VDA Verband der Automobilindustrie

Comité des Constructeurs Français d'Automobiles

AKA Arbeitskreis Autobanken

Position Paper

On EBA Discussion Paper on simple standard and transparent securitisations EBA/DP/2014/02, 14 October 2014

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Impact on refinancing of automobile captives and the real economy

The ***Comité des Constructeurs Français d'Automobiles*** (CCFA) and the ***Verband der Automobilindustrie*** (VDA) represent the leading companies of the automotive industry in the UK, France and Germany.; and the AKA represents the automotive captives in Germany.

The Captives are an indispensable partner for the vehicle manufacturers in the marketing of passenger cars and commercial vehicles. Each year about 12 million new passenger cars are registered in the European Union. Approximately 60 % of the cars sold are either financed or leased with a significant proportion of the finance being provided by the Captives. Automobile finance and leasing companies ensure that the automotive value chain runs smoothly.

In order to provide customers and car dealers with sufficient funding, the Captives depend on a solid refinancing strategy themselves. In this regard, the securitisation of customer receivables – so-called Auto-Asset Backed Securities (Auto-ABS) – is a vitally important financing tool for the Captives. It allows for diversification by providing an alternative funding source to deposits, bank loans and other capital market instruments and offers valuable protection against market volatilities.

Against this background we welcome the opportunity to comment on the EBA Discussion Paper on simple standard and transparent securitisations. Due to the US subprime crisis, securitisations have suffered from a general stigmatisation. Yet the ABS class is fairly heterogeneous, and EBA quite rightly points out in the executive summary of the discussion paper that the performance of securitisations during the crisis varied substantially across different asset classes and regions. We agree with EBA that therefore, a "one-size-fits-all regulatory approach to securitisations appears to be no longer appropriate".

Moreover, the European Commission has acknowledged that securitisations can play a crucial role in the Long-Term Financing of the European Economy. In the delegated acts to the liquidity coverage requirements for credit institutions adopted on 10 October 2014, the European Commission stated that certain types of asset backed securities such as high quality prime Auto-ABS will qualify as High Quality Liquid Assets and will thus be eligible within liquidity buffers for credit institutions.

Since the crisis, a number of regulations have been put in place in order to modify and enhance the rules regarding ABS. New regulations such as Basel 2.5, CRD II and III in Europe have introduced multiple safeguards and improvements for investors and have increased the level of confidence in ABS.

However, the European securitisations market in total still does not show a "substaintial recovery". Therefore, the European Commission has decided to work on the differentiation of high quality securitisation products as well as cooperating with international standard setters like the Basel Committee and the International Organisation for Securities Commissions (IOSCO) in order to develop common standards that allow for the establishment of sustainable securitisation markets.

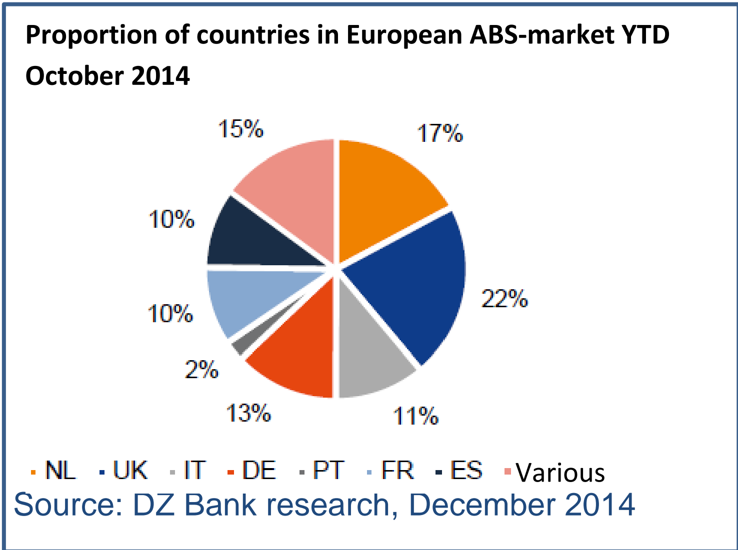
The development of an EU framework for high-quality securitisation is among the top priorities of the new Commissioner for financial services, Lord Hill, in order to create an ambitious capital markets union that encourages long term investment, innovation, jobs and growth.

With our comments to the EBA consultation paper we would like to support this aim.

A. General Comments

We welcome the efforts to develop quality criteria for simple, standardised and transparent securitisations in general. However, we feel that the proposed criteria are far stricter than what the European Commission may have envisaged. In total, EBA suggests 22 criteria with numerous further sub-criteria with regard to securitisation as well as three criteria with sub-criteria for securitised exposures.

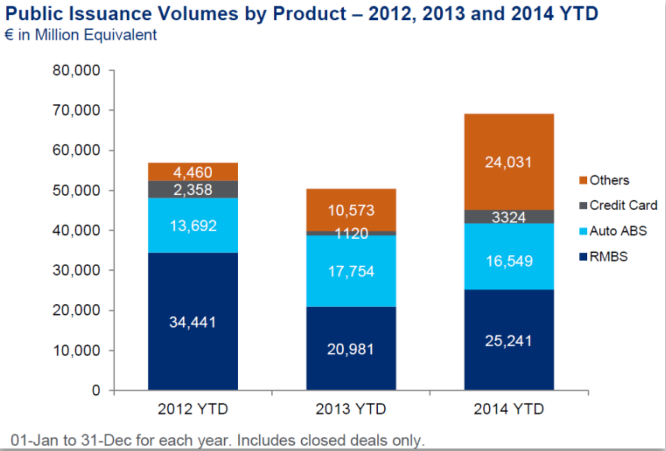
We would like to point out that the development of new quality criteria for securitisations should, from our point of view, be based on an encompassing perspective of the European securitisation market. According to the discussion paper, the UK is the most important market, followed by the Netherlands, Spain and Italy. France or Germany, however, have not been mentioned as relevant markets. We therefore would like to draw your attention to a recent study from DZ Bank research from October 2014. The study indicates that while UK was indeed the most important market with a share of 22 %, followed by the Netherlands with 17 %, Germany and France had a proportion of 13 % and 10 % respectively.



Source: DZ Bank research, December 2014

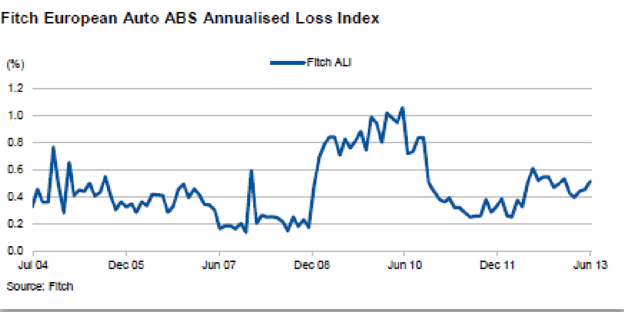
As regards Auto-ABS in particular, we feel that the importance and the quality of prime Auto-ABS should be properly acknowledged. The paper gives the impression

that Auto-ABS does not play any role in the securitisation market but only RMBS followed by SME securitisations are the dominant asset classes. Yet this does not take into account that Auto-ABS, apart from RMBS, is the only asset class with fundamental meaning for the public European securitisation market. The share of publicly placed Auto-ABS has increased over the last couple of years from 24.9% in 2012 to 30.1% in 2014 with an issuance volume of 16.5 billion euros.



