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Online Submission

EBA Discussion Paper on simple, standard and transparent securitisations (EBA/DP/2014/02)

Moody's Investors Service ("MIS") appreciates the opportunity to provide comments to the European Banking Authority ("EBA") on the discussion paper: *on simple, standard and transparent securitisations* (the "Paper").

MIS welcomes the willingness to discuss the securitisation market. Having already provided comment on similar topics to the European Central Bank ("ECB") and Bank of England ("BoE"), as well as the Basel Committee on Banking Supervision ("BCBS") and International Organisation of Securities Commissions ("IOSCO"), our response on this Paper draws on those comments. These include:

1. The concept of "qualifying/simple" securitisation; and
2. Sovereign risk.

In Annex 1, we have provided our comments on the three pillars (simple, standard and transparent) while in Annex 2 we have responded to some of the individual questions posed in the Paper. Annex 3 contains our views on governance factors.

1. The concept of "qualifying/simple" securitisation

1.1 Factors that MIS considers as contributing to uncertainty in forecasting credit risk

The Paper highlights a number of proposed principles that are considered necessary for a securitisation to constitute a "qualifying/simple securitisation", these being *simplicity*, *standardisation* and *transparency*. MIS understands the benefit such a classification may have for the EBA, particularly in regard to the predictability, certainty and level of assessment of the risk.[1]

"Qualifying/simple" securitisation correlates with prediction confidence. In addition, ensuring that a securitisation transaction's assets or structure have certain predefined features does not guarantee that it

[1] Our views on qualifying securitisation can be found in our Special Comment: *Key Factors in Assessing the Credit Quality of European Structured Finance Transactions (30 September 2014).*

will be a qualifying/simple securitisation, given that its performance may still not be predictable to a high degree of confidence.

Assumptions about future asset performance and how well the structures can withstand legal and governance challenges leads to uncertainty in securitisation transactions. Specifically, uncertainty can arise from a combination of the following factors.

1) **Collateral pool and structure:** Although all transactions are exposed to a variety of risks, the specific characteristics of the underlying portfolio and structure render some risks more relevant to a transaction than others. The nature of the pool and the structure, not the asset class, generally determines whether a transaction is simple or complex.

2) Historical data adequacy, performance variability and quality of disclosure: The length and quality of historical performance data and the extent, timeliness and quality of disclosure of collateral characteristics may vary significantly, even for transactions within the same asset class. In some cases, the historical data available may be insufficient to assess future portfolio performance with confidence. For example, the data may not reflect the performance of assets during an economic downturn. Even if data for numerous years is available, it may not specifically relate to the assets being securitised. We may not be able to use the data effectively to predict a portfolio's performance if there have been changes in the originator's method of origination, underwriting standards, product features, demographic or geographic target market, or if the originator has purchased delinquent receivables from a pool. In the past several years, regulatory and industry initiatives have made significant progress in defining the appropriate standard of data for securitisation transactions. In many markets, repeat originators have become adept at supplying an appropriate amount of data.

3) **Governance:** Although a transaction's documentation sets out how a transaction is supposed to work, in practice, numerous governance issues may come into play. These issues include the experience and ability of transaction parties, the alignment of interests among transaction parties and the impact of the legal and regulatory framework. Please see Annex 3 for a further explanation of the governance factor.

Finally, the allocation of losses may be complicated, preventing an immediate understanding of an investor's risk. Analytical complexity results in a loss of an intuitive understanding of the final outcome. A sophisticated model may have many inputs, and the impact of these inputs on performance and their impact on one another may be quite complex. Also, an event such as the insolvency of the originator may impact a transaction in many ways: disruption in servicing, a reduction in financially able obligors' incentive to pay, dilution, legal risk and set-off. The interrelatedness of effects makes it harder to predict the outcome of a transaction. For example, a change in consumer protection laws may result in a higher than expected prepayment rate, which in turn leads to back-ended losses. However, market participants may well change their view of a type of transaction from it being complex to simple as its features become standardised and tested. Some examples are waterfalls in German auto asset-backed securities (ABS) or UK prime RMBS, where the level of uncertainty around their performance has been reduced.

