

Strictly private and confidential

August 2015

**AFME private comments on Commission working documents:
securitisation “building blocks”**

Introduction

AFME and its members strongly support efforts by the European Commission and all those involved in current efforts to develop a new EU framework for high-quality securitisation.

The Commission has said that "The development of a high-quality securitisation market constitutes a building block of the Capital Markets Union and contributes to the Commission's priority objective to support a return to sustainable growth and job creation" and "Securitisation is a crucial element of well-functioning financial markets. Soundly structured, securitisation can be an important channel for diversifying funding sources and allocating risk more efficiently within the EU financial system."

The seven years or so that have passed since the onset of the financial crisis have provided strong evidence of how well most European securitisations have performed, such that securitisation is now part of the solution, not part of the problem. A robust EU framework will help to reinforce this confidence in securitisation.

However, it is of critical importance that all of us – policymakers, regulators and all market participants – work together to get the new framework right. It must be successful.

In this paper, AFME offers in a spirit of constructive engagement some detailed comments on proposals made in the Commission working documents on “building blocks” towards a new EU Framework for Simple, Transparent and Standardised Securitisation. We respectfully ask that policymakers to consider these points as the details of the new framework are being developed.

1. Risk retention

1. **Carry-over of existing provisions:** it is not clear to us whether the current provisions of the RTS on risk retention and due diligence under the CRR would be carried over in the potential new framework. We note that the guidance provided by these RTS is essential to interpret the obligations and therefore we ask that this be carried over intact. In fact, all existing exemptions should be carried over.
2. **Originator definition:** rather than proposing to amend the originator definition, the working document seeks to add an additional restriction for originators for retention purposes. This approach avoids some of the unintended consequences (relating to the possible amendment of the general definition) which cause us concern. However the restriction as drafted in the working document is potentially quite broad and in our view unlikely to achieve the intended outcome: primary purpose tests are inherently uncertain and the proposal would appear on the one hand to *restrict* entities as retainers based only on their connection to the transaction,

while on the other *allowing* unintended arrangements involving entities lacking real substance. We prefer the principles-based restriction, as referred to in the EBA's Securitisation Risk Retention Opinion and Report published in December 2014, which in our view achieves a more sensible outcome. Further, there are **existing transactions** that may be affected by the proposed restriction.

3. **The direct approach:** this gives rise to a number of questions, some of which overlap with points that AFME raised in the context of Article 8b CRA3. In particular, it is not clear what is intended to occur in the context of transactions where there is not an entity involved in the arrangement which satisfies the definition of "originator, sponsor or original lender" and/or in circumstances where one or more entities (who may or may not be involved in the transaction) is not EU-established. On the latter point, while the explanatory text in the working document indicates that the indirect approach would continue to apply in circumstances where none of the originator, sponsor or original lender is EU-established, it appears that the direct approach (revised obligations) would apply in the context of transactions where any one of the originator, sponsor or original lender *is* EU-established (regardless of whether the relevant entity is involved in the transaction) and this could give rise to application, supervision and enforcement issues where non-EU entities are relevant and would potentially be caught by the other retainer definitions. On the involvement point, we note by way of comparison that the **US requirements** do not pose the same problems because the sponsor definition has an inherent link to involvement in the securitisation. Further, we note that adding a direct approach while still making investors responsible (especially if investors have to "ensure" that originators do what they are required to do) would make the situation still different from, and more onerous than, US retention rules (where only "sponsors" will be responsible for risk retention).
4. **Timing of application of the proposed provisions:** this is unclear and no provision seems to preserve the grandfathering for certain 2011 transactions. More generally, to the extent that any substantive changes are made via the revision of the Level 1 and/or Level 2 provisions on risk retention (e.g. to remove any flexibility), grandfathering is essential for transactions which have already been structured to comply with the current requirements.
5. **Seller's share holding option:** it is helpful that this is stated to be available for revolving securitisations in general and that the provision relating to retention on a consolidated basis for regulated entities has been amended to remove the unhelpful reference to securitising exposures from several institutions (the proposed wording refers to "one or more" which is more flexible).
6. **Retention on a consolidated basis:** We welcome clarification of consolidated retention within credit institution groups. However, we also request consideration of retention on a consolidated basis more generally: it is allowed in US risk retention rules and was allowed under pre-CRR interpretation of CRD Article 122a (which is transposed almost word-for-word in CRR 404-410).

2. Disclosure and transparency

1. **Proposals for private and bilateral transactions continue to cause concern:** we have spoken at length on this issue in our responses to ESMA so it is disappointing that little seems to be proposed to address this. The only flexibility seemingly contemplated for these transactions is an option to disclose the required information to investors and the competent authorities, rather than more generally, on a public website. Thus, regardless of how widely these arrangements are defined under the proposed corresponding (new) technical standards, commercial sensitivity and confidentiality concerns of AFME members remain unaddressed with respect to the provision of loan level information in the context of these transactions.