Relevance of Auto-ABS for the securitisation market

Auto-ABS with auto loans as underlying assets enjoy a strong reputation with investors. Thanks to low default rates and high granularity, public Auto-ABS is assessed as a particularly low-risk investment that can be liquidated at short notice. Even during the financial crisis, European Auto-ABS proved to be extremely crisis-resistant and did not cause investors to suffer any losses. In detail, Auto-ABS are characterised by the following features:



Historical losses of Auto-ABS

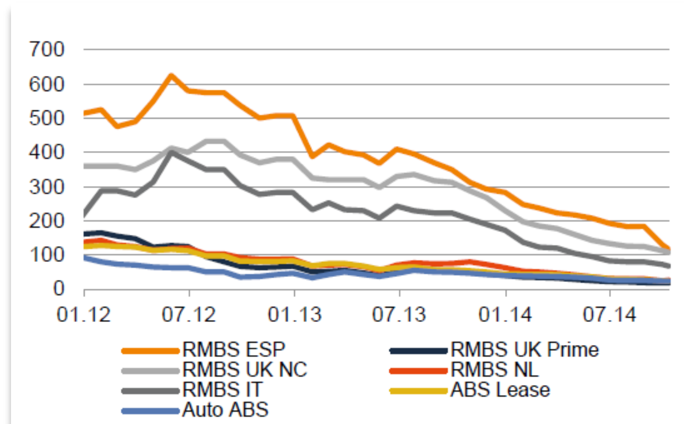
Sustainable low loss levels

Throughout the crisis Auto-ABS suffered only a modest increase of the absolute loss level from 0.4% to 0.8%, returning to 0.5% thereafter. This is well below the rating agencies' best case assumptions starting at 1.2% and the credit enhancement levels starting at 6% for A(sf) and 9% for AAA(sf) for the top quality issuers. The bottom line of these facts is that there has been no reason for Auto-ABS investors to sell their paper due to performance reasons.

Spread development for Auto-ABS

The quality and the reward of perceived simple, transparent and standardized top quality Auto-ABS by investors is reflected in the extreme low and stable spreads for triple A rated Auto-ABS.

Triple A spreads in Europe in basis points:



Source: DZ Bank research, December 2014

Historical Performance of European Auto-ABS

To demonstrate the high quality of Auto-ABS we have enclosed a table that shows for European Auto-ABS based on an analysis of Fitch Ratings Global Structures Finance, which set out the rating migrations to CC or worse between 1996 and 2012 – the very good performance of European Auto-ABS.

Downgrades to CC and below within one year - Fitch Rating (1996 - 2012)	
AAA	0,00%
AA	0,00%
A	0,00%
BBB	0,53%
BB	0,93%
B	8,00%
CCC	33,33%

Even subordinated junior A-tranches have never experienced a downgrade to CC or below.

B. Comments to Consultation Paper

Before we move on to discuss the questions contained in the consultation paper we would like to make some preliminary points.

Firstly, we think that it is extremely important that whatever the final criteria are, it is going to be essential that there is a fast and effective method for deciding SST qualification. If investors do not know whether a transaction meets the SST criteria or not at the point of offer then assuming such classification brings meaningful benefits they will not be able to buy. This could undermine the entire SST initiative and is therefore something which is very important to look at. It seems to us that it will never be acceptable for originators/issuers to self-certify SST qualification and we cannot see how it would be possible for investors to make this determination so it must be the case that an independent third party will need to be appointed for this purpose.

Secondly, we think it is important that the SST criteria should also apply to **private, bi-lateral securitisation transactions** because these also play a very important role in funding the European real economy and it is not altogether clear from the consultation paper that these are in scope (see for instance the Prospectus Directive requirement). In our view they must be eligible for SST qualification. The same also applies to ABCP which in turn funds many securitisation transactions.

Finally, please be assured that we strongly support the Simple, Standard and Transparent initiative. We admire the foresight of the European Union in launching this initiative to safeguard an asset class which brings tremendous benefits to European citizens.

Further we highly appreciate and welcome the work to this very difficult task by EBA on this topic in order to find appropriate criteria for securitisations that are from a structural point of view “High Quality” and in line with established market standards of securitisations already perceived as simple, transparent and standardised by investors and honoured by high demand and low spreads. We are fully committed to help develop a workable solution that combines the ambition of defining structural high quality criteria and the need and reflection of a well-established Auto-ABS market standard and hence would welcome further exchange with EBA. In principle, we agree with the criteria but see some need for adaption in detail to avoid an exclusion of Auto-ABS as “qualifying securitisations”.

The following consultation responses are provided in good faith and from the position of wanting to promote high quality securitisation for the good of the automotive sector and the European real economy.

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

Answer:

Overall yes – However, from our point of view the regulatory impediments are the most eminent ones. From the market side we don't see impediments for Auto-ABS which is perceived as simple, transparent and standard ABS by the investors with an outstanding track record of more than 15 years in Europe. Thus, while we support greater transparency we refute that there has ever been a lack of transparency in mainstream European Auto-ABS originated by the Captives and therefore we do not agree that a lack of transparency has been a major impediment to investment in our European Auto-ABS transactions. A great deal of information is made available to investors in our prospectuses and investor presentations to properly inform investment decisions. Our asset class has always performed extremely well and no investor in Europe has ever suffered a loss.

For the time being, rule makers in Europe send two signals that contradict each other. On the one hand, the evolution of the securitisation market shall be promoted to enhance the funding of the real economy. On the other hand, the regulatory requirements and frameworks will be significantly tightened more than 7 years after the outbreak of a financial crisis caused by problems in the subprime RMBS segment in the United States. There are the following obstacles that will impede the evolution of the European securitisation market if rule makers do not review the criteria for "qualifying" securitisations.

- The capital requirements for top high quality securitisations with triple-A-rating such as Auto-ABS that never have suffered any losses shall be more than doubled. The floor shall increase from 7% to 15% for investors that are IRB-credit institutions. However, most of the banking investors are IRB credit institutions, because only these credit institutions usually have the resources to perform in-depth due diligence.
- Likewise, EBA proposes a floor of 15%. This means, that the doubling of capital requirements compared to the current situation would not be revoked although the performance of European High Quality securitisations such as Auto-ABS, which was outstanding even during the last financial crisis, would justify abstaining from increasing the Basel II-floor of 7%. Compared to Covered Bonds having a risk weight of 10% this means a 50% higher capital requirement which will amplify the distortion between High Quality Securitisations and Covered Bonds.
- At the same time the deal economics will deteriorate, because up to date no Auto-ABS fulfils the proposed EBA criteria completely. This applies both for the non-impairment requirement for the underlying securitised loans and leasing contracts according to the delegated acts to the LCR and to Solvency II, but also for the non-impairment requirements of EBA's Discussion Paper that are similar to the requirements of the delegated acts but not equal. Thus,

modifications will be necessary to be eligible as "qualifying securitisation". Especially, the non-impairment requirement for the securitised auto loans and auto leases will have major detrimental impacts on the further evolution of the Auto-ABS market if the non-impairment requirements for the securitised loans and leasing contracts should not be adapted to be in line with successfully established market standard. This would be very regrettable because the performance of the underlying securitised assets of Auto-ABS based on common market standard was at all times excellent. Currently, common market standard for Auto-ABS is that only those auto loans and auto leasing contracts are eligible for Auto-ABS being not delinquent. This is simple, objective and has proved to be very successful to ensure high quality of underlying securitised loans and leasing contracts. Thus, at least as an alternative, this well established strict, simple and objective eligibility criterion should be permitted instead of using external or internal scores.