In our credit analysis of securitisation transactions we assess the combined impact of these factors. We do not have prescriptive rules capping their impact on securitisation transactions. Credit enhancement or structural features can typically address the uncertainty that may arise from these factors. In some instances, these factors constrain the highest rating assigned to a transaction.

1.2 Two essential factors for any "qualifying/simple" securitisation

There are two areas where we, as users of the information flowing from securitisations, continue to see as risk factors in analysing a securitisation in the EU. These are:

- Transparency, comparability and quality of data; and
- Legal certainty around the securitisation structure.

Taking each of these in turn:

1.2.1. Transparency, comparability and quality of data

As MIS uses financial data published by issuers as one of the key inputs for its credit analysis, we welcome regulatory initiatives focused on increasing the frequency, quality and consistency of publicly available information. The implementation of Article 8b of Regulation (EC) 1060/2009[2] and the creation of the website by the European Securities Markets Authority ("ESMA") relating to information on securitisation instruments should be an important step in the right direction.

These initiatives should allow detailed, consistent information about underlying credit risks to be provided by issuers to the investing public which in turn increases the diversity of opinion and level of debate in the market which improves the functioning of markets.

However, information disclosure is only the foundation of an effective market discipline framework. Enhancing the disclosure regime for issuers so that detailed, *consistent* quality information about underlying credit risks is provided by issuers to the investing public is important. Information should be disclosed at regular intervals or periods and in a consistent and standardised format that allows for comparability and be of sufficient quality that allows users of the information to rely on the information without an additional verification process. Currently, there is no standardisation with regard to terminology and calculations for ratios and triggers in the EU securitisation market.[3] It would be beneficial for EU securitisation if there were a focus on having consistent standards for measuring loan performance (such as aging and charge-offs). Furthermore, the definitions in the various transaction reports are often unclear or inconsistent. If definitions are not clearly provided, it is difficult for investors to ensure consistency of analysis across transactions and benchmark them appropriately. It is therefore imperative that all the terms are clearly defined in the investor report and detailed formulae are provided for ratios and triggers to support high quality monitoring analysis.

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[2] Article 8b (1) states that "the issuer, the originator and the sponsor of a structured finance instrument established in the Union shall, on the website set up by ESMA pursuant to paragraph 4, jointly publish information on the credit quality and performance of the underlying assets of the structured finance instrument, the structure of the securitisation transaction, the cash flows and any collateral supporting a securitisation exposure as well as any information that is necessary to conduct comprehensive and well-informed stress tests on the cash flows and collateral values supporting the underlying exposures."

[3] For example, there is currently no consistency with regard to the delinquency definition across transactions. Some transactions report delinquency based on the number of days delinquent independent of the amount unpaid, while others report delinquency based on the ratio amount unpaid divided by the contract monthly obligation. Some transactions report defaulted loans and repossessed loans in the late stage of the delinquency bucket, while others report these loans separately.

1.2.2 Legal certainty around the securitisation structure

A key component in determining the level of risk in a securitisation is whether the legal system provides certainty and an understanding of the implication of legal outcomes. The absence of a clear and consistent legal framework for transaction structures creates uncertainty in any analysis.

Standardised terminology and documents that cover true sale, title to ownership, insolvency and bankruptcy provisions would help to reduce uncertainty around legal risk and would allow for greater comparability of transactions.

An additional benefit is that with a more certain legal environment and disclosure framework, potential barriers to the availability of transaction counterparties are reduced. Such a framework would reduce the risk of, and allow for, an easier interchange of transaction counterparties.

2. Sovereign risk criteria

We believe that the interests of the credit markets are best served by ratings that aim to reflect all credit-related risks, including risks measured by the sovereign ratings caps or Local Country Ceilings ("Sovereign Ceilings").