Similarly, the express provisions relating to certain **adjusted disclosure requirements for ABCP** in the draft indicates that our points on these transactions have not been accepted. Consistent with our comments on the ABCP programme criteria, we ask for clarification or amendment such that ABCP programmes will not have to disclose loan-level data, specific terms or parties etc. of underlying transactions.

2. **Scope of the revised provisions:** the timing of application is not clear and it is not evident when reporting would begin. It would severely hinder revival of the securitisation market if the requirements applied in respect of *all* existing transactions including those involving securities issued prior to 26 January 2015 and regardless of the underlying asset type. Related to this, it is not clear that the obligations would need to be complied with only where standardised templates have been issued for the relevant underlying asset type.
3. **Standardised templates:** it is also not clear whether the standardised templates proposed under the corresponding (new) technical standards would align with any existing templates, such as the ECB forms as contemplated by the current technical standards made under Article 8b CRA3.
4. **STS template and proposed required disclosures:** more information will be required with respect to these. Our concerns here relate to the ability to confirm compliance and achieve sufficient certainty of the same, any verification procedure and how consistency in views between authorities will be achieved. As well as the standard applied under the penalty provisions should an error be made.
5. **Event based reporting requirements:** for these, which apply when MAD/MAR does not (i.e. in respect of transactions which are not admitted to trading on an EEA-regulated market), it is not clear why it should be necessary to disclose any amendment to the transaction documents without any qualification.
6. **ESMA website:** it is helpful that this requirement appears not to be part of the proposals.

3. Due diligence

1. **Carry-over of the current provisions of the CRR retention / due diligence RTS:** it is not clear that these would be carried over. As noted above, the guidance provided by the RTS is essential to interpret the obligations, on the due diligence side as well as for retention.
2. **The obligation on an investor to “ensure” retention:** the introductory text to the retention section suggests that the authorities are considering moving to the direct approach in general in Europe with the indirect approach remaining for non-EU transactions (more specifically, for transactions where none of the originator, sponsor or original lender are established in the EU) only, with a view to reducing the burden for EU regulated investors. However, item (b) of the initial “due diligence / prior to investing” points would require the relevant institutional investor to “ensure” that “the originator, sponsor or original lender retains a material net economic interest and discloses it to the institutional investor”. The requirement to “ensure” that an eligible retainer retains the required interest would seem effectively to require investors to confirm the compliance status of a retention arrangement and to look beyond the disclosure / retention commitment statement provided.
3. **Investors to be required to ensure compliance with re-cast disclosure obligations:** similarly, item (c) of the initial “due diligence / prior to investing” points refers to the institutional investor “ensuring” that for the securitisation in question “the originator, sponsor and SSPE make available the information required by and in accordance with the frequency and modalities provided for”. The drafting of this requirement is unclear but it could be read as meaning that investors would be *required to ensure* that the originator, sponsor and SSPE comply with their obligations under the re-cast disclosure obligations. Investors can *check* that a relevant entity has committed to provide certain information but cannot *control* the actual compliance / performance and should not have any responsibility in this regard. A similar concern applies to item (a) in the same list.

Again, if investors will have to “ensure” in this way, the new rules for securitisation will be more onerous, not less onerous, than both existing rules and the US rules.

4. **Qualitative requirements in AIFMR not included:** it is helpful that the due diligence requirements corresponding to the qualitative matters related to originators and sponsors referred to in Article 52 (b)/(c)/(d) in the AIFMR are not included in the proposals but it is unfortunate that item (a) of the initial “due diligence / prior to investing” points *has* been included, which is similar to Article 52(a). This can present challenges for transactions involving acquired portfolios of assets.
5. **Existing qualifications for stress tests not carried over:** item (b) of the ongoing due diligence points is similar to wording in Article 406(1) CRR regarding required regular stress testing but does not carry over the wording that “to this end, institutions may rely on financial models developed by an ECAI provided that institutions can demonstrate, when requested, that they took due care prior to investing, to validate the relevant assumptions in and structuring of the models and to understand methodology, assumptions and results”. That said, item (b) does describe the required stress tests as being “commensurate with the nature,

scale and complexity of the risk”, which would seem to preserve some flexibility which is important in the practical context.

4. Definitions

1. **Sponsor definition:** we argue that it should be possible for a non-EU regulated investment firm also to be a sponsor and to be able to retain as a result. This needs to be considered in the light of, and balanced against, the direct obligations imposed on sponsors under the re-cast provisions.
2. **SSPE definition:** the reference to “and in which the holders of the beneficial interests have the right to pledge or exchange those interests without restriction” is appropriate for certain entities in respect of which the instruments or interests are subject to transfer restrictions, for instance in private and/or bilateral transactions. Where the current SSPE definition is proposed to be used in the context of certain direct obligations (such as the disclosure provisions) this could be seen to suggest that these transactions should be outside scope - but this is unlikely to be the intention. It is our view that the current proposal for the “sponsor” definition is too restrictive for STS purposes and gives rise to uncertainty. We therefore suggest that the end wording is removed.
3. **"Asset-backed commercial paper (ABCP) transaction":** this is not yet defined in the CRR. As noted in both our high-level and detailed comments on the ABCP transaction criteria, we think the modified criteria proposed for ABCP transactions should be adapted to apply also to other “private” securitisation transactions.
4. **"Management body":** this term is not particularly relevant to securitisation, therefore we ask for its removal.

