Leaseurope
The Voice of Leasing and Automotive Rental in Europe

eurofinas
SPECIALISED CONSUMER CREDIT PROVIDERS IN EUROPE

Brussels, 20 July 2018

Leaseurope & Eurofinas response to the EBA consultation paper on its Draft Guidelines on the STS criteria for non-ABCP securitisation

Eurofinas and Leaseurope, the voices of consumer credit and leasing providers at European level, welcome the opportunity to respond to the European Banking Authority (EBA) consultation on the STS criteria for non-ABCP securitisation.

General Comments:

Leaseurope and Eurofinas support the introduction of a new European label for high quality securitisations in Europe, the so-called Simple, Transparent and Standardised (STS) securitisations. We believe that the long-term impact of the new regime can be positive. We welcome the EBA's efforts to provide more clarity regarding the new securitisation framework in Europe. We think that overall the EBA Draft Guidelines adequately clarifies a number of aspects of the STS regulation published in the Official Journal (OJ) of the European Union on 12 December 2017. However, we are concerned with the EBA interpretation of "predominant dependence" as it may exclude residual values from obtaining the STS label, which was not intended by the final political agreement on STS (see our response to question 18). In addition, we provide below some comments, clarifications and suggestions on certain aspects of the EBA Draft Guidelines.

Responses to the EBA Questions:

1. Criteria related to simplicity

True sale, assignment or transfer with the same legal effect (Article 20(1), 20(2), 20(3), 20(4) and 20(5))

Q1: Do you agree with the interpretation of these criteria, and the aspects that the interpretation is focused on? Should interpretation be amended, further clarified or additional aspects be covered? Please substantiate your reasoning.

We think that the overall interpretation of the criteria provides enough level of clarification.

However, we are concerned with the disclosure of the legal opinion. According to paragraph 13 of the Draft Guidelines, the legal opinion should be accessible and made available to third parties. This is particularly problematic for law firms issuing such legal opinions since they would be obliged to distribute the opinion to any third party regardless whether the party has a legitimate interest in the legal opinion or not. This obligation might become an unpredictable liability risk which may not be covered by an insurance. As a result law firms could be excluded from supporting the securitisation processes.

Legal advice is crucial for a smooth and successful handling of securitisation transactions. Therefore, a shortage of legal advice resulting from the proposed distribution requirement would add an extra burden for market participants of the European securitisation market.

Therefore, we propose to restrict the scope of legitimate recipients and to limit the access to the legal opinion on a non-reliance basis to third party certification agents and competent authorities supervising STS certifications.

Q3. Do you believe that in addition to the guidance provided, additional guidance should be provided on the application of Article 20(2)? If yes, please provide suggestions of such severe clawback provisions to be included in the guidance.

The legal opinion should refer exclusively to the legally effective transfer of assets. Only those risks that may impair the asset transfer should be addressed. These are essentially clawback risks and re-characterisation risks. By contrast, commingling risks and set-off risks are not directly related to the transfer of the assets but may exist independently from them. These matters are typically not components of a true sale opinion.

Therefore, commingling risks and set-off risks should be deleted from subparagraph 10.b.

Eligibility criteria for the underlying exposures/active portfolio management (Article 20(7))

Q7: Do you agree with the techniques of portfolio management that are allowed and disallowed, under the criterion of the active portfolio management? Should other techniques be included or excluded?

The interpretation of which portfolio management techniques are allowed should be further extended in order to maintain current practices. Paragraph 18.c. of the Draft Guidelines only allows investing the proceeds from the underlying exposures into additional exposures during a “ramp-up” period.

However, for instance in the case of captives, most of them have warehouse programs in which exposures are sold to a private investor base several times per year. Their volumes can be increased or decreased on an ongoing basis. Additionally the collection proceeds of such underlying exposures are used to refinance the purchase of further exposures during the revolving period in order to keep the transaction volumes stable. Besides, it is market common practice to transfer such exposures into public term transactions. This market practice which has proven to be workable in the past would not be covered by paragraph 18.c.

