

**Bank of America  
Merrill Lynch**



Jonathan Hill  
Commissioner for Financial Stability,  
Financial Services & Capital Markets Union  
European Commission  
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Dear *Jonathan*,

Bank of America Merrill Lynch appreciates the opportunity to comment on the draft legislative securitisation package, as published and reported on by the Financial Times in August 2015.

We fully understand the economic and political challenges that the European Commission is facing in order to achieve its objectives regarding securitisation. At the same time, we are committed to contribute to the discussion. We share the view that a step by step approach is the best suited to bring about our common objectives of reviving the securitisation sector in Europe.

Bank of America Merrill Lynch's initial view of the available texts is that the draft regulation on STS correctly identifies the issues the sector is facing but does not sufficiently address the hurdles. However, we do believe that the industry and the European Commission can take advantage of the more favourable legislative and political context and work together to push for a successful EU securitisation market.

In order for securitisation to contribute significantly to the CMU and Juncker Plan goals of the European Commission, Bank of America Merrill Lynch considers the following elements to be crucial for the legislation:

#### **1. Grandfathering of existing transactions**

The recast retention and due diligence provisions should apply only to transactions originated after the adoption of the new regulatory framework. It will be highly disruptive to the markets to apply retrospectively the new retention rules and due diligence criteria to transactions, which have been completed prior to their publication, especially in light of the administrative and criminal sanctions for non-compliance and of the complexity, if not practical impossibility, to restructure existing transactions to meet the recast criteria. More fundamentally, we believe that applying what amounts to new legislation retrospectively is contrary to basic legal principles.

## **2. Clarification of the originator and sponsor definitions**

The intended narrowing down of the originator definition to exclude entities which have been set up and operate primarily for the purpose of securitising exposures, thus precluding such entities from providing retention for securitisation transactions, is unclear and potentially counterproductive. In our view, the originator definition should focus on the economic substance of the originator, i.e. an entity which operates as a business enterprise beyond a single purpose of acquiring exposures to securitise or providing retention for such securitisation exposures; this would be consistent with the recommendations made in the EBA report on risk retention dated 22 December 2014 (the "EBA Report") which recommends looking at real economic substance.

Furthermore, the requirement for a retention holder, acting in a capacity as "sponsor", to be a credit institution or an investment firm should be modified to include some MiFID investment firms as well as investment firms which are not established in Europe. We believe that the narrow definition of "sponsor", and the discrepancy within it between CRR and MiFID investment firms, precludes otherwise appropriate entities, including certain non-European securitisers, to provide retention for a European securitisation.

## **3. Clarification of the STS criteria for ABCP**

The ABCP rules as to STS scope and disclosure generally must differentiate between liquidity provider bank, which needs all the disclosure on a private basis, and the commercial paper holder, which relies on bank sponsor 'guarantee'. STS ABCP Conduit must provide full STS information to the liquidity provider, but only selected parts of this information should be made publicly available. The one year cap on remaining asset maturity in the ABCP conduit pool should be replaced with a 4-5 year cap for fully supported multi-seller conduits. Failure to extend the asset maturity cap will result in the exclusion of a large range of exposures which most directly service the European SME sector.

## **4. Adjust regulatory capital calibration to further risk sensitivity and level playing field**

Securitisation capital should be calibrated on the basis of modified neutrality, such that capital after securitisation can exceed capital before securitisation by a pre-defined factor of between 1.25 - 1.50. Duration adjustments for banks should also be eliminated. Capital for senior tranches of STS securitisations should be reduced further to reflect their reduced risk and to realign them with other similar instruments (covered bonds). Capital for banks and for insurance companies should be sized in a way to allow for redistribution of risk from banks to insurers - that would require different (lower) capital levels for mezzanine tranches for insurers than for banks. The regulatory capital for STS securitisation for insurers can be set at the same level as the regulatory capital for equally rated corporates and the regulatory capital for non-STS securitisations to be equal to the regulatory capital for corporates of one (for upper mezzanine) or two (lower mezzanine) lower rating categories. The regulatory capital for securitisation, covered bonds, whole loan portfolios and other comparable exposures should be realigned with the regulatory capital for underlying exposures acting as a cap on regulatory capital for upper mezzanine tranches. Regulatory capital for retained equity exposures by banks should be reduced below a one-for-one deduction, as the first loss position reflects only expected loss, while the capital calibration for banks is based on unexpected loss.

**5. Modification of LCR to reflect STS securitisations**

With the establishment of STS securitisation in regulatory terms, it is now possible to include some or all STS eligible securitisations into 2A bucket for LCR purposes. That corresponds to the historical experience of many of the asset classes which meet the STS criteria and will allow for levelling the playing field between STS securitisation and covered bonds.

**6. Differentiate due diligence requirements for STS and non-STS securitisations**

Due diligence requirements for STS and non-STS securitisation should be differentiated to reflect the different nature of the two securitisation categories. Due diligence requirements should be clarified so that they apply only to direct investors in securitisation, while investors who choose to invest via specialised funds can rely on the due diligence requirements demanded from such UCITS and AIFM funds.

**7. Retention methods**

The STS criteria address some aspects of the realignment of the interests of issuers and investors, thus reducing the importance of retention to some degree. The discrepancy between the retention level of 5% and the low level of expected loss of STS portfolios is evident. Hence, there is a possibility to reduce retention to, say, 2%. An alternative solution would be to introduce L-shaped retention, similar to the US, where the originator retains a 2.0% or 2.5% horizontal slice and a 3% or 2.5% vertical slice from each securitisation. The vertical retention slice can be subject to a sunset provision, i.e. it can be released once certain pool performance parameters are met, such as level of seasoning, stable state delinquency or loss levels. The reduction in retention requirements will improve the economics of a securitisation transaction for its originator.

Yours sincerely