- Further impediments might result from the fact that, as a consequence of the final published Securitisation Framework of the Basel Committee, many IRB credit institutions could be virtually forced to use the External Ratings Based Approach. In particular, this could be the case if it is too expensive for these credit institutions to develop own IRB models. In such a case, the risk weight increases from 7% to 20%. This is almost a triplication of the capital requirements for high quality securitisations. The reason for the 20% risk weight is that the conditions to calculate the tranche maturity based on the average weighted life are so strict that virtually all securitisations will have to calculate the tranche maturity based on the final legal maturity which is usually not less than 5 years even if the average weighted life of the contracts is only about 2 years. For this kind of credit institution it could become uninteresting to further invest in ABS. This could diminish the investor basis. Thus, it is important that the floor in the External Ratings Based Approach will be reduced to 7% for top High Quality Securitisations to avoid that such investing IRB credit institutions will suffer from higher capital requirements. In any case the discrimination against the capital requirements of Covered Bonds must be avoided.
- The relative capital requirements under Solvency II for securitisations compared to other asset classes e.g. Covered Bonds are too high. This applies even for recognised high quality Type 1 securitisations. Thus, from an economic point of view it could be unattractive for insurance companies to further invest in Auto-ABS. For High Quality Junior Bonds with single A-Rating the capital requirements are even prohibitive. Although the historical loss ratio of single A-rated Auto-ABS in Europa have been 0%, insurance companies will be required to hold 80% capital when the bond has duration of 5 years. As a consequence insurance companies will no longer invest in junior bonds although the risk-return profile is very favourable. This will increase the funding costs and impede the deal economics significantly.
- If the current draft of the EU regulation by the EU commission on structural

measures improving the resilience of EU credit institutions, which envisages a separation of Core Credit Institutions and Trading Entities comes into force as proposed then this might have negative repercussions on the securitisation market, because the amortising swaps that are required to create floating rate ABS virtually can only be offered by the separated Trading Entities. Floating rate ABS are very important for its marketability, because the interest rate risk is transferred to the swap counterparty with the result that the prices of the asset backed securities are very stable which in turn is important for the liquidity of the instrument. If the draft regulation is not amended then a decrease of potential counterparties might to be expected as a consequence. There are already first signals that many credit institutions would seek to avoid a separation of their business activities and would stop business which would entail a separation of their business activities. Hence, the number of potential counterparties would decrease further. Already today, the number of potential counterparties is limited.

- The liquidity of ABS is very important for its marketability and attractiveness. Market makers play an important role to ensure liquidity of Auto-ABS. The new regulation on the separation of business activities envisages restrictions which might reduce the number of market maker.
- Although the capital requirements for Auto-ABS in the trading book were reduced in the recent consultative paper on the fundamental review on the trading book compared to the last consultative paper, we expect increasing capital requirements for Auto-ABS in the trading book. This could entail significant decline in the trading of Auto-ABS with potential negative repercussion on Auto-ABS and its liquidity.
- According to the draft by the EU Commission on the Money Market Funds Regulation from September 2013 that is currently debated by the experts of the EU Parliament and the European Council money market funds shall be banned to invest in Auto-ABS. Unless amended, this shall even apply if the Auto-ABS are eligible as High Quality Liquid Assets according to the delegated act to the LCR

Against this background there is high uncertainty how these regulations that have not come into force yet will affect the demand on Auto-ABS. We fear that the regulatory tightening will reduce the investor basis, which will negatively affect the depth and scale of the Auto-ABS market und thus the spreads and finally the deal economics.

Further uncertainty results from the adoption of the delegated acts to the LCR and Solvency II. In order to save the value of their investments investors are beginning to require Auto-ABS that are conform to the requirements of the delegated acts to the LCR and Solvency II as High Quality Liquid Assets and High Quality Type 1 securiti-

sations, respectively.

We assume that this trend will increase in the next months. However, due to partially vague legal requirements it is currently unclear how to interpret and implement these requirements. Thus, it is currently not feasible for originators to meet investor's expectations as to the LCR and Solvency II conformity. In the next future, this might entail reservations of potential investors to invest in Auto-ABS because price discounts are to be expected on the stock exchange if Auto-ABS should not be eligible as High Quality Liquid Assets and High Quality Type 1 securitisations according to the delegated acts to the LCR and Solvency II.

This problem is particularly striking as to the non-impairment requirement for the securitised loans and leasing receivables. Instead of simply exclude all loans and leasing receivables that are in default, that show evidence of impairment according to the accounting rules (IFRS) or that are delinquent and past due, respectively, that is simple and common practice for high quality Auto-ABS, in future all loans and leasing receivables shall be excluded that represent "significant risk" based on an internal or external score. However, it is currently fully unclear when a risk is "significant" and under which conditions an internal or external score can be used.

Furthermore, it is unclear, for example, what is meant by "adverse history" and how long it goes back. Also in the discussion paper there are no specifications that enable originators to implement the non-impairment requirement. It is beyond controversy, that impaired receivables should be excluded to ensure high quality of the securitised receivables. However, the non-impairment definition should also be specified that high-quality securitisations that are well-established in the market and in which the historical loss of the underlying assets were low, can fulfil them.

Thus, at least as an alternative to the use of internal or external scores to exclude loans and lease receivables with "significant risk" is should be permitted to exclude all loans and lease receivables that are delinquent and past due, respectively.

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?

Answer:

No comment.

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?

Answer:

No comment.

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?

Answer:

Yes. Jurisdictions should be limited to those that are widely acknowledged to have the infrastructure required to support sophisticated financial transactions. The list of eligible jurisdictions should be quite wide so as to be inclusive and not cut off European investors from issuers from outside of Europe. However, jurisdictions with inadequate legal systems or suffering from long term political instability (for instance) should be excluded as to do otherwise would undermine the very essence of what the SST framework is meant to achieve.

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?

Answer:

To answer to the question whether the distribution of voting rights to the most senior tranches in securitisation conflict with any national provision is not feasible at present without having qualifying legal opinions by qualified law firms.

This said, we refuse such distribution because the holder of the junior bonds would be disadvantaged. This might have a significant adverse effect on the marketability of the junior bonds. Without marketability of the junior bonds merchantability of the whole ABS transaction might be casted in doubt. This would be contrary to the aim to promote the expansion of the securitisation market.

If despite the reservations put forward as to the conferment of voting rights to an "identified person" are pursued then it is to ensure that these voting rights are limited to the case of the occurrence of an insolvency or default event. Furthermore, the holders of the junior bonds ought to be included for this case to ensure the protection of their interests, because they bear the main risk and might be more interested than the senior bond holders to maintain the value of the securitised receivables. Otherwise the marketability of the junior bonds might be endangered due to the structural misalignment of interests. As a consequence, the spreads for junior bond holders would significantly increase.

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?

Answer:

No to both questions. In particular, disclosing transaction documentation prior to issuance would only create uncertainty and confusion amongst investors, and encourage debate and negotiation around documents that had already been concluded. Such disclosure would be extremely detrimental to the issuance process and induce a paralysis that would make it impossible to close a transaction. In the case of public ABS, a comprehensive summary of the main transaction documents is provided in the prospectus.

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?

Answer:

We believe that the threshold is appropriate for retail transactions. However, the requirements with respect to the group of connected clients should be softened a little bit in a way that this applies “according to the best knowledge” of the originator. The reason is that there are partly thresholds in the retail bulk business for the identification of a group of connected clients to reduce the workload. Such practice does not endanger the identification of single risks but could entail that small exposures might not be identified to belong to a group of connected clients. Although it is very unlikely that the granularity threshold would be exceeded, it cannot be fully excluded that very few cases could exist that exceed the granularity threshold. In order to avoid that in such case a securitisation would not be eligible as “qualified” the wording should be softened as proposed.

With respect to wholesale transactions such as the securitisations of receivables from car dealers the threshold is too low. Thus, a significantly higher threshold must be envisaged.