The Paper suggests that:

> *since 2010, the rating agencies have changed substantially their rating methodologies for certain risks (namely sovereign and macroeconomic risk) and asset classes of the securitisation market, leading to a general increase in the levels of credit enhancement required for supporting a given rating grade.*

In addition:

> *the resulting adjustments and sovereign rating caps affect the credit enhancement on the positions placed with investors and make the economics of credit risk transfer less sustainable.*

In our view, all debt issuers, including securitisation vehicles, are exposed to some level of unavoidable risk simply because they operate in a given environment. In the EU, Sovereign Ceilings primarily reflect the very low probability but high impact resulting from economic and financial consequences of a disorderly sovereign default which, for euro area issuers, include the possibility that default is accompanied by euro exit and currency redenomination. We do not believe that either diversification or credit enhancement allows securitisation transactions to mitigate those risks fully. No issuer can be more diversified than the sovereign, and risks such as capital controls, currency redenomination or interference in transactions through regulation or legislation cannot be eliminated with higher levels of credit enhancement.

Equally, we recognise that not all market participants share our view of country risk, and that some investors find it helpful to understand what the credit rating would have been at the closing

of a transaction were the Sovereign Ceiling not capping the rating. In other words, what might the initial ratings be if not impacted by the current Sovereign Ceiling? MIS has recently published a report "Updated Sensitivity Analysis Clarifies How Sovereign Risk Affects Structured Finance Ratings" which is intended to provide investors with additional information on securitisation ratings and which may meet some of the concerns expressed in the Paper.[4] The parameter sensitivities included in the report provide a quantitative, model-indicated calculation of the number of notches that a MIS rated securitisation security may vary if certain input parameters used in the initial rating process differed.

We review our approach continuously to make sure our credit view stays current. In light of this, MIS has now issued two new Requests for Comment (RFC) relevant to country risk;

1. "**Proposed Changes to Local Currency Country Risk Ceilings in Currency Unions**"[5]:

In light of the actions taken by euro area member states during the recent crisis, we now believe that the risk of exit and redenomination following a government bond default by euro area members is significantly lower. As such, we are proposing a change to our risk assumptions. To reflect this, we propose to raise the country risk ceilings for a number of non-Aaa euro area countries. We propose a maximum notching in the euro area between a government bond rating and its country risk ceiling of six notches. Please see the RFC document for more details.

2. **"Changes to Minimum Portfolio Credit Enhancement in EMEA ABS and RMBS"**[6]:

Information and data gained during the global financial crisis prompted us to revisit the relevance of our minimum portfolio CEs. Collateral performance during the significant economic downturn provides information that enables us to better forecast future performance. As such, we propose changes to the minimum portfolio credit enhancement (CE) levels in ABS and residential RMBS in most EMEA markets because we consider that the minimum levels are no longer necessary in these cases. Please see the RFC document for more details.

For further information on the above and to address some of the specific questions in the discussion paper, please see Annex 2.

We trust that you will find our comments helpful and would be pleased to discuss our views with you at your convenience.

Yours sincerely

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[4] www.moodys.com/research/Updated-Sensitivity-Analysis-Clarifies-How-Sovereign-Risk-Affects-Structured-Finance--PBS_SF368089

[5] See Proposed Changes to Local Currency Country Risk Ceilings in Currency Unions, 20 November 2014

[6] See Changes to Minimum Portfolio Credit Enhancement in EMEA ABS and RMBS, 26 November 2014

ANNEX 1

THREE PILLARS – CRITERIA

PILLAR 1 (SIMPLE SECURITISATION)

