POSITION PAPER

ESBG response to EBA Discussion Paper on simple standard and transparent securitisations

ESBG (European Savings and Retail Banking Group)

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ESBG Transparency Register ID 8765978796-80

January 2015

ESBG

ESBG welcomes the EBA proposal for simple standard and transparent securitisations as ESBG considers that the paper finally corrects the "one-size-fits-all" shortage of the current regulatory approach and the proposed revisions to the securitisation framework. ESBG is highly satisfied that the existing CRR capital requirements are used as a basis instead of those proposed in the revision from December 2013.

However, ESBG is concerned that the EBA paper focuses more on the impact for banks acting as investors of securitisation, and very little on the motivation for a bank to use securitisation as a funding or risk transfer tool. There is today very little incentive for a bank to securitise their assets, as it is a complex and cumbersome project from an accounting and IT standpoint and it has very little benefits compared to using covered bonds. Proposing for example that tranches of a securitisation SPV that are sold to third party investors are accounted out of the Leverage Ratio of the issuing bank would be a huge incentive for banks to securitise their assets.

If the EBA goes towards the idea of a two-stage approach, a decrease in the capital requirement for qualifying securitisations to near neutrality of capital charges compared to the underlying portfolio of exposures and an alignment of the different regulations, securitisations will become economically feasible for originators again and the comeback of this essential risk transfer and funding instrument will be facilitated.

ESBG would like to additionally insist that the creation of a separate category of securitisation is very welcome but should be focusing solely on simplicity, standardisation and transparency, and not on risk. Introducing risk parameters in a label will create the false illusion that the label is granting a new institutionalised "AAA" rating with all the consequences observed during the crisis. The risk analysis should be made by the investor and the label should only be a guarantee that all necessary risk analysis elements are available to the investor.

<u>Question 1:</u> Do you agree with identified impediments to the securitisation market?

Yes, ESBG agrees.

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

It is ESBG's view that synthetic securitisations should not be excluded from the framework for simple, standard and transparent securitisations.

Careful differentiation should be made between a synthetic securitisation that is used to create an arbitrage, or allow hedge funds to create short positions on specific asset classes such as the Abacus transactions during the crisis, and a "non-true sale" transaction that is created because there is no simple or efficient way to actually transfer the legal ownership of assets. Furthermore, for some banking institutions it is the only way to participate in risk transfer transactions without the need of selling loans or clients. Indeed, with regard to "cash" transactions the transfer of the risk is made synthetically because the true sale is impossible (transfer restrictions) or too cumbersome (notification for example). If this difference is not made, these institutions will not take advantage of this two-class system as their client policy and given words of not selling performing loans to external investors will prevent it.

Furthermore these are not public transactions. The "Mezzanine" piece is only sold to very sophisticated investors (such as hedge funds) that clearly understand the structures even if they are complex. The "retained" tranches (that are usually implicit tranches) are retained by the bank that originated the underlying risk and that most of the time structured the transaction. Therefore applying penalties to that bank doesn't make any sense either.

In addition, synthetic securitisations can be structured in a way to fulfil all mentioned criteria for qualifying securitisations. The non-compliance of legal true sale under criterion 3 and again mentioned under criterion 1 (legal and economic transfer) can be eliminated with funded trustee accounts from investors and the originator. The investors pay the notes notional on a trustee account to cover losses of the underlying assets. The originator pays the interest on the notes on a trustee account for fulfilment of its payment obligations until maturity. A legal transfer for recourse is therefore not necessary.

Not including synthetic transactions would be a differentiation from the CRR in which the same capital requirement calculations apply for both traditional and synthetic transactions.

In addition, ESBG would like to emphasize that the reliance on external ratings should be reduced as much as possible as already stated by EBA recommendation number 5 so as to have a simple, standard and transparent synthetic securitisation regime.

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

Instead of defaulted exposures (criterion 5 ii) ESBG would recommend to only allow current exposures for qualifying securitisations at the time of inclusion.

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

No, ESBG does not believe that there should be limits imposed on the type of jurisdiction. However the use of European level directives such as the Financial Collateral Directive to ensure a homogeneous granting of security over assets should be encouraged. This directive and its various transcriptions into local laws is an example of Europe-wide initiatives that have helped the development of secured funding transactions including covered bonds. In the case of securitisation, the use of this existing framework should be encouraged as a way to mitigate counterparty risk.