In general, a further discussion on this topic is needed.

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?

Answer:

In principle, we agree with the criteria. However, we see some need to adapt the criteria in detail to avoid an exclusion of well-established and marketable Auto securitisations as "qualifying securitisations" that from investor's perspective already meet the requirements for simple, standardised and transparent securitisations. If these criteria were not adapted to reflect market specifics, we would expect negative repercussions on these kinds of securitisations because they would not be eligible as “qualifying”.

In particular, it is necessary to adjust the non-impairment requirements for the loans and lease receivables (see below).

In addition, we think that it might be useful to consider a qualitative assessment of the originator and servicer, e.g. an assessment based on what type of institution it is, whether it holds a banking licence, it is subject to oversight from a regulator, it is owned by a large manufacturing group or whether it has been originating loans of the type being securitised for many years.

Pillar I: simple securitisations

Criterion 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)).*

EBA Rationale:

Simple securitisations should only include those transactions that are referred to in the EU regulation as ‘securitisations’, i.e. those transactions for which: i) payments depend on the performance of underlying assets and, ii) the tranching of credit risk determines the distribution of losses during the on-going life of the transaction. As mentioned previously, the criteria proposed in this paper regard term securitisations only; ABCP, while meeting the CRR definition of securitisation, are out of the scope of the criteria proposed in this paper.

In addition, simple securitisations should be traditional securitisations, i.e. they should imply a legal and economic transfer of the securitised assets either through transfer of ownership to an SSPE or through sub-participation by an SSPE. The transfer of the assets to be securitised ensures that securitisation investors have recourse to those assets should the SSPE not fulfil its payment obligations. Such recourse cannot be granted in non-traditional transactions, i.e. synthetic transactions, due to the fact that only the credit risk associated with the underlying assets, rather than the ownership of such assets, is transferred to the SSPE. In addition, most synthetic structures add to the complexity of the securitisation in terms of counterparty credit risk and risk modelling.

Re-securitisations have been structured in the past into highly leveraged structures where lower credit quality notes could be re-packaged and credit enhanced, resulting in transactions where small changes in the credit performance of the underlying assets severely impacted on the credit quality of the re-securitisation bonds. The modelling of the credit risk arising in these bonds proved very difficult, also due to high correlations arising in the resulting structures. For these reasons re-securitisations should not be considered as simple securitisations.

Comment:

As to term Auto-ABS transaction, we agree.

However, it should be possible that Auto-ABCP's can qualify to be eligible as "qualifying securitisations" as well. In the case of Auto-ABCP programs there is typically one SPV that purchases the auto loans and/or auto leases and that securitises these loans and leases by the issuance of Auto-ABS. These Auto-ABS are transferred to a second SPV to back the ABCP's issued by the second SPV with High Quality Auto-ABS. It should be clarified that the mentioned cases are not excluded due to the "non-re-securitisation" requirement, because this kind of structure is necessary to back the ABCP's with High Quality Auto-ABS.

Criterion 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.

EBA Rationale:

The payments of simple securitisations should depend exclusively on the performance of the underlying assets: active portfolio management adds a layer of complexity and increases the agency risk arising in the securitisation by making the securitisation's performance depending on both the performance of the underlying assets and the performance of the management of the transaction. Replenishment practices and practices of substitution of non-compliant exposures in the transaction do not configure as active management of the transaction provided that they do not result in any form of cherry-picking.

Comment:

Agreed.

Criterion 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 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.

EBA Rationale:

Simple securitisations should achieve ring-fencing and segregation of the securitised assets from an insolvent originator's estate through a true sale process; furthermore no provisions should be incorporated which facilitate the reversion of the true sale. Risk analysis and due diligence analysis by investors become too complex in the presence of severe clawback provisions threatening the enforceability of the investors' claims over the underlying assets.

Comment:

None at present.

Criterion 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.

EBA Rationale:

Simple securitisations should include underlying exposures that are standard obligations, in terms of rights to payments and/or income from assets.

The exposures that are to be securitised should not belong to an asset class that is outside the ordinary business of the originator, i.e. an asset class over which the originator may have less expertise and/or interest at stake. The quality of the securitised exposures should not be dependent on changes in underwriting standards and only exposures underwritten to consistent standards should be in the pool.

Simple securitisations should only rely on underlying assets arising from legally enforceable obligations: as such, they should not include assets arising from obligations vis-à-vis special purpose entities, against which enforceability is more complex.

In addition, in order to mitigate refinancing risk and the extent to which the securitisation embeds maturity transformation, the assets to be securitised should be self-liquidating assets. Simple securitisations should mainly rely on the principal and interest proceeds from the securitised assets to repay investors. Reliance on refinancing and/or asset liquidation increases the liquidity and market risks to which the securitisation is exposed and makes the credit risk of the securitisation more difficult to model and assess from an investor's perspective. Partial reliance on re-financing (future borrowing) or re-sale of the asset securing the exposure may occur provided that re-financing is sufficiently staggered within the pool and the residual values over which the transaction relies are sufficiently low.

Comment:

Homogeneous in terms of asset type: It should be clarified that the securitisation of corporate and retail exposures in one transaction is not excluded by this requirement.

iv) (a): <u>Only as to Auto-ABCP's</u>: In typical Auto-ABCP structures with two SPV's where one SPV transfers High Quality Auto-ABS to a second SPV to back the ABCP's, it should be permitted to avoid a general exclusion of such Auto-ABCP's that the second SPV has recourse to the first SPV if the first SPV comply with criterion iv) (a).

<u>iv) (b) Residual value risk:</u> In the absence of detailed clarification we are concerned that criterion 4 iv) may preclude the securitisation of retail auto loans in some member states where it is customary to allow the customer to satisfy the final balloon instalment of the loan by returning the car – this is a common feature of hire purchase in the UK and in many other European Member State markets. If this were the practical outcome of criterion 4 iv) it would place some Member States and their citizens at a disadvantage to others and would therefore fall short of the basic requirements of "good" regulation, i.e. a fair and even treatment of all affected EU citizens.

There have been already intense deliberations during the preparation of the delegated act to the LCR. Thus, the wording should be adapted to the wording of Article 13 (3) of the delegated act to the LCR. In the phrase "on the basis that the repayment necessary to repay the securitisation 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" the words "in

whole or in part, to be substantially" should be replaced by the words "to be predominantly" to be consistent to the wording in the delegated act to the LCR. Otherwise, many Auto-ABS could be excluded**.**

Criterion 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 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.

EBA Rationale:

At the time when they are structured, simple securitisations should not be characterised by underlying assets whose credit risk has already been affected by negative events such as lender/borrower disputes or default events, as identified by the EU prudential regulation. Risk analysis and due diligence assessments by investors become more complex whenever the securitisation includes exposures subject to ongoing negative credit risk developments. For the same reasons, simple securitisations should not include underlying exposures to borrowers that have a history of credit impairment.

Transferable financial instruments add to the complexity of the transaction and to the complexity of the risk and due diligence analysis to be carried out by the investor.

The same applies to derivative instruments, except in the case where these instruments provide genuine hedging of the interest and currency risks arising in the transaction. Hedging derivatives enhance the simplicity of the transaction since hedged transactions do not require investors to engage in the modelling of currency and interest rate risks.

Comment:

No. 5 iii) Non-impairment requirements: The definition of credit-impaired borrowers to be excluded is still unclear. Without further specification, it will not be feasible to issue Asset Backed Securities that fulfil the criteria. This is a very critical point. In addition, it should be re-considered from a conceptual point of view whether these requirements should not be part of the credit risks.