CRITERIA	MIS COMMENT
1. The securitisation should meet the following conditions: • It should be a securitisation as defined in the CRR (as per Article 4 (61)); • It should be a 'traditional securitisation' as defined in the CRR (as per Article 242(10)); • It should not be a 're-securitisation' as defined in the CRR (as per Article 4 (63)).	Please see our comments in the cover note.
2. The Securitisation should not be characterised by an active portfolio management on a discretionary basis. Assets transferred to a securitisation should be whole portfolios of eligible exposures or should be randomly selected from those satisfying eligibility criteria and may not be actively selected or otherwise cherry-picked. Substitution of exposures that are in breach of representations and warranties should in principle not be considered as active portfolio management.	In order to assess whether a portfolio was actively selected or cherry-picked, it is necessary to have full and transparent information on the objectives pursued and criteria followed in the selection of the portfolio to be securitised There is also a risk that this criteria would exclude: • CLOs – as they have prefunding and allow some active management during a revolving period; • Auto ABS – as they have a prefunding or top up revolving feature; and • Credit card structures – as these have ongoing account eligibility criteria where Master Trusts are topped up with new accounts.
3.The securitisation should be characterised by legal true sale of the securitised assets and should not include any severe insolvency clawback provisions. A legal opinion should confirm the true sale and the enforceability of the transfer of assets under the applicable law(s). Severe clawback provisions should	True sales are complicated for bank sellers particularly given "bail in" regimes. Please see our comments in the cover note above, regarding legal certainty around the securitisation structure.

include rules under which the sale of cash flow generating assets backing the securitisation can be invalidated by the liquidator solely on the basis that it was concluded within a certain period (suspect period) before the declaration of insolvency of the seller (originator/intermediary), or where such invalidation can only be prevented by the transferees if they can prove that they were not aware of the insolvency of the seller (originator/intermediary) at the time of the sale.	
4. The securitisation should be backed by exposures that are homogeneous in terms of asset type, currency and legal system under which they are subject. In addition, the exposures should meet the following criteria: i) They arise from obligations with defined terms relating to rental, principal, interest or principal and interest payments, or are rights to receive income from assets specified to support such payments; ii) They are consistently originated in the ordinary course of the original lender's business pursuant to uniform and non-deteriorating underwriting standards; iii) They contain a legal, valid and binding obligation of the obligor, enforceable in accordance with its terms against any third party, to pay the sums of money specified in it (other than an obligation to pay interest on overdue amounts); iv) They are underwritten: (a) with full recourse to an obligor that is an individual or a corporate and that is not a special purpose entity, and (b) on the basis that the repayment necessary to repay the securitisations was not intended, in whole or in part, to be substantially reliant on the refinancing of the underlying exposures or re-sale value of the assets that are being financed by those underlying exposures.	There is a risk that "*exposures are consistently originated in the ordinary course of the original lender's business pursuant to uniform and non-deteriorating underwritings*" could be difficult to achieve as originators may continue to update their terms and business practices. It would also arguably be hard to police and could discriminate against larger SME loans where lending may not be against a standard loan document, but may include some bespoke terms. This homogeneity provision would also preclude deals with pan-European collateral such as trade receivables securitisations from being eligible for achieving qualifying/simple criteria. We note that currency variation has not been included in the EBA's paper.
5. At the time of inclusion in the securitisation, the underlying exposures should not include: i) Any disputes between original lender and borrower on the underlying assets; ii) Any exposures which are in default. An exposure is considered to be in default if: a. it is more than 90 days past-due; b. the debtor is assessed as unlikely to pay its credit	Yes, but in order to understand credit risk, there should be an understanding of the level of arrears present in loans of a similar type held on an originators balance sheet. Information that helps to identify obligors in a weak financial condition, which may not be reflected by arrear data (e.g. obligors

obligations in full without realisation of collateral, regardless of the existence of any past-due amount or of the number of days past due. iii) Any exposures to a credit-impaired borrower. For these purposes, a borrower should be deemed as credit-impaired where he has been the subject of an insolvency or debt restructuring process due to financial difficulties within three years prior to the date of origination or he is, to the knowledge of the institution at the time of inclusion of the exposure in the securitisation, recorded on a public credit registry of persons with adverse credit history, or other credit registry where a public one is not available in the jurisdiction, or he has a credit assessment by an ECAI or a credit score indicating significant risk of default; iv) Any transferable securities, as defined in Directive 2004/39/EC (MIFID) or derivatives, except derivatives used to hedge currency and interest rate risk arising in the securitisation. In addition, the original lender should provide representations and warranties that assets being included in the securitisation are not subject to any condition or encumbrance that can be foreseen to adversely affect enforceability in respect of collections due.	that are current but are on "watch" status, obligors that benefit from forbearance, etc) would be useful to CRAs.
6. At the time of inclusion, the underlying exposures are such that at least one payment has been made by the borrower, except in the case of securitisations backed by personal overdraft facilities and credit card receivables	This criteria could exclude trade receivables from being qualifyin/simple. The exemption of at least one payment for credit card receivables would be an introduction of a looser standard than that applicable in the US.