To solve this issue, we propose adding to paragraph 18 the following wording:

d. replacement of underlying exposure of which the SSPE has disposed in accordance with the terms of the governing contractual framework by exposure that meets the same predefined eligibility criteria

We would also propose the EBA to complement paragraph 19 as follows to clarify that a sale of exposures in exercise of a clean-up call option should not be considered portfolio management:

a. sale of underlying exposure(s) for reason other than those described in the paragraph 18 ***or in exercise of a clean-up call option as contemplated in Article 244 (3) (g) of Regulation (EU) No 575/2013;***

Homogeneity, obligations of the underlying exposures, periodic payment streams, no transferable securities (Article 20(8))

Q8: Do you agree with the interpretation of this criterion, and the aspects that the interpretation is focused on? Should interpretation be amended, further clarified or additional aspects be covered? Please substantiate your reasoning.

For the purposes of Article 20(8) of Regulation (EU) 2017/2402, exposures payable in a single instalment in the case of revolving securitisation, as referred to in Article 20(12) of Regulation (EU) 2017/2402, exposures related to credit cards facilities, exposures with higher final instalments ("balloon-payments"), bullet loans, residual values and exposures with instalments consisting of interests only (including interest only mortgages), should also be considered to have defined payment streams relating to rental, principal, interest, or to any other right to receive income from assets warranting such payments.

Underwriting standards, originator's expertise (Article 20(10))

Q10: Do you agree with the interpretation of this criterion, and the aspects that the interpretation is focused on? Should interpretation be amended, further clarified or additional aspects be covered? Please substantiate your reasoning.

The proposed disclosure of changes in the underwriting standards included in paragraphs 28 and 29 of the Draft Guidelines is not compatible with competition and anti-trust laws as the required information is confidential. Furthermore, it breaches the provisions of the General Data Protection Regulation (GDPR) (EU) 2016/679 since it requires disclosing personal data.

Q11: Do you agree with this balanced approach to the determination of the expertise of the originator or original lender? Do you believe that more rule-based set of requirements should be specified, or, instead, more principles-based criteria should be provided? Is the requirement of minimum of 5 years of professional experience appropriate and exercisable in practice?

We agree with the interpretation of this criteria. Nonetheless, we would highlight that paragraph 39 may conflict with the General Data Protection Regulation (GDPR) (EU) 2016/679 as it requires the disclosure of personal data.

No exposures in default and to credit-impaired debtors/guarantors (Article 20(11))

Q13. Do you agree with the interpretation of this criterion, and the aspects that the interpretation is focused on? Should interpretation be amended, further clarified or additional aspects be covered? Please substantiate your reasoning.

Regarding the 'best knowledge' requirement, public information should be used only where it has been recognised and processed by the originator. We think that the general wording in the second half-sentence of subparagraph 44 ('including publicly available information') contradicts the idea

expressed in subparagraph 41 ('not to be deemed unduly burdensome') as well as subparagraph 45 ('not require the originator ... to take other steps in order to collect further information …').

The second half-sentence in subparagraph 44 should therefore be amended accordingly or deleted.

Q15. Do you agree with the interpretation of the requirement with respect to the exposures to credit-impaired debtors or guarantors that have undergone a debt-restructuring process?

In a guaranteed portfolio/asset, the requirement of non-impairment is to apply not just to the debtor but also to the guarantor (subparagraph 43 'neither the debtor, nor the guarantor'). We think this is excessive and has no practical relevance from a lending perspective. In particular, for an 'impaired' debtor, a further guarantor is relevant as a risk bearer. The focus must then be on that guarantor. A portfolio or an individual asset should be deemed credit-impaired only if both the debtor and the guarantor are impaired (i.e. cumulatively).