Problems:

It is unclear when a credit assessment by an ECAI or a credit scoring indicates a significant risk.

In addition, it is not clear whether external credit assessments and internal credit scorings can be used alternatively or whether they have to be used in combination. The wording would allow both interpretations. The latter would be linked with significantly high additional costs.

Further, it is unclear which ECAI's and which credit scorings could be used under which conditions. Many originators of high quality ABS still use the credit standardised approach and thus have no IRB approval by the supervisory authorities although they have scoring procedures and models in place that are validated annually and that are comparable to those of IRB credit institutions and that have a significantly better discriminatory power than the scoring and rating procedures of ECAI's.

Although the assessments of ECAI's are often used in the credit process as additional piece of information, especially, if the internal score does not indicate a "green" case, they are often not used for the credit standardised approach, and hence the requirements of the CRR to use the assessments of ECAI's are not implemented yet. The reason is that the costs would be too high due to the fact that the external ratings or scorings would have to be applied worldwide consistently. In addition, it has to be noticed that it is intended by the EU to reduce the dependency on external ratings. However, the new requirement would increase the dependencies on external ratings and scorings, respectively again.

To ensure comparability across Europe of "significant risk", a PD-threshold would have to be determined. The use of Scoring and PD-models implies model risks. The same problems exist with respect to model risks for ECAI-scores. In addition, it has to be noted that the default definition in Europe has not been harmonised yet. In some countries of the European Union such as Italy, for instance, a borrower is first deemed to be in default after more than 180 days. This means that the PD's of those countries that use the more than 90 days past due criterion are more conservative and thus not comparable with those based on 180 days. As a result, ABS from coun-

tries which have implemented the default definition on the basis of more than 90 days past due would be discriminated against the ABS of countries that have implemented the default definition based on more than 180 days past due, because the PD's of one and the same portfolio would be higher on the basis of the default definition based on more than 90 days past due. As a result, based on the default definition of more than 90 days past due more borrowers would have to be excluded than based on the default definition based on more than 180 days past due as "significant risk".

For the time being, many high quality securitisations are not based on ECAI-assessments or internal credit scoring but on the non-overdue status. Accordingly, all underlying exposures that are overdue at the time of the selection (pool-cut) or additionally in case of replenishment after incorporation at any time after issuance are excluded from the selection. In future, this proved and tested processes which have ensured low losses of the underlying assets from securitisations even in crisis times would have to be changed.

Further, it is not clear under which conditions and how long a credit history is deemed adverse or not adverse anymore after a company has recovered or a private person is able to pay after a phase of unemployment. Such requirement would especially prevent the recovery of SMEs after an economic downturn due to increased financing costs even if the company has good credit quality in the meantime.

Moreover, companies, such as SMEs, that have recovered after an insolvency or debt restructuring process should not be excluded if they are not impaired any longer according to the applicable accounting rules. Even according to the accounting rules, it has to be assessed after a recovery whether the borrower is still credit-impaired. If this is the case, then such loans would have to be exempted from the securitisation of high quality ABS. According to the current proposal such borrowers would be excluded for three years notwithstanding the current creditworthiness which would be detrimental to the recovery of such companies. In addition, it should be clarified that only those borrowers should be excluded based on a "debt restructuring process" where the "debt restructuring" is recorded on an "official" register or where the originator has knowledge on the "debt restructuring process". The reason is that it can be difficult to obtain knowledge of "private debt restructuring process" with third parties.

Finally, it will be difficult to implement the requirements because the required information is not stored in a structured manner in the IT-systems that technically could support the exclusion of the loans defined as credit-impairment according to a new definition that significantly deviates from the credit-impairment definition according to the accounting rules. Thus, it is unclear how to exclude such borrowers and lessees that are not credit-impaired any longer according to the accounting rules or in default and are serviced in the meantime in the normal course of business after their recovery, but to be excluded as credit-impaired according to this Discussion Paper and the delegated acts to the LCR and Solvency II. The required information to identify such borrowers is often only available in an unstructured manner in credit agency reports.

High granular ABS can comprise up to 90 thousands contracts. It is virtually impossible to check all these contracts manually.

As a result, many existing high quality ABS structures are not catered for the proposed non-impairment requirements, although existing eligibility criteria that mainly referred to the non-overdue status proved a high performance even under stressed conditions during the last crisis.

The effect of this would be that many issuers of Auto-ABS would be locked out of the market for a substantial period of time while they accumulated enough assets based on the new required underwriting standards. Any such issuance hiatus would be bad for European securitisation markets and could possibly result in investors leaving the market.

Proposed Solutions:

As an alternative, which should be at least eligible as well, we plead for objective minimum credit quality criteria already used that do not need further guidance and interpretation, that can be simply complied with and that are applied consistently across Europe to ensure a harmonised application of minimum credit quality criteria. Thus, we propose to exclude all exposures that are in default according to article 178 of Regulation (EU) 575/2013 ("CRR") or Basel II that are credit-impaired with objective evidence of impairment according to the relevant accounting standard or appendix A of IFRS 9 or that are overdue. The overdue status is a clear and objective indicator for credit quality to indicate "significant risk" that can be simply measured and that does not rely on any credit assessments or model risks. This would contribute to reduce reliance on the assessment of external credit agencies as well. In addition, it would facilitate the identification of the exposure to be excluded.

To consider a forward looking perspective and a prudent selection of the receivables to be securitised that are in line with existing business practices we propose the following:

In addition, only loans and leases are eligible to be securitised that would have to be accepted in the ordinary course of business if not securitised. To ensure a forward-looking perspective, the credit acceptance process has to be supported by an internal or external scoring or rating procedure.

To avoid any adverse selection the loans and leasing contracts originated according to the internal policy should be selected randomly from a target portfolio. By combining the past due status and by using an internal forward-looking acceptance scoring and rating procedure it would be possible to have a prudent procedure in place that would be in line with good market standards without excluding Auto-ABS from "qualifying" securitisations.

Criterion 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

EBA Rationale:

Simple securitisations should be structured so as to avoid that assets are included that are affected by fraud or operational problems. It is relevant to ensure that at least one payment has already been made by each underlying borrower, since this reduces the likelihood of the loan being subject to fraud or operational issues. Simple securitisations should minimise the extent to which investors are required to analyse and assess fraud and operational risk.

In the case of personal overdraft facilities and credit cards, where the inclusion of numerous new balances/card accounts (for which no payment has been made as of the time of inclusion) may be inherent to a common way of structuring and managing the securitisation transaction in a dynamic fashion, exposures with no payment are the common practice and should not be excluded as a safeguard against operational/fraud risks.

Comment:

Agreed. However, it is to be noted that under SEPA it is possible for customers to ask for payments to be refunded for a considerable period of time after the payment due date. The question of whether a payment has been made must therefore take this into consideration. Further, the question of whether a payment has been made must also allow for the way that the direct debit process works and payments should be regarded as "made" at the time that the originator sends the relevant direct debit file.

Pillar II: standard securitisations

Criterion 7:

The securitisation should fulfil the CRR retention rules (Article 405 of the CRR).

EBA Rationale:

Standard securitisations should ensure that originators'/sponsors'/original lenders' and investors' interests are aligned, i.e. the securitisation does not follow an originate-to-distribute model. The originate-to-distribute securitisation model, as highlighted in this discussion paper, is one of the features that mostly contributed to the bad performance of certain securitisation products.

Comment:

No comment at present.

Criterion 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.

EBA Rationale

Mitigating and/or hedging interest rate and currency risks arising in the transaction enhances the simplicity of the latter since it does not require investors to engage in the modelling of those risks and of their impact on the credit risk of the securitisation investment.

Comment:

No comment at present.