PILLAR 2 (STANDARD SECURITISATION)

CRITERIA	MIS COMMENT
7. The securitisation should fulfill the CRR retention rules (Article 405 of the CRR).	
8. Interest rate and currency risks arising in the securitisation should be appropriately mitigated and any hedging should be documented according to standard industry master agreements. Only derivatives used for genuine hedging purposes should be allowed.	Derivatives should also be market standard (i.e. presence of willing 3rd party replacements- so no total return swaps). What constitutes "appropriately mitigated" should be explained further.

9. Any referenced interest payments under the securitisation assets and liabilities should be based on commonly encountered market interest rates and may include terms for caps and floors, but should not reference complex formulae or derivatives.	
10. The transaction documentation of those transactions featuring a revolving period should include provisions for appropriate early amortisation events and/or triggers of termination of the revolving period, which should include, at least, each of the following: i) A deterioration in the credit quality of the underlying exposures; ii) A failure to generate sufficient new underlying exposures of at least similar credit quality; and iii) The occurrence of an insolvency-related event with regards to the originator or the servicer.	
11. Following the occurrence of a performance-related trigger, an event of default or an acceleration event: i) The securitisation positions are repaid in accordance with a sequential amortisation payment priority, whereby the seniority of the tranches determines the sequential order of payments. In particular, a repayment of noteholders in an order of priority that is 'reverse' with respect to their seniority should not be foreseen; ii) There are no provisions requiring immediate liquidation of the underlying assets at market value.	
12. The transaction documentation should clearly specify the contractual obligations, duties and responsibilities of the trustee, servicer and other ancillary service providers as well as the processes and responsibilities necessary to ensure that: i) the default or insolvency of the current servicer does not lead to a termination of the servicing of the underlying assets; ii) upon default and specified events, the replacement of the derivative counterparty is provided for in all derivative contracts entered into for the benefit of the securitisation; and iii) upon default and specified events, the replacement of the liquidity facility provider or	Further details should be provided with respect to the replacement of the derivative counterparty and whether this is a contractual right to seek a replacement or requires the equivalence of real time substitution (and how the related costing of this would work).

account bank is provided for in any liquidity facilities or account bank agreements entered into for the benefit of the securitisation.	
13. The transaction documentation contains provisions relating to an ‘identified person’ with fiduciary responsibilities, who acts on a timely basis and in the best interest of investors in the securitisation transaction to the extent permitted by applicable law and in accordance with the terms and conditions of the securitisation transaction. The terms and conditions of the notes and contractual transaction documentation should contain provisions facilitating the timely resolution of conflicts between different classes of noteholders by the ‘identified person’. In order to facilitate the activities of the identified person, voting rights of the investors should be clearly defined and allocated to the most senior credit tranches in the securitisation.	
14. The management of the servicer of the securitisation should demonstrate expertise in servicing the underlying loans, supported by a management team with extensive industry experience. Policies, procedures and risk management controls should be well documented. There should be strong systems and reporting capabilities in place.	