The originator should therefore not have to perform a review of the credit history or current credit status. Subparagraph 43 should therefore contain a clarification accordingly.

No predominant dependence on the sale of assets (Article 20(13))

Q18: Do you agree with the interpretation of the predominant dependence with reference to 30% of total initial exposure value of securitisation positions? Should different percentage be set dependent on different asset category securitised?

We disagree with the EBA interpretation of "predominant dependence" in paragraph 53.a. The final political agreement on STS replaced the term "substantially" by the term "predominantly" to allow residual values being eligible for the STS label. The EBA interpretation of predominantly dependence would work against the political agreement on residual values.

The table below shows what would be the ideal percentage for the reliance on sales proceeds depending on the average duration of the contract:

Average Original Duration of the Lease Contract	Maximal dependency on sales in % of initial exposure value, calculated over the total portfolio
<= 1 year	90%
> 1 year <= 4 years	70%
> 4 years <= 6 years	50%
> 6 years <= 10 years	35%
> 10 years <= 20 years	30%
> 20 years	25%

Regarding paragraph 55, we would highlight that it is common practice that customers pay affordable monthly instalments but do not repay the full credit amount, thus leaving a balance due at maturity. At the end of the term the customer has a choice between refinancing or paying the outstanding amount. A third option would be to return the asset to the lender and being released from the final payment, provided they have paid at least half the total price. If the actual value of the returned asset is lower than the final payment there is a shortfall. The risk of this shortfall is the so-called residual value risk.

Usually residual values are fully backed by repurchase obligations by either the originator, the manufacturer or the dealer. In cases where the risk that the sales price of the asset is lower than the calculated value of the asset, the residual value risk is fully borne by the party that has assumed the repurchase obligation or residual guarantee. There is no longer market risk because the repayment in those cases depends on the credit quality of the party that has assumed the repurchase obligation or guarantee.

The final political agreement aimed at allowing residual values and repurchase agreements to be STS eligible. For this reason, a second paragraph was introduced in Article 20 (13), stating that such repurchase obligations are not dependent on the sale of assets securing the underlying exposures.

However, paragraph 55 of the Draft Guidelines states that the exemption of a repurchase obligation is only valid if it is held by a CRR institution or a central bank in accordance with Article 201 (1) of Regulation (EU) 575/2013 and Article 249 of Regulation (EU) 2017/2401 amending Regulation (EU) 575/2013.

The EBA proposal will restrict the final agreement on the subject matter. We therefore urge the EBA to delete paragraph 55.

2. <u>Criteria related to standardisation</u>

Requirements in case of enforcement or delivery of an acceleration notice (Article 21(4))

Q21: Do you agree with the interpretation of this criterion, and the aspects that the interpretation is focused on? Should interpretation be amended, further clarified or additional aspects be covered? Please substantiate your reasoning.

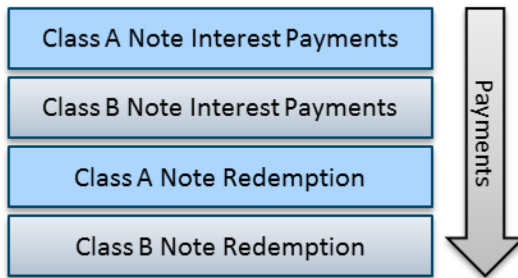
The introduction of a mandatory sequential redemption in Article 21(4) of Regulation (EU) 2017/2402 creates uncertainty on what the requirements of such sequential redemption would be.

In practice transactions often provide for different waterfalls for going concern scenarios compared to enforcement scenarios. The main difference usually is the ranking of interest coupons on junior notes as shown in the below picture. Whilst, as shown in option 1, in a going concern scenario a non-sequential payment waterfall applies with interest on junior notes ranks ahead of principal on senior notes, in an enforcement scenario option 2 would apply in which there would be a sequential payment waterfall in which interest payments on junior notes are subordinated to principal on senior notes. This is mainly to comply with the requirement of Article 77 (2) of Guideline (EU) 2015/510 of the European Central Bank.

