large corporates" in the proposed definition might appear to create flexibility in relation to SME and mid-corporate portfolios[2], this is illusory. Corporates whose turnover is less than the EUR 500 million threshold cannot be securitised together based on the proposed RTS definition (and nor should they be) if there is misalignment with the bank's internal underwriting process: the requirements for consistent underwriting and servicing in the Existing RTS[3] prevent this. As discussed below, banks' internal underwriting processes are currently highly unlikely to align with the proposed definition. Arbitrarily splitting portfolios between large and non-large corporates in this way does not further guarantee homogeneity. Difficulties in securitising their exposures will create issues for affected corporates in accessing credit and potentially impact on the pricing of credit where obtained.

The CRR3 "large corporate" definition, which the proposed RTS replicates, will not be in force in the EU until (on current expectations) 2025. It is therefore not a metric in use by originators. The "large corporate" definition in the proposed RTS is based on a draft definition in the Commission's CRR3 proposals[4]. CRR3 has not yet been finalised and is not proposed to enter into force in the EU until (on current expectations) 2025. The definition is therefore not in use by originators and will be implemented in the proposed RTS long in advance of its use, more broadly, as a CRR metric.

In contrast to its use in the CRR AIRB mechanics, the use of the "large corporate" definition in the proposed RTS will, in effect, dictate the underwriting policies of banks and the shape of the corporate securitisation market – this is not the purpose, as we understand it, of the homogeneity requirements and is not proportionate. (As a practical matter, the revenue threshold in the "large corporate" definition would introduce volatility in STS compliance if tested on an ongoing basis (rather than at the point of origination).) In the CRR, the proposed "large corporate" definition relates to the prohibition on use of the advanced internal ratings based (**AIRB**) approach for large corporate exposures. In that context, this prudential definition regulates access to internal modelling for certain parameters used in credit risk regulatory capital calculations. In the context of the RTS, by contrast, the definition will directly regulate the types of corporate portfolio that can be offered to investors in STS deals (in effect dictating, for example, that: "you cannot offer investors a portfolio of corporate exposures combining corporates with EUR 450m turnover and corporates with EUR 550m turnover"). This is not proportionate in the context of the mandate. It is not, we believe, the purpose of the homogeneity requirements to dictate the underwriting policies of banks and shape the corporate securitisation market in this way. (As a practical matter, the revenue threshold in the "large corporate" definition would introduce volatility in STS compliance if tested on an ongoing basis (rather than at the point of origination).)

*For the reasons articulated above, a **regulatory** definition distinguishing between "large corporates" and other corporate exposures should not be imposed for homogeneity purposes. Any distinction drawn between different*

[2] Since corporates with group turnover up to EUR 500 million count as a non-large one.
[3] See Article 1(b) and 1(c) of the Existing RTS.
[4] Draft Article 142(1)(5a) CRR3.

types of obligor should be based on originators' internal underwriting processes. This would be in line with the approach taken generally in the proposed RTS and, in particular, with the proposed changes in relation to lending to enterprises that are underwritten as individuals/consumer lending.

However, as discussed further below, we note that ***any*** *distinction drawn between "large corporates" and other corporates in the proposed RTS – even if based on originators' internal underwriting processes – will create significant issues for the corporate securitisation market in terms of transaction granularity/concentration, and have a dampening effect on the market as a whole. It is also unnecessary: the risks associated with large corporates and mid-corporates are very much the same and a pool of such exposures originated on a consistent basis is homogeneous – segregating these exposures in no way makes it easier to model or to understand the associated risks via diligence.*

The measures that the EBA is proposing in the name of homogeneity undermine another, critical, objective: ensuring sufficient portfolio granularity/the absence of dangerous concentration risk. The requirement for homogeneity in STS securitisations is an acknowledged and important investor-protection measure, facilitating due diligence and analysis of transactions on the buy side. However, the measures that the EBA is proposing in its name (as indicated above, we do not believe these measures to be necessary to achieving, or assisting in achieving, homogeneity) undermine another, critical, objective: ensuring sufficient portfolio granularity/the absence of dangerous concentration risk. This is a key concern for all investors in the transaction, as well as for the prudential regulation of the originator. The Existing RTS explicitly recognises that the STS homogeneity requirements should not provide incentives that would lead to excessive concentration in portfolios[5] and the level of detail with which homogeneity is specified in the Existing RTS is asset class-specific. For example, homogeneity for (broadly) consumer finance and trade receivables exposures is established based on asset class and consistent underwriting and servicing policies without the application of further homogeneity factors.