PILLAR 3 (TRANSPARENT SECURITISATION)

CRITERIA	MIS COMMENT
15. The securitisation should meet the requirements of the Prospectus Directive.	
16. The securitisation should meet the requirements of Article 409 of the CRR and Article 8b of the CRA (disclosure to investors).	
17. Where legally possible, investors should have access to all underlying transaction documents.	
18. The transaction documentation should provide in clear and consistent terms definitions, remedies	

and actions relating to delinquency and default of underlying debtors, debt restructuring, debt forgiveness, forbearance, payment holidays and other asset performance remedies. The transaction documents should clearly specify the priority of payments, triggers, changes in waterfall following trigger breaches as well as the obligation to report such breaches. Any change in the waterfall should be reported on a timely basis, at the time of its occurrence. The originator or sponsor should provide investors a liability cash flow model, both before the pricing of the securitisation and on an ongoing basis.	
19. The transaction should be subject to mandatory external verification on a sample of underlying assets (confidence level of at least 95%) at issuance, by an appropriate and independent party or parties, other than a credit rating agency. Confirmation that this verification has occurred should be included in the transaction documentation.	
20. investors and prospective investors should have readily available access to data on the historical default and loss performance, such as delinquency and default data, for substantially similar exposures to those being securitised, covering a historical period representing a significant stress or where such period is not available, at least 5 years of historical performance. The basis for claiming similarity to exposures being securitised should also be disclosed.	The requirement for *readily available access to data on historical default and loss performance* could restrict access of new participants to securitisation.
21. Investors and prospective investors should have readily available access to data on the underlying individual assets on a loan-by-loan level, at inception, before the pricing of the securitisation, and on an ongoing basis. Cut-off dates of this disclosure should be aligned with those used for investor reporting purposes.	.
22. Investor reporting should occur at least on a quarterly basis. As part of investor reporting the following information should also be disclosed: - All materially relevant data on the credit quality and performance of underlying assets, including data allowing investors to clearly identify debt restructuring, debt forgiveness, forbearance,	

payment holidays, delinquencies and defaults in the pool; - Data on the cash flows generated by underlying assets and by the liabilities of the securitisation, including separate disclosure of the securitisation's income and disbursements, i.e. scheduled principal, scheduled interest, prepaid principal, past due interest and fees and charges; - The breach of any waterfall triggers and the changes in waterfall that this entails.	

ANNEX 2:

QUESTIONS FROM THE DISCUSSION PAPER

QUESTION 1? :Do you agree with identified impediments to the securitisation market?

MIS broadly agrees with the impediments identified by the EBA. First, the securitisation market has yet to replace the exits of a large segment of formerly active investors. Second, we understand that the anticipated regulatory cost imposed on the remaining EU investors (when compared to other asset classes, particularly covered bonds) also diminishes the pure economic attractiveness of the product for both investors and originators. These costs are perceived by some to be both punitive (particularly compared to the treatment of other asset classes), complex and, given the pace of change, uncertain. Third, the infrastructure costs of investing in securitisation are relatively high; a particular barrier for smaller investors. Additionally, MIS believes that the slow macro-economic recovery across the euro area is affecting loan origination. This factor, combined with the continued balance sheet evolution of many EU banks, limits the volume of underlying assets available to be securitised. There is also a tension between providing investors with the return they appear to require given perceptions of financial risk (as well as regulatory costs), and the interest rates that can be charged to borrowers. This is likely to be particularly constraining the securitisation of SME assets, for which the information asymmetry between originator and investor is widest and therefore the risk adjusted returns required by investors make securitisation an uneconomic way of funding banks lending to SME obligors. The cost, complexity and volatility in regulation are as much a barrier for issuers, as for investors with the inconsistent treatment of securitisation across jurisdictions.

QUESTION 2: 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?

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?

MIS assigns ratings to transactions with various "default definitions". We see a number of benefits for our analysis of having a standard definition in line with Criterion 5 (ii) (i.e. more than 90 days past-due and debtor assessed as unlikely to pay):

(1) Performance measurement of the transaction should be comparable against that of the originator bank's balance sheet. The trend in Europe is to adopt a standard NPL measure.
(2) If (1) is achieved there is a greater alignment of interest of the bank as servicer and the performance of the deal. Banks normally service their own loan portfolio towards improving balance sheet metrics. Hence, if both bank and securitisation metrics are comparable there is a better incentive for the bank to do a better servicing on the securitised assets.
(3) Having a comparable default definition across transactions and across jurisdictions (e.g. Europe wide) at an originator level makes benchmarking easier for the benefit of investors. As a by-product it may provide support to the possibility of pooling loans from different jurisdictions.