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

ESBG is of the opinion that the distribution of the voting rights to the most senior tranches could shorten the decision-making process, strengthen the most senior tranche and help to support the decrease in the capital requirement for this tranche. However ESBG warns against granting all the voting rights to the senior tranche given the level of conflicts of interest it would create. For example, fundamental matters such as varying the capital structure, maturities, coupons etc. should obviously be voted by the majority of all classes. The vast majority of securitisations give the controlling rights to the most senior tranche, therefore allowing such tranche to direct the acceleration of the securitisation post event of defaults.

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

ESBG considers that it is not realistic to provide the documents before the issuance as the timeframe for closing transactions is usually very short, and legal documents are prepared until the closing date. There have not been difficulties caused by this, as the Offering Circular / Prospectus already provide detailed description of the transaction. Therefore there is little value to provide legal documentations prior to issuance. The prospectus should remain the central decision-tool when it comes to understanding the fundamental features of the transaction and its legal structure.

Question 7: Do you agree that granularity is a relevant factor determining the credit risk of the underlying? Does the threshold value proposed under Criterion B pose an obstacle to the structuring of securitisation transactions in any specific asset class? Would another threshold value be more appropriate?

The criterion for at least 100 exposures eliminates CMBS as well as most CLOs from qualifying securitisations. ESBG clearly understands and share the aim of the granularity rule. However ESBG would suggest that granularity criterion is changed for a diversification criterion that takes into account the following:

- Granularity, as currently suggested by EBA discussion paper;
- Concentration, as currently suggested by EBA discussion paper (criteria B in Credit risk criteria); and
- Diversification.

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

ESBG agrees with most of the proposed criteria, apart from the exclusion of synthetic transactions, and appreciates that certain asset classes are not eliminated right from the start. However, with the granularity criterion 7, CMBS and CLOs with below 100 exposures would be eliminated. The loan-to-value 100% limit needs further explanation in terms of value (e.g. foreclosure value in NL). Does it mean that the 100% risk weight limit under ii) d) for all other exposures corresponds to the exclusion of all B and lower rated SME and corporate exposures (Table 2, page 27) under qualifying securitisations? Therefore ESBG asks the EBA for more clarification.

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

ESBG does not consider that it would be the case as long as qualifying securitisations will benefit from lower capital requirements compared to the CRR requirements and for non-qualifying securitisation transactions the capital requirements of the CRR will not be increased (in contrast to the revisions to the securitisation framework).

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

In the hypothesis where the bank that holds the instruments has originated and structured the transaction itself, ESBG considers that there should be no difference between whether the securitisation is qualifying or not. Indeed, such transaction is *de facto* transparent for them and they should not be penalised if it is not qualifying.

In the hypothesis where the bank is a third party investor into a securitisation, it should benefit from lower thresholds / RWAs. This would also encourage them to start market making activities, which would help to build an efficient qualifying securitisations market.

In the hypothesis where the bank is the originator of the instrument, there should be some strong incentive, such as a reduction in the leverage ratio for tranches sold to third party investors. Securitisation creates non-recourse financing for the originating bank, when tranches are sold to a third party, but this non-recourse funding is not taken into account in IFRS accounting.

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

A calibration towards near neutrality of the qualifying securitisation compared to its underlying exposures will already reduce the capital requirement of qualifying securitisations. ESBG agrees with the proposed reallocation across tranches in favour of the more junior tranches versus more senior ones other than the most senior tranche.

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

As in the IRB approach it should be done through lowering the capital requirement for the most senior tranche versus non-senior tranche at the same CQS (Credit Quality Step). As an alternative, it could be proposed that the ratings should be applied for securitisation tranches with the same level of seniority, without taking into account the rating ceilings.

About ESBG (European Savings and Retail Banking Group)

ESBG brings together savings and retail banks of the European Union and European Economic Area that believe in a common identity for European policies. ESBG members support the development of a single market for Europe that adheres to the principle of subsidiarity, whereby the European Union only acts when individual Member States cannot sufficiently do so. They believe that pluralism and diversity in the European banking sector safeguard the market against shocks that arise from time to time, whether caused by internal or external forces. Members seek to defend the European social and economic model that combines economic growth with high living standards and good working conditions. To these ends, ESBG members come together to agree on and promote common positions on relevant matters of a regulatory or supervisory nature.

ESBG members represent one of the largest European retail banking networks, comprising of approximately one-third of the retail banking market in Europe, with total assets of over €7,300 billion, non-bank deposits of €3,479 billion and non-bank loans of €3,947 billion (31 December 2012).

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Published by ESBG. January 2015