Although the CRR contains certain constraints on concentration and incentives to granularity, these target extreme levels of concentration. They do not ensure the higher levels of granularity that JSTs require in practice, and which are desirable, for diversified and predictable securitisations. We note that the CRR contains certain constraints on concentration and incentives to granularity in the securitised exposure pool. For STS securitisations, specifically, a 2% hard floor applies on concentration to a single obligor and its connected clients[6]. In the securitisation position risk-weighting mechanics, the SEC-IRBA 'p factor' is also adjusted to reflect granularity of the exposure pool (with an effective number of exposures ('N') of 25 being a relevant threshold), while the ratings on which the SEC-ERBA is based are assumed to take asset granularity into account (the SEC-SA does not provide for a granularity adjustment, neither (evidently) does the full deduction option). The minimum 50 asset exposure pool implied by the STS 2% concentration floor, and the SEC-IRBA's key threshold 'N' of 25, however, both fall far short of the levels of granularity that ECB JSTs require in real-world transactions. Though the required granularity depends on multiple factors[7], as a ball-park figure, granularity in excess of 100 exposures is typically required for wholesale transactions. Granularity may not be relevant to the capital requirements for a securitisation position depending on the risk-weighting approach applied. Where granularity is relevant to the capital requirements for a securitisation position, it will be taken into consideration against other factors in structuring the exposure pool, including the availability of the STS prudential benefit which will, of course, depend (amongst other things) on compliance with the homogeneity requirements of the proposed RTS. The CRR's constraints on concentration and incentives to granularity in

[5] See Recital 5 of the existing RTS.
[6] 2% of the aggregate outstanding exposure value at the time of contribution to the securitisation, see Art 243(1)(b)/243(2)(a) CRR.
[7] Including transaction structure (tranche thickness, amortisation etc.) and maximum concentrations to individual obligors.

the securitised exposure pool are designed to target extreme levels of concentration. They do not ensure the levels of granularity that JSTs require, and which are desirable, for diversified and predictable securitisations.

The more granular a portfolio, the safer it is. The homogeneity proposals for corporate exposures will lead to smaller, less granular portfolios, many of which may not be viable, at all, given the granularity expectations of ECB JSTs (and, indeed, of originators as prudent investors in senior tranches). This will not be an advantage for investors compared to the status quo. If a portfolio is too concentrated and lacking in granularity, the transaction is intrinsically more exposed to single name risk. Granularity is positive in securitisation. The more granular a portfolio, the better it behaves when stressed. As indicated above, the distinction between "large corporates" and other corporates proposed in the proposed RTS will – at best – involve the fragmentation of single transactions into multiple transactions, making them smaller and less granular. However, in many cases, the sub-divided transactions may not be viable at all. JST expectations in relation to granularity, and indeed originator expectations in relation to granularity as a prudent investor in the senior tranche (which is adversely affected by decreasing granularity), may mean that these transactions are not achievable and viable at all. On the "large corporate" side of the proposed boundary, granularity will be inherently limited due to the high turnover level required to qualify. Smaller, less granular transactions, or no transactions at all, will not represent an advantage for investors compared to the status quo.

In addition to granularity impacts, the proposals for corporate exposures will constrain the effectiveness of securitisations as a balance sheet management tool facilitating lending to corporates. This will deprive the Union of a potentially powerful tool to assist in (amongst other things) recovery from the Covid 19 economic crisis and the economic consequences of Russian hostilities. As envisaged in the report of the High Level Forum on Capital Markets Union[8] and in the Capital Markets Recovery Package, securitisation is a potentially powerful tool to assist the EU in (amongst other things) recovery from the Covid 19 economic crisis. The same is true in relation to recovery from the economic consequences of current Russian hostilities. This tool, in the context of OBS securitisations of corporate exposures, has the potential to create prudential headroom to facilitate lending to the real economy, to support investment for the green transition, and to reduce sovereign risk weight linkages flowing from (amongst other things) Covid 19-related sovereign guarantees. The proposed RTS will lead to, at best, a fragmentation of the market for corporate exposure securitisations, which will constrain its effectiveness as a means to facilitate funding to corporates. The impact will be particularly marked for smaller players in the market who do not have the critical mass of exposures to structure a homogeneous securitisation.