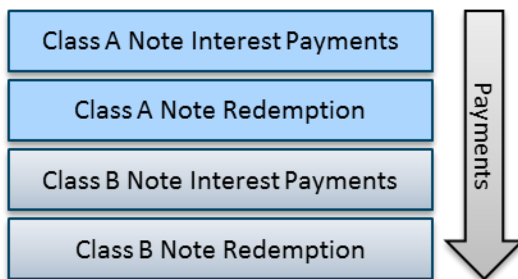
Therefore, it is not clear for market participants whether a sequential redemption as required by Article 21(4) of Regulation (EU) 2017/2402 would also require a certain order of priority.

We would welcome further clarification on the EBA understanding of the requirements for a sequential redemption.

Option 1:



Option 2:



Expertise of the servicer (Article 21(8))

Q25: Do you agree with the interpretation of this criterion, and the aspects that the interpretation is focused on? Should interpretation be amended, further clarified or additional aspects be covered? Is the requirement of minimum of 5 years of professional experience appropriate and workable in practice? Please substantiate your reasoning.

In general, we agree with the interpretation of this criterion. However, we would point out that paragraph 76 contradicts the General Data Protection Regulation (GDPR) (EU) 2016/679 as it requires the disclosure of personal data.

Q26: Do you agree with this balanced approach to the determination of the expertise of the servicer? Do you believe that more rule-based set of requirements should be specified, or, instead, more principles-based criteria should be provided? Is the requirement of minimum of 5 years of professional experience appropriate and exercisable in practice?

In principle, we agree with the proposed approach. However, we are concerned with paragraph 78.b. as it could entail an additional requirement for leasing companies conducting the servicing within the transactions. Paragraph 78.b. states that the proof of “well documented and adequate

policies and risk management controls" as well as the other requirements mentioned in this paragraph should be substantiated by a third-party review.

This proof would require the third party to check inside the processes of the leasing company, which is confidential information. Furthermore, this requirement would breach the provisions of data protection within the European Union.

Therefore, in order to provide legal certainty, we suggest the EBA to define the pool of potential third parties as well as the format of substantiation for conducting the required proof.

Resolution of conflicts between different classes of investors (Article 21(10))

Q28: Do you agree with the interpretation of this criterion, and the aspects that the interpretation is focused on? Should interpretation be amended, further clarified or additional aspects be covered? Please substantiate your reasoning.

We mostly agree with the interpretation of this criterion. However, in a number of European civil law jurisdictions there are already specific statutory concepts for creditor resolutions which should prevail. Therefore, it would be expected by investors to apply them and should not be mistaken with discretionary contractual arrangements which investors may not expect.

Hence, we propose the EBA adding to paragraph 80 the following sentence:

e. the maximum period from the time where conflicts between different classes of investors occur and the resolution of such conflicts by means of holding a meeting or conference call**, unless the statutory law governing the transaction documents already provides for rules and procedures for creditor resolutions.**

3. Criteria related to transparency

Verification of a sample of the underlying exposures (Article 22(2))

Q30: Do you agree with the interpretation of this criterion, and the aspects that the interpretation is focused on? Should interpretation be amended, further clarified or additional aspects be covered? Please substantiate your reasoning.

We are concerned that the EBA interpretation in paragraph 86 would create difficulties for the verification process.

Paragraph 86 would expand the scope of Article 22 (2) by requiring that the offering document should include a confirmation of the external verification of the underlying exposures. This verification will be conducted by an auditor. Hence, the obligation would entail that the originator would have to disclose the Agreed-Upon-Procedures (AUP) of the auditor in the offering to third parties.

The AUP´s are core to the relationship between an originator and the auditor. Therefore, they are confidential and any disclosure is subject to data protection regulation. Thus, we think that it will be very difficult – if not impossible – to obtain the consent for disclosure from the responsible auditor.