Criterion 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.

EBA Rationale

Standard securitisations should not make reference to interest rates that cannot be observed in the commonly accepted market practice. The credit risk and cash flow analysis which investors must be able to carry out should not involve atypical rates or variables which cannot be modelled on the basis of market experience and practice.

Comment:

Commonly accounted market interest rates: In the automobile business loans and leases are subsidised by the car manufacturers or car dealers to promote the sale of the cars. it should be clarified that loans and leases subsidised, for instance, by the manufacturer and/or the car dealer are not excluded, particularly given the fact that loans or leases e.g. with interest rate subventions show normally a lower default rate.

Criterion 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.

EBA Rationale

Standard securitisations should ensure that, in the presence of a revolving period mechanism, investors are sufficiently protected from the risk that principal amounts may not be fully repaid. Sufficient protection should be ensured by the inclusion of provisions that trigger amortisation of all payments at the occurrence of adverse events such as those mentioned under (i) to (iii).

Comment:

No comment at present.

Criterion 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 note-holders 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.

EBA Rationale

Standard securitisations should be such that the required investor's risk analysis and due diligence does not have to factor in complex and difficult to model structures of the payment priority; nor should the investor be exposed to complex changes in such structures throughout the file of the transaction.

The performance of standard securitisations should not rely, due to contractual triggers, on the liquidation at market price of the underlying collateral: market risk on the underlying collateral constitutes an element of complexity in the risk and due diligence analysis to be carried out by investors.

Comment:

No comment at present.

Criterion 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 account bank is provided for in any liquidity facilities or account bank agreements entered into for the benefit of the securitisation.

EBA Rationale

Standard securitisations should provide investors with certainty over the replacement of counterparties involved in the securitisation transaction in crucial roles which impact the credit risk of the securitisation, including the servicing of the underlying assets, the hedging through derivative instruments of risks arising in the securitisation as well as roles of support to the securitisation, such as those of liquidity facility providers and bank account providers.

Comment:

i) Servicer: It should be clarified that it is to ensure that the default or insolvency of the current servicer does not automatically lead to a termination of the servicing of the underlying assets without the replacement of the current servicer by a new servicer.

Criterion 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 note-holders 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.

EBA Rationale

The identified person may be the trustee of the securitisation, including the noteholders' trustee. Standard securitisations should ensure that an entity is available to take effective decisions, in all circumstances and in accordance with applicable law, and where necessary to appoint third parties. Consultation of market participants has highlighted that, particularly in the EU, the role currently played by the noteholders' trustee often results in sub-optimal outcomes and in a lack of alignment of interest with investors, particularly as adverse events materialise.

With a view to making more effective the decision-making process, for instance in circumstances where enforcement rights on the underlying assets are being exercised, it is also proposed that the legal documentation provides clear information on

how such disputes between note-holders are solved in a timely manner, in accordance with national law.

Comment:

"Voting rights of the investors" to be undertaken by the "identified person" is to be rejected (see our comment in relation to question 5).

Criterion 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.

EBA Rationale

Ensuring that all the conditions are there for the well-functioning of the servicing function is crucial given the central nature of this function within any securitisation transaction.

Comment:

Generally agreed. However, this requirement should be considered fulfilled if the servicer is a company which is supervised by a banking supervisory authority or if the servicer is the originator and is well established in the market more than 10 years.

Pillar III: transparent securitisations

Criterion 15:

The securitisation should meet the requirements of the Prospectus Directive.

EBA Rationale

Compliance with the Prospectus Directive ensures that, at issuance, the investors have access to all the information that is necessary to make an informed investment decision.

Comment:

This is agreed for public Auto-ABS transactions but we note that this would prohibit many private transactions, where there is no prospectus, from meeting the SST eligibility criteria. The same applies in the case of Auto-ABCP where only a prospectus exists on the ABCP program, but not on the Auto-ABS that back the ABCPs.

We think it is critical that private securitisation should be able to meet the requirements for SST eligibility as a great many Captives finance themselves through this

means. It is therefore imperative that the EBA develop a set of SST criteria for private securitisation transactions. A modular approach may work in this respect with certain requirements allowed to be omitted where the securitisation is private and bilateral in nature.

Criterion 15 may also impact on the ability of foreign issuers to meet the SST criteria if their notes are listed on a market outside of the EU in a jurisdiction where third country equivalence has not been granted.

Criterion 16:

The securitisation should meet the requirements of Article 409 of the CRR and Article 8b of the CRA (disclosure to investors).

EBA Rationale

The CRR and CRA requirements on disclosure to investors and prospective investors ensure that these parties have access to the data which is relevant for them to carry out the necessary risk and due diligence analysis with respect to the investment decision, directly addressing the opaqueness and analytical complexity which have characterised investors' perception of securitisations in recent years.

Comment:

No comment at present.

Criterion 17:

Where legally possible, investors should have access to all underlying transaction documents.

EBA Rationale

Documentation on the agreements and procedures underlying the transaction should be disclosed to investors and prospective investors in order to allow them to get comprehensive information on the functioning of the transaction in all of its components, particularly in a scenario of default of any of the parties involved in the transaction or other relevant events.

Comment:

Criterion 17 is unclear and clarification is required before it can be properly assessed. For example, it is not obvious what is meant by "underlying transaction documents". This could relate only to transaction documents or it could extend to documents relating to the underlying assets. If it is the latter this would inhibit originators from engaging in securitisation (if they are required to disclose proprietary information to "prospective" investors for instance). This is even more so the case given that public deal documents – though possibly not private deal documents – will in the near future be publicly available on the ESMA web site in accordance with article 8b

of CRAIII.

For public Auto-ABS transactions current practice is that the main transaction documents are summarised in the prospectus and are kept at the registered office of the issuer and can be inspected – the Note Trustee also has copies of all of the main transaction documents. There is therefore already a high degree of transparency with respect to contractual documentation. If these measures, insofar as they apply to the transaction documents only, are to be extended it is critical that it is done in a way that works as a practical matter – for instance, documents should be stored centrally and be available for inspection as opposed to there being a requirement to send sets of transaction documents to anyone that asks for them.

Where a back-to-back interest rate swap structure is used, back swap documentation is technically not a "transaction document" and frequently regarded as proprietorial and therefore a business secret – although it relates closely to the front swap. Back swaps should therefore continue to be excluded from any definition of "all underlying transaction documents".

In any case, "Access to all underlying transaction documents" should be limited to "all material and reasonable underlying transaction documents" to enable potential investors to assess the structure and the credit quality of the securitisation. In addition, it should be clarified that originators are not obliged to disclose information deemed as business secret e.g. own scorecards or price or interest calculation that are of relevance for competitors.

Criterion 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.

EBA Rationale

Investors and prospective investors should be in a position to know, as they receive the transaction documentation, what procedures and remedies are foreseen in case adverse credit events affect the underlying assets of the securitisation. Transparency of remedies and procedures, in this respect, allow investors to model credit risk of the underlying exposures with less uncertainty. Clear timely and transparent information on the characteristics of the waterfall determining the payment priorities is necessary for the investor to correctly price the securitisation position. A cash flow model related to the liabilities of the securitisation enables investors to model pay-

ment obligations and price the securitisation accordingly.

Comment:

It should be noted that processes and especially certain kinds of action are partly not predetermined but characterised by a certain level of discretion that decision makers have when taking their decisions. The requirement could be understood that the remedies and actions relating to delinquency and default of underlying debtors, debt restructuring, debt forgiveness, forbearance, payment holidays and other asset performance remedies have to be predetermined. This would conflict with established processes where a certain level of discretion is common business practice. In addition, processes, definitions and actions might change during the lifetime of an ABS transaction without lowering the standards. We fear that a description of the prescribed processes, definitions and actions could oblige the originator not to change the processes which would deter originators to securitise loans and leasing contracts.