The proposed changes will also represent a backwards step from the flexibility to combine SME loans with other assets facilitated by the former Article 270 CRR.

Prior to the changes introduced by the Capital Markets Recovery Package, effective from 1 April 2021, Article 270 CRR permitted OBS securitisations to benefit from an STS-equivalent prudential treatment where only 70% (not 100%) of the securitised assets by principal amount were credit exposures to SMEs, and statements in the Existing RTS indicate that this flexibility was not prejudiced by compliance with the Existing RTS criteria[9]. It would run counter to the purpose of the OBS STS regime for the proposed RTS to remove or reduce this flexibility.

[8] https://ec.europa.eu/info/sites/info/files/business_economy_euro/growth_and_investment/documents/200610-cmu-high-level-forum-final-report_en.pdf

[9] See paragraph 34 which indicates, inter alia, that compliance with the requirement for "*the underlying exposures in the pool [to] all fall within the same asset category*" was not required for Art 270 deals.

AFME MEMBERS' PROPOSALS:

- In light of the arguments set out above, AFME members believe that the appropriate treatment of corporate exposures within the homogeneity criteria would be to permit such exposures (like consumer lending and trade finance exposures) to qualify as homogeneous, based on asset class and consistency of underwriting and servicing policies (as is already provided for in the RTS) without the imposition of further homogeneity factors. Securitisation of a mixed pool of SMEs, mid-corporates, and large corporates should be permitted, as long as homogeneous principles of underwriting and risk management apply to the entire portfolio.

- If (for reasons that remain opaque to us in light of the legislative context of its mandate) the EBA feels unable to permit corporate exposures to qualify as homogeneous based on asset class and consistency of underwriting and servicing policies without the imposition of further homogeneity factors then:

  I. as indicated above, any categories identified in the "type of obligor" homogeneity factor must be based on originators' internal underwriting processes; and

  II. in addition to identifying any categories in the "type of obligor" homogeneity factor based on originators' internal underwriting processes, the "type of obligor" homogeneity factor must incorporate a permitted margin of overlap between categories.

  The margin of overlap referred to in II above could, for example, be achieved by including mid-corporates (defined in line with originators' internal underwriting processes) as a cross-over class, i.e. distinguishing between portfolios containing micro, SMEs and mid-corporates on the one hand, and portfolios containing mid-corporates and large corporates on the other.

  Alternatively, if the specified obligor types remain "large corporates" on the one hand and other corporates on the other (in each case, as defined in line with originators' internal underwriting processes), the margin of overlap referred to in II above could be achieved by allowing an explicit percentage cross–over for example, permitting up to 30% (or such higher limit as the EBA might be minded to set) of the obligors in a deal with predominantly one "type of obligor" to belong to the other type, i.e. 70% or more of obligors that are not "large corporates", with up to 30% of obligors that are "large corporates". We consider this an option of last resort. It tries to solve the issue, in our view, in a rather inefficient way – and also only partially, it would also be complex from an operational standpoint, so hard to implement in practice. Therefore we suggest focusing on the other options above.

This would enable pools to be structured that are more representative of originators' business models and reduce difficulties for originators in reaching critical mass to generate pools of a marketable size (a potential issue for smaller players in the SME space, in particular).

We understand that, as currently articulated, the "type of obligor" homogeneity factor permits the combination of larger non-financial corporates with corporates that are financial institutions

Articles 1(4) and 2(3) of the proposed RTS do not indicate that exposures to enterprises and corporates *exclude* exposures to corporates that are financial institutions. In practice, OBS securitisations by multi-jurisdictional originators routinely combine loans to larger non-financial corporates with loans to corporates

that are financial institutions, with such lending being underwritten and serviced in accordance with centrally defined policies and IRB models/credit risk management. We understand and assume that, for purposes of Articles 1(4) and 2(3) of the proposed RTS, exposures to enterprises and corporates *include* exposures to corporates that are financial institutions.

***Q3**. Do you agree with the proposed amendment in Article 1 to the "type of obligor" for auto loans and leases?*

See our response to Question 2 above.