5. Penalties

1. **A strict liability standard is inappropriate:** this seems to be proposed for the purposes of breach of the re-cast provisions applicable to all securitisations. This is worrying, particularly when coupled with the reference to possible criminal sanctions as designated by member states.
2. **Consistency:** our members have concerns about cooperation and consistency in the application of qualifying securitisation criteria and other provisions, given that investors and other parties to securitisations would potentially be supervised by different authorities.

6. STS criteria

1. **“True sale”:** the requirement that the underlying exposures be acquired “by means of a true sale by a SSPE in a manner that is enforceable against any third party” is problematic and unclear as the sale is *to* the SSPE, not *by* the SSPE. The formulation “true sale or effective assignment”, which has been proposed the EBA, more appropriately covers the types of mechanisms used in cash securitisations.
2. **External verification:** this requirement needs to be clarified. The EBA report (Criterion 19) provides good clarification of this point.

3. **Homogeneity:** this requirement needs to be clarified, ideally by requiring only homogeneity of asset class (although even this needs clarification).
4. **Restriction of payment streams:** restricting these to rental, principal, interest or principal and interest payments is unnecessarily restrictive and has no obvious benefits. We do not see the reasons to exclude other types of payment streams (e.g. royalties).
5. **Interest rates:** the restriction to those "based on generally used market interest rates" is problematic as it does not allow for banks' standard variable rates, which are very common in mortgage lending. This criterion should also include an option for sectoral rates reflective of a lender's cost of funds.
6. **Seller experience:** the requirement for the seller to "have sufficient experience in originating exposures of a similar nature to those securitised" is very unclear. It is not clear what constitutes "sufficient experience" and how and by whom this is to be measured. For clarity and consistency in drafting we suggest that this requirement should be stated to apply to the "originator" rather than the "seller".
7. **Credit quality standards:** the inclusion of these (compliance with Directives 2014/17/EU and 2008/28/EC) in the STS criteria is a new requirement, and problematic. AFME has objected to the inclusion of these standards generally, arguing that credit quality is addressed by capital weightings, but to include them in STS criteria (rather than as separate credit quality criteria as the EBA has done) is particularly unhelpful.
8. **Credit-impaired debtors:** the exclusion of exposures to credit-impaired debtors is too general. It should be tailored to the specific credit the debtor is seeking. The same obligor might be "credit impaired" for the purposes of a €1m residential mortgage, but nonetheless perfectly appropriate for a €10,000 auto loan or a credit card with a €1,000 limit.
9. **Defaulted assets:** a similar objection exists in relation to this definition, which would be problematic for credit cards, where assets over 90 days past due are routinely kept in the portfolio as long as the originator believes they will still be paid.
10. **First payment:** the requirement for at least one payment to have been made is not problematic in principle but the asset class-based exemptions from the requirement raise some concerns. A principles-based exemption for "exposures payable in a single instalment or having a maturity of less than one year, including without limitation monthly payments on revolving credits" would be preferable.
11. **Compliance with risk retention principles:** this is justified, however it should be articulated as a requirement to comply with *applicable* risk retention requirements (or EU requirements where these would not be mandatory but the transaction complies with them voluntarily).
12. **Servicer expertise:** this is unclear and needs clarification.
13. **Disclosure of data covering a full economic cycle:** this requirement for disclosure of data relating to substantially similar exposures to those being securitised covering at least a full economic cycle is problematic. It is unhelpful to introduce separate disclosure requirements as

part of STS that are not part of the overall legislative disclosure regime. Also, the requirement for a "full economic cycle" is unclear and difficult to comply with. If it appears at all, it should be replaced with a specified number of years. Finally, the requirement for many years' worth of historical data would make it very difficult for any new asset classes or even traditional asset classes in new jurisdictions to be treated as STS.

14. **Transparency:** this requirement is articulated in an unhelpful manner. It is of course acceptable to require that the relevant parties comply with transparency obligations to the extent that such obligations apply to them. However, to require separately that they "make available to potential investors before pricing all information required by investors" suggests a subjective standard with which it is difficult or impossible to comply (not least because it would require the originator, sponsor and SSPE to be aware of the individual circumstances of all investors). We would suggest that the existing, objective standard of providing all material information is more appropriate and should be retained. Generally, we believe the addition of further disclosure standards on top of existing securities law requirements, Article 409 of the CRR and Article 8b of CRA3 is unnecessary and ill-considered.
15. **Draft "information" prior to pricing:** the requirement to provide "the information" at least in draft or initial form before pricing is ambiguous. For instance a requirement to provide a preliminary prospectus is reasonable. If the requirement is, on the other hand, to provide draft transaction documents, then that would be problematic. Such a requirement would have very complex liability implications that would need to be addressed by amendments to the Prospectus Directive and national implementing legislation before it became practicable.