In addition, it must be recognised that one of the major reasons that investors choose to invest in some securitisations and not others is in order to gain exposure to pools of assets originated and serviced by particular companies that they believe have a proven track record and expertise in the origination and servicing of those assets. If, as indicated in the first part of criterion 18, securitisation documentation is overly prescriptive as to how assets should be serviced it will undermine the ability of servicers to use their expertise and it will go against the very reason that the investor chose to invest in a particular transaction in the first place. Originators/servicers must be allowed a sufficient degree of latitude to allow them to service assets in exactly the same way that they service their own un-securitised assets – with no distinction. While there must be and there already are safeguards, overly prescriptive securitisation documents will only inhibit servicing and could even make securitisation impossible as a practical matter.

In any case, such operational processes could be briefly summarized in the transaction documents although they might change during the lifetime of the ABS. Thus, we propose to require a representation that these processes are governed and documented in internal policies and procedures and that any changes will not materially adversely affect the standards existing as of the cut-off date.

Investors should not depend on a liability cash flow model of the originator. This could promote overreliance on the model provided by the originator without challenging the assumptions of such model. Thus, originators should provide investors with all relevant data necessary to build a cash flow model.

Criterion 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.

EBA Rationale

Increased transparency towards investors and prospective investors is ensured by the fact that an external entity, not affected by potential conflict of interest within the transaction, is mandated to carry out checks on the underlying exposures of the securitisation.

Comment:

It is unclear what is to be verified. Further specifications are necessary. An extensive verification can be very extensive and costly which can endanger the economics of the transaction. Hence, it should be clarified that the verification refers to the adherence to the pool-cut criteria.

Criterion 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.

EBA Rationale

Eligible securitisations should be transparent to the extent that they always allow investors to rely on evidence around the historical performance of the assets to be securitised. This evidence is not only necessary for investors to carry out proper risk analysis and due diligence, but it also contributes to building confidence and reduce uncertainty over the market behaviour of the underlying asset class. New asset classes entering the securitisation market, for which a sufficient track record of performance has not yet been built up, may not be considered transparent in that they cannot ensure that investors have appropriate tools and knowledge to carry out proper risk analysis.

Comment:

In principle we agree. However, there might be circumstances that make it difficult to deliver the required data for 5 years. In exceptional a period of 3 years should be permitted as well.

Criterion 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.

EBA Rationale

Disclosure of loan-by-loan data on the underlying assets ensures that investors have, on a regular basis, access to timely and accurate information on the composition and performance of the underlying pool, necessary to carry out risk analysis and due diligence checks. Regular disclosure of accurate information on composition and performance is also instrumental to the liquidity of the transaction on the secondary market, where each prospective buyer of the transaction has to be able to timely assess the quality of the underlying. The cut-off dates used to disclose loan-by-loan performance data should be aligned with the dates used for the purposes of regular investors' reporting to facilitate the investors' analysis.

Comment:

In the week before pricing prospective investors currently receive data in the form of pool stratification tables the accuracy of which has been externally verified and which are also included within the prospectus. In addition, cash-flow data are made available to investors so that they can model the data themselves using their own assumptions. This is consistent with the overall drive within the EU for investors to conduct their own due diligence and not be overly reliant on others (the rating agencies for instance).

In the case of a typical retail Auto-ABS portfolio there may be up to 90,000 individual contracts and therefore it is clear that a prospective investor using standard analytical techniques would not be able to use loan level information in any meaningful way to assess a transaction without first aggregating the data. We therefore disagree with the suggestion that loan level information should be made available to prospective investors before the pricing of the securitisation.

Post-closing, investors may access the EDW to see loan level information in respect if ECB eligible public securitisation transactions.

If any additional disclosure obligations are imposed through the SST framework we would strongly urge that existing mechanisms are utilised for this purpose (e.g. the prospectus, the investor report, the EDW and the Bank of England loan level templates) so as to avoid further expensive development costs.

The above applies in the case of public securitisation transactions. If it is going to be possible for private, bi-lateral securitisation transactions to meet the SST eligibility criteria then we would propose that these should be exempt from loan level reporting due to the high level of private, proprietorial information that is often included within transactions that have been deliberately structured to be private and have been extensively "due-diligence" by the bi-lateral investor. This would also be proportionate given the much lower level of "systemic" risk associated with private transactions where the notes tend to be very difficult to transfer as a practical matter.

Criterion 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.*

EBA Rationale

Transparent securitisations should ensure that investors have access to all material information that is needed to perform a comprehensive and well-informed analysis of the risks arising in the securitisation, where this analysis also takes the form of stress tests on the cash flows and collateral values supporting the underlying exposures.

Investor reporting, together with loan-by-loan disclosure of performance data, is instrumental to allowing investors to carry out, on a regular basis, appropriate risk analysis and due diligence checks. As the loan-by-loan disclosure, investor reporting is also beneficial to the prospective investor on the secondary market and, therefore, to the liquidity of the transaction.

Transparent securitisations should ensure that investors can identify and disentangle, at all times, the cash flow components of the transaction, are able to reconcile all such different components and are in a position to monitor the risks related to the cash flow dynamics, such as pre-payment risk.

Comment:

Over-all we agree. However, we would note that "data allowing investors to clearly identify debt restructuring, debt forgiveness, forbearance, [and] payment holidays," may not be possible for the time being and is in any case unnecessary as all of this is captured within "delinquencies and defaults" which are currently reported and should be more than sufficient to allow investors to assess transactions.

Credit Risk Criteria

Criterion A:

Underlying exposures should be originated in accordance with sound and prudent credit granting criteria. Such criteria should include at least an assessment of the borrower's creditworthiness in accordance with paragraphs 1 to 4, 5(a) and 6 of Article 18 of Directive 2014/17/EU or Article 8 of Directive 2008/48/EC, as applicable.

EBA Rationale

A minimum level of credit quality of underlying exposures can only be ensured if such exposures are underwritten according to the prudential requirements applicable under EU regulation to different exposure types.

Comment:

No comment at present.

Criterion B:

The pool of exposures to be securitised should be such that the largest aggregated exposure to a single obligor does not exceed 1% of the value of the aggregate outstanding balance. For the purposes of this calculation, loans or leases to a group of connected clients, as referred to in Article 4(39) of the CRR, should be considered as exposures to a single obligor.

EBA Rationale

A minimum level of credit quality of the securitisation can only be achieved in those cases where the pool is sufficiently granular, i.e. the impact of idiosyncratic risk is minimised by the fact that none of the securitised exposures represents a too large portion of the pool of underlying exposures. It is important that, in fulfilling the granularity requirement, exposures related to groups of connected clients be considered a single source of idiosyncratic risk.

Comment:

Identification of the group of connected clients can be very challenging in the retail bulk business and can imply high operational costs with little benefit from a risk management perspective. In practice, there are often thresholds in place in the retail bulk business to reduce the workload and to strike the right balance between operating costs and the necessity to identify single risks ensuring proper risk identification and complying with regulatory requirements. Thus, to ensure that the identification of the group of connected clients can be based on the existing processes of the originator who has to identify group of connected clients it should be added the words “to the best knowledge of the originator”.

Just for information purposes, we would reiterate that from an Auto-ABS perspective a 1% threshold for retail is appropriate. However, for wholesale transactions a significantly higher threshold is necessary (see our comments on question 7).