***Q4**. Do you agree with the proposed amendment in Article 1 to the "type of obligor" for credit card receivables?*

See our response to Question 2 above.

***Q5.** Do you see the need for the grandfathering provisions in Article 2 for the outstanding STS ABCP and STS non-ABCP securitisations? If yes, please elaborate.*

We agree with the proposal for permanent (non-time-limited) grandfathering to be provided for in respect of existing traditional STS securitisations (ABCP and non ABCP). It is an important principle of legal certainty that changes in law or regulation should not be imposed with retrospective or retroactive effect.

***Q6.** Do you agree with the deferred application date in Article 2 for the outstanding STS on-balance-sheet securitisations?*

Temporary/time-limited grandfathering for OBS STS securitisations (in effect, in terms of general principles of EU law, 'retroactive' application of new secondary legislation, undermining 'legal certainty' and market participants' 'legitimate expectations', and inconsistent with the principle of 'proportionality') is wholly unworkable in the context of these SRT transactions. Unfortunately, while the proposed RTS provides for permanent (non-time-limited) grandfathering in respect of existing traditional STS securitisations (ABCP and non ABCP), it is proposed that OBS STS securitisations notified before entry into force of the proposed RTS will benefit from time-limited grandfathering only. OBS STS securitisations issued prior to the entry into force of the proposed RTS will be required to comply with its provisions a year after its entry into force.

This proposal undermines important general principles of EU law requiring 'legal certainty', and that changes in law or regulation should not have retrospective or 'retroactive' effect, or undermine market participants' 'legitimate expectations',. It is also hard to reconcile the proposal with the principle of 'proportionality', requiring that measures adopted by Community institutions do not go beyond what is appropriate and necessary to achieve their objectives.

Temporary/time-limited grandfathering for OBS STS securitisations is unworkable. It is not possible to reverse-engineer compliance of the exposure portfolio of a securitisation following closing. This is true of securitisations in general, since the exposure portfolio is critical to investor diligence and the terms agreed with investors. The impracticality is compounded for significant risk transfer (SRT) securitisations (OBS STS

securitisations are necessarily SRT deals), given the restrictions applicable to such transactions, including the implicit support regime.

The proposal would effectively – in conjunction with proposed time-limited grandfathering proposed in the context of the EBA's final RTS on STS sequential amortisation triggers[10] – result in declassification of most, if not all, existing OBS STS securitisations. This does not appear appropriate or necessary to the objectives of the STS framework.

The proposed temporary/time-limited grandfathering unfairly penalises on-balance-sheet relative to traditional securitisations for no good reason, and – among originators – penalises early adopters of this regulatory-led initiative. Market participants must be free to transact based on Level 1 provisions of the Securitisation Regulation pending development of RTS without fear of their transactions being overturned. Otherwise – given the time taken for RTS to be enacted (the risk retention RTS, for example, remains outstanding nearly four years following entry into force of the Securitisation Regulation) – the regime would be entirely dysfunctional. The imposition of different grandfathering proposals for traditional and OBS securitisations is out of line with the EBA's expressed desire to align the treatment of the traditional and OBS securitisation formats and to maintain a level playing field between them. Further, originators who committed significant time and resource to embrace the new on-balance-sheet STS regime and to further standardise and improve the nature of their issuance will be penalised relative to issuers who have been slower to embrace this regulatory-led initiative.

The OBS STS regime entered into to force on 1 April 2021, and originators were actively encouraged to notify OBS transactions as STS prior to finalisation of the technical standards envisaged in the Level 1 regulation (witness, for example, the interim notification templates developed by ESMA).

While the Securitisation Regulation clearly envisages further detail on aspects of the framework being provided via RTS, it is not the case that the statutory framework is inoperable until that further detail is provided. Market participants must be free to transact based on Level 1 provisions of the Securitisation Regulation pending development of RTS without fear of their transactions being overturned. Otherwise – given the time taken for RTS to be enacted (the risk retention RTS, for example, remains outstanding nearly four years following entry into force of the Securitisation Regulation) – parties would be exposed to a wholly inappropriate level of regulatory uncertainty and market disruption, and the Securitisation Regulation regime would be entirely dysfunctional.