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?

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?

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?

This would be of assistance to CRAs.

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 level of granularity and concentration of a certain portfolio drives the approach MIS follows when determining the range (distribution) of default rate scenarios (or loss scenarios). For example, as a general rule we assume a stylised distribution of defaults (formula) for granular portfolios, while we run simulations to generate the distribution for non-granular portfolios.

The pool granularity is a relevant factor in our analysis when determining the distribution of default scenarios of a portfolio. Everything else being equal, a low granularity level generally increases the probability of high default rate scenarios.

In addition to obligor concentration, in the Paper there is no mention of industry sector concentration, which is a particularly relevant factor we look at when analysing transactions backed by lending to corporate obligors (whether SMEs or large corporate).

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?

See Annex 1

QUESTION 9: Do you envisage any potential adverse market consequences of introducing a qualifying securitisation framework for regulatory purposes?

QUESTION 10: How should capital requirements reflect the partition between qualifying and non-qualifying?

QUESTION 11: 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?

QUESTION 12: Considering that rating ceilings affect securitisations from certain countries, how should the calibration of capital requirements on qualifying and nonqualifying securitisations be undertaken, while also addressing this issue?

This could be addressed through the CRA being more transparent about the impact of the ceiling on the rating.

ANNEX 3

Governance Factors in Qualifying/Simple Securitisation

Willingness and alignment of interest of key parties: The behaviour of transaction parties in ways not initially envisioned can alter the distribution of cash and the performance of assets in a securitisation transaction, giving rise to unanticipated outcomes. Although risk retention rules implemented in the US and EU[7] will go some way to address this issue, it remains that a financially weak originator may overly rely on securitisation because funding alternatives are limited, uncertain or unstable. Alternatively, a transaction party may depend minimally on the securitisation market and therefore not feel its reputation is at risk in a transaction.

Legal and regulatory framework: Legal risk in a securitisation transaction is a function of the probability that the transaction will be subject to a legal challenge, and that such a challenge will have a material impact on the fulfilment of the transaction's promises. In a new market, the legal framework governing asset transfer, issuer solvency and other important aspects of the transaction may have a history of less than five years, not be clearly understood and/or be untested in court. Alternatively, the legal framework may be quite complex and nuanced, making it difficult to predict the likely outcome with accuracy. The ramifications of a key transaction party, such as an originator filing for bankruptcy, may be unknown. Although established markets are not immune from new legal challenges, as markets become more established, frameworks are often tested and more clarity on outcomes are available.

Complexity: Whilst infrequently seen, complex structures or means of analysing a transaction lead to a loss of an intuitive understanding of precisely how the transaction will work. In complex structures, it may be quite difficult to understand how collections will be allocated. The mechanism that governs the allocation of collections (the waterfall) may have numerous steps, especially in the instance of *pari passu* and sequential classes, or multiple issuances through a single issuer. In addition, the waterfall may have an element of conditionality, leading to unpredictable outcomes if certain performance triggers are breached.

Experience and ability of transaction parties: A transaction may not work as its designers initially contemplated if a transaction party (1) is ineffective in performing important tasks or (2) fails to perform its duties due to termination or disruption of its operations resulting from a bankruptcy. In addition, one or more of the transaction parties may have minimal experience securitising the particular asset class or lack the resources to perform its duties successfully. However, many securitisation transaction participants have reduced their exposure to transaction parties through the use of triggers that require replacement of a party when its credit quality deteriorates below a certain level. Furthermore, a few European transaction parties have entered into insolvency, leading to more information being available on the likely impact of insolvency on securitisation transactions.

[7] See Moody's Special Comment: Select Regulatory Developments. www.moodys.com/research/Select-Regulatory-Developments--PBS_SF344698