Criterion C:

The underlying exposures should fulfil each of the following criteria:

i) They have to be exposures to individuals or undertakings that are resident, domiciled or established in an EEA jurisdiction, and

ii) At the time of inclusion they have to meet the conditions for being assigned, under the Standardised Approach and taking into account any eligible credit risk mitigation, a risk weight equal to or smaller than: a) [40%] on a weighted average basis where the exposure is a loan secured by a residential mortgage or fully guaranteed residential loan, as referred to in paragraph 1(e) of Article 129 of the CRR; (b) [50%] on an individual loan basis where the exposure is a loan secured by a commercial mortgage (c) [75%] on an individual loan basis where the exposure is a retail exposure (d) [100%] on an individual loan basis for any other exposures.

iii) Under (a) and (b) loans secured by lower ranking security rights on a given asset should only be included in the securitisation if all loans secured by prior ranking security rights on that asset are also included in the securitisation. Under (a) no loan in the securitised portfolio should be characterised by a loan-to-value ratio higher than 100%

EBA Rationale

In conjunction with the requirement that each individual exposure be underwritten in accordance with underwriting standards compliant with prudential regulation, the requirement of a maximum risk weight to be assigned to the individual exposures ensures that in any simple standard and transparent securitisation considered for differentiated regulatory treatment the credit risk stemming from underlying assets is duly contained. A differentiated regulatory treatment particularly in the area of own fund requirements may not be considered for transactions that, despite being simple standard and transparent are characterised by very high levels of credit risk with regard to all or some of the underlying exposures.

Maximum risk weights, as well as a maximum LTV ratio in the case of residential mortgage loans, ensure that the riskiness of the securitised exposures is prudentially limited.

Comment:

We have noted that the Basel Committee has launched a consultative paper on Revisions to the Standardised Approach for credit risk on 22 December 2014. We are still analysing the document and thus have to make caveat on this point until we have a clear picture on the potential impact of the revised standardised approach for credit risk on criterion C.

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

Answer:

Yes. We see following main risk:

We think that it is envisaged by EU policy makers that following the implementation of the SST regime the securitisation market will be segmented in two with a minority of transactions receiving favourable regulatory treatment on the basis that they meet

the SST criteria, and the majority receiving less favourable treatment on the basis that they do not meet the SST criteria. However in our view there is a significant danger that if the capital treatment for non SST transactions is too punitive there may in fact be only SST transactions post implementation of the regime and the rest of the market may die off completely. We do not think that this is the aim of policy makers but it must be a real possibility especially given the huge number of obstacles to healthy European securitisation markets that already exist (increasing regulation, regulatory uncertainty etc.) and that have already been identified in this paper. In order to ameliorate this concern it is crucially important that the SST criteria are catered to allow a wide section of the well-established EU securitisation market to qualify. In this way, if the non SST market fails to thrive post implementation there will still be enough "healthy" securitisation to support the financing needs of the EU economy.

To avoid cliff effects we would encourage EBA to follow the path that the whole ABS transaction but at least the junior bonds following immediately the senior bonds are "qualifying securities" as well.

If the SST criteria do not allow non-European issuers to qualify then it may fragment and undermine the evolution of a global broad and deep simple, transparent and standard High Quality ABS market and contradict to the efforts undertaken by the Basel Committee and IOSCO to define simple, transparent and comparable securitisations on a global level (see the consultative document released on 11 December 2014). In addition, this could be understood as discrimination against securitisations from outside the European Union. In the end, this could result in regulatory repercussions for EU issuers hoping to issue in other jurisdictions outside of the EU.

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

Answer:

The capital requirements should be made on the basis of historical data for qualifying and non-qualifying exposures and should differentiate between the most significant ABS segments according to the differentiation of the ECB as to the loan level data requirements, because we are convinced that the special risk characteristics of the underlying assets have in addition to the fulfilment of certain eligibility criteria as "qualifying" significant impact on the risk profile of the ABS transaction. The reason is that the eligibility criteria can significantly reduce the operational risks from such transactions. However, the credit risks are essentially driven by the characteristics of the underlying assets and stable underwriting standards. Thus, it seems impossible that CMBS, for instance, achieve a similar favourable risk profile as Auto-ABS because the unexpected losses would be definitely higher even if the expected losses were comparable due to the fact that the maturity of the underlying assets is much longer and the volatility of the evolution of the credit quality is significantly higher than in the auto loans and auto leasing business. Thus, in any case for the sake of

transparency and due to the significance of Auto-ABS, the results should be reported separately at least for the most significant asset classes such as, for instance, Auto-ABS.

In addition, we generally recommend segmentation between European and non-European ABS. The reason is that in the past the European Auto-ABS has generally historically outperformed US ABS. This applies especially for European ABS that would probably not be eligible as "qualifying". To avoid harsh cliff effects on European non-qualifying securitisations that might have sound quality as well, such segmentation is urgently necessary. We would like to avoid a situation that historical data on US subprime ABS are used for the calibration of the capital requirements for European ABS. Otherwise, we fear that the capital requirements could be clearly too high for European non-qualifying ABS.

As the empirical findings of the EBA suggest the historical losses of "qualifying securitisations" and non-qualifying securitisations with the same external rating differ significantly. This should be reflected in the capital requirements for the ABS segments according to the differentiation of the ECB as to the loan level data requirements though we would hope that the capital transition between SST and non SST transactions would be fairly smooth and avoid cliff effects.

In total, the capital requirements and especially the capital floor for qualifying securitisation should not be higher than today if this can be justified based on historical data.

The hierarchy according to the securitisation framework of the Basel Committee should not be changed. Despite some reservations towards rating agencies the External Ratings Based Approach has the highest risk sensitivity after the IRB Approach. In addition, rating agencies have learned from the mistakes in the past, improved their rating methodology clearly and are supervised by ESMA in the meantime. With respect to the standard approach based on historical data, we recommend deriving average parameters for qualifying and non-qualifying securitisations to be applied for the calculation of capital requirements.

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?

Answer:

We advocate maintaining the Basel II floor of 7% according to Basel II for „qualifying" securitisation. This seems to be justified due to the reduced operational risks including structural risks.

We refuse the proposal of re-allocating the overall capital across tranches, because a certain ABS tranche held by an investor is exposed to a certain risk. A re-allocation

of risk would disregard this fact. Capital requirements should remain risk sensitive.

Question 12: 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?

Answer:

We propose for countries that are part of the European Union to determine the capital requirements for “qualifying” securitisations before the sovereign rating cap if it can be justified on the basis of historical data.

Berlin, Köln, Paris – 14 January 2015

Verband der Automobilindustrie, Behrenstrasse 35, 10117 Berlin, Germany

Constructeurs Français d’Automobiles, 2, rue de Presbourg, 75008 Paris, France

Arbeitskreis der Banken und Leasinggesellschaften der Automobilwirtschaft, Gut Maarhausen, Eiler Straße 3 K1, 51107 Köln, Germany

Supported by:

Banque PSA Finance, 75 avenue de la Grande Armée, 75116 Paris, France
BMW Bank GmbH, Heidemannstr. 164, 80939 München, Germany
FGA Capital S.p.A., Corso Agnelli 200, 10135 Torino, Italy
Ford Credit Europe Bank plc., Eagle Way, Brentwood, Essex CM13 3AR, United Kingdom
GMAC Bank GmbH, Adam Opel Haus, Friedrich-Lutzmann-Ring, 65428 Rüsselsheim, Germany
Mercedes-Benz Bank AG, Siemensstr. 7, 70469 Stuttgart, Germany
RCI Banque, 14 avenue du Pavé Neuf, 93168 Noisy le Grand, France
Volkswagen Financial Services AG, Gifhorner Str. 57, 38112 Braunschweig, Germany