Exercise of regulatory calls is a last resort and adverse to the interests of the investors the STS regime exists to protect, as well as to originators and their regulators. The current proposals would be likely to lead to the exercise of a large number of regulatory calls in a short space of time. AFME members note that the IACPM's 2022 annual on-balance-sheet synthetic securitisation survey records 15 STS transactions issued by EU banks between Q4 2020 and Q1 2022, totalling EUR 36.4 billion in underlying loans. Of those 15 transactions, 14 involved SME, mixed corporate, or larger corporate portfolios, and are thus potentially impacted by the changes to the homogeneity requirements for the corporate exposure class proposed in the RTS. An AFME member that has analysed the detailed impact of the proposals on its own on-balance-sheet STS securitisations issued to date[11] (all of which were assessed as STS compliant by PCS or SVI) notes that 50% of these deals are incompatible

[10] EBA/RTS/2022/08.

[11] i.e. deals issued under the on-balance-sheet STS regime, excluding deals issued under the predecessor regime for SME deals in Art 270 CRR.

with the revised homogeneity requirements as articulated in the Final Draft RTS and will – if the proposals stand – need to be called.

Use of regulatory calls, where these are available, should always be a last resort. Regulation should never be designed in the knowledge that it will, in all likelihood, lead to the exercise of a significant number of regulatory calls. This is a situation that will suit no one, from regulators to underlying borrowers. Originators are extremely reluctant to exercise regulatory calls in light of the consequences for investors, as well as the impact on their own capital positions. By effectively requiring the exercise of regulatory calls (where these are available) for existing OBS STS transactions, the EBA will economically penalise investors in affected transactions, who will have modelled their returns based on much longer maturity periods. This will be disruptive and damaging to confidence in the STS label. It will also be ironic, given that investors are the parties whom the homogeneity criteria are intended to benefit. Further, originators who committed significant time and resource to embrace the new on-balance-sheet STS regime and to further standardise and improve the nature of their issuance will be penalised relative to issuers who have been slower to embrace this regulatory-led initiative.

We believe that explicit, permanent, grandfathering can, and should, be provided for existing OBS securitisations. If the EBA feels that it can provide only for a time-limited period before the provisions of the proposed RTS enter into force for OBS securitisations, that period must be sufficiently long to ensure that transactions in the market are not impacted. We gather that the EBA may consider itself constrained, as a technical matter, from applying grandfathering provisions to OBS securitisations in the same way as is proposed for traditional securitisations.

As indicated above, it is hard to reconcile a conclusion that the Securitisation Regulation requires the proposed RTS to apply to transactions executed before its entry into force, with certain general principles of EU law (the principle of 'legal certainty', the principles that changes in law or regulation should not have 'retroactive' effect, or undermine market participants' 'legitimate expectations' and the principle of 'proportionality'). On the contrary, those principles suggest that it should be open to the EBA/Commission, in finalising the proposed RTS, to provide for it to apply only to transactions executed after the date on which it enters into force. We believe that explicit, permanent, grandfathering – providing the market with clarity and certainty – can, and should, be provided for existing OBS securitisations.

In any case, substance (achieving the substantively fair and appropriate outcome) must be prioritised.

If the EBA continues to believe itself constrained from explicit *grandfathering*, it could, for example, consider requiring compliance with the Existing RTS (included as a schedule to the proposed RTS), as an *operative* provision of the proposed RTS applicable to OBS securitisations in existence at the time of entry into force of the proposed RTS.

Alternatively, an argument has been raised to the effect that, while compliance with the homogeneity requirement is an ongoing obligation, there is a difference between failing to satisfy the STS requirements on an ongoing basis due to actions of the originator (where loss of STS status is logical), and failing to satisfy those requirements as a result of evolution in the requirements themselves. The argument is made that, in the latter case, and where the relevant evolution in requirements represents further detail or guidance as to what the existing criteria require (as is generally the case where evolution results from RTS or guidelines mandated by the Level 1 text), rather than a change of policy or approach (such as amending the legislation to introduce entirely new criteria) or change in the substance of existing criteria (such as removing the possibility of non-sequential amortisation entirely), a transaction that complied with the level 1 text to the extent it was possible to do so at the time of its execution should not (given that it is not possible to go back and amend the

transaction after the RTS enter into force in order to comply with that additional detail) be considered non-compliant merely because the evolution (in this case publication of the RTS) imposes requirements that are inconsistent with the terms of the existing transaction. On this basis, it is argued, were the EBA to provide for the RTS provisions to apply to transactions executed only *after* the date of its entry into force, an existing OBS securitisation would not be non-compliant with its continuing obligations in relation to homogeneity merely as a result of the entry into force of the proposed RTS. Clearly, this approach would be sub-optimal, providing significantly less clarity and certainty to the market than explicit permanent grandfathering.