To solve this issue we suggest the EBA to delete the proposed interpretation from the Draft Guidelines.

Liability cash flow model (Article 22 (3))

Q31: Do you agree with the interpretation of this criterion, and the aspects that the interpretation is focused on? Should interpretation be amended, further clarified or additional aspects be covered? Please substantiate your reasoning.

According to paragraph 88 the originator should bear the full responsibility for the submission of the information deriving from a cash flow model which is developed by third parties. It is common practice that the originator buys a cash flow model from the arranger. However, the arranger in its own responsibility and without any participation of the originator develops, calculates and prepares the cash flow model. We are not against bearing the responsibility for the transaction, but we think that the responsibility for a service which is being conducted by a third party and which is communicated to the investor should remain with the third party.

In addition, we think that the wording of Article 22 (3) does not cover the current interpretation as it only mentions the obligation of the originator to make available the cash flow model, but does not provide the distribution of responsibilities.

Therefore, we propose the EBA to amend paragraph 88 so that the responsibility for the cash flow model remains with the arranger.

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About us

The membership of our two Federations covers institutions specialised in one or more of the following activities:

Lending to consumers, for instance via personal loans, credit cards or lease/hire purchase agreements; leasing to businesses of all asset types, including machinery and industrial equipment, ICT and others assets; motor finance, granted to individuals or businesses, either in the form of loans or leases

The consumer credit, asset finance and leasing markets have developed to respond to business investment and consumption needs as well as to accompany the development of local industrial production and distribution. The types of institutions represented by the Federations include specialised banks, bank-owned subsidiaries, the financing arms of manufacturers as well as other, independently-owned institutions.

Specialised financial services providers across the European Union (EU)/European Economic Area (EEA) encompass a diversity of organisations of different legal nature (i.e. credit institutions, financial institutions) and with various operational characteristics (independent companies, subsidiaries of banks, captive finance companies of manufacturers). All share a very high degree of specialisation and have a very limited mix of business activities compared to traditional mainstream banking organisations.

In 2016, the leasing firms represented through **Leaseurope's membership helped European businesses invest in assets worth more than 334 billion EUR**, reaching 779 billion EUR of outstandings at the end of the year[1]. Leasing is used by more European SMEs than any individual category of traditional bank lending taken altogether (around 40% of all European SMEs make us of leasing which is more than any other individual form of lending)[2] and is also extremely popular amongst larger corporates[3]. It is also extremely useful to support the public sector (e.g. leasing to schools, hospitals, etc.).

In 2016, consumer credit providers that are members of **Eurofinas helped support European consumption by making more than 457 billion EUR goods, services, home improvements and private vehicles available to individuals**, reaching 1.024 trillion EUR of outstandings at the end of the year[4]. Consumer lending is procyclical and is highly positively correlated with households' disposable income[5]. By providing access to finance to individuals and households, consumer credit supports the social and economic well-being of millions of consumers across Europe.

Eurofinas and Leaseurope are entered into the European Transparency Register of Interest Representatives with ID n° 83211441580-56 and 430010622057-05

[1] Leaseurope 2016 Annual Statistical Enquiry
[2] Oxford Economics, *The Use of Leasing Amongst European SMEs,* 2015; Eurostat, *Access to Finance Statistics,* 2011; International Finance Corporation *Leasing in Development: Guidelines for Emerging Economies,* 2009; European Investment Fund *The importance of leasing for SME finance, 2012*; and UEAPME, *UEAPME Newsflash,* 2012
[3] European Central Bank, *Survey on the Access to Finance of Small and Medium-Sized Enterprises in the Euro Area* , April 2013
[4] Eurofinas 2016 Annual Statistical Enquiry
[5] Eurofinas, *Consumer Credit, Helping European Households Finance their Tomorrow,* 2015