If the path of least resistance, in this respect, is to provide for a longer, time-limited period before the provisions of the proposed RTS enter into force for OBS securitisations in existence at the time of entry into force of the proposed RTS, the period for such deferred entry into force will need to ensure that existing on-balance-sheet securitisations are not adversely affected.

The AFME member (referred to above) that has analysed the impact of the RTS on its outstanding on-balance-sheet securitisations, indicates that, while certain of these transactions have very long final maturities (up to c 30 years), the remaining WAL of these transactions is up to four years, three months.

Q7. *Are there any aspects that should be considered with regard to the homogeneity of the STS on-balance-sheet securitisations which are not specified in these RTS?*

Project finance exposures are not suitable for securitisation in traditional STS format, but are suitable for on-balance-sheet STS securitisation. Since these deals are often multi-jurisdictional and can involve obligors/underlying obligors that are SMEs as well as larger corporates, there would be merit in establishing a stand-alone asset class for project finance without further homogeneity factors. However, this will not be necessary if changes are made to homogeneity requirements for the corporate exposure class in line with AFME members' primary suggestion above.

OBS securitisations are well-designed to facilitate the securitisation of project finance lending, including ESG projects such as windfarms, solar energy plants, and hospitals. European legislators have helpfully noted the inapplicability, in an OBS STS securitisation context, of the maturity transformation concerns that apply to cash STS securitisations[12], and have deliberately not included eligibility criteria in this respect in OBS STS framework.

On this basis, project finance is a potential (and one would anticipate purposively welcome) asset class within the OBS STS regime provided that (among other eligibility criteria) the 2% concentration limit in Article 243(2)(a) CRR can be met.

Project finance exposures can potentially be included within the asset class covering "*credit facilities, including loans and leases, provided to any type of enterprise or corporation*". Alternatively, since (as the CRR specialised lending provisions attest) the immediate (often SPV) counterparty is typically not the real credit risk in the transaction, project finance exposures can potentially be included within the asset class covering "*other underlying exposures that are considered by the originator or sponsor to constitute a distinct asset type on the basis of internal methodologies and parameters*".

[12] These are concerns re reliance on sale or re-financing of assets to enable repayment of securitisation positions. In OBS securitisations, unlike cash securitisations, investors are not repaid from asset proceeds; rather repayment is an obligation of the originator (written down to reflect losses incurred on the assets).

However, project finance projects are often multi-jurisdictional and can involve obligors/underlying obligors that are SMEs as well as larger corporates. There might therefore be merit in establishing a separate asset class for such transactions. Potentially, like the existing asset categories for trade receivables and credit facilities to individuals for personal, family or household consumption purposes, this could be without further homogeneity factors on the basis that the category is already considered sufficiently homogeneous and the application of additional requirements would lead to excessive concentrations in securitised portfolios.

The requirement for consistent servicing should take into account OBS structures that do not involve an SSPE

Article 1(c) of the Existing RTS relates to consistent servicing of the securitised exposures. The article requires servicing "*in accordance with similar procedures for monitoring, collecting and administering cash receivables on the assets side of the SSPE*". However, OBS securitisations do not necessarily involve an SSPE (unfunded credit protection and directly issued CLNs are also possible). The article should therefore be amended to require servicing "*in accordance with similar procedures for monitoring, collecting and administering cash receivables <u>of the originator, or</u> on the assets side of the SSPE*".

Q8. *Are there any impediments or practical implications of the criteria as defined in these draft RTS for STS traditional securitisations?*

None identified.

Q9. *Are there any important and severe unintended consequences of the application of the homogeneity criteria as specified in these RTS?*

See comments above in relation to the implications for (i) transaction granularity and (ii) the market for securitisations of corporate exposures.

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