

To: All EU Co-legislators

21st September 2016

RE: Simple Transparent and Standardised Securitisation Regulation ('STS Regulation')¹ - Importance of Issuer Provided Liabilities Waterfall Models

Dear Sir,

In our view the work on this file by all concerned with the EU co-legislative process has been thorough and of the highest quality.

The inclusion of issuer provided Liabilities Waterfall Models (LWMs) as a requirement appears to be universally accepted by the European co-legislators in the various drafts of STS Article 10 paragraph 3. See [here](#) for definition of a LWM (i.e. a LWM does not model the performance of the assets – just the liabilities of the transaction).

EuroABS would like to reinforce the importance of these models and the benefits to issuers and investors and for the protection of EU citizens exposed to asset backed securities (ABS) either directly, indirectly or, indeed, systemically.

Benefit 1 – Transparency and Discouraging of Unnecessary Complexity

“Structure your transaction and include complexity as required, but then model it to show how it works and stand behind the model”

The process of conversion of a granular pool of assets into an investable security is often a complex process – but does provide some real economic benefits as discussed at length. Many suppliers to these ABS transactions may be called upon to provide derivatives and swaps, different classes of beneficiaries/tranching may provide credit enhancement devices, etc. The liabilities waterfall of these transactions can become necessarily complicated.

The drafting of EU securitisation regulation contains little in the way of restrictions on structure and complexity of transaction. Having attended various ESA sponsored open hearings on Securitisation it is clear that this is deliberate to help avoid ‘cliff effects’ that might result in the arbitrary exclusion of certain transactions and the subsequent loss of related economic benefit. It is therefore clear that the Article 10(3) LWM requirement is there to provide licence to the issuer to structure the transaction as is necessary, but to then model the liabilities waterfall to show exactly how it works and stand behind that model.

Issuers should not be selling ABS into the market for which they cannot model the liabilities waterfall with certainty – the simpler the liabilities waterfall, the simpler the model. This process should hold no fear for the issuer.

Benefit 2 – Discovery and Elimination of Drafting Errors

Issuer provided LWM production facilitates a useful formal and transparent process for checking the liabilities waterfall documentation and to flush out errors and problems – which have occurred and do occur from time to time.

Liabilities waterfall documentation is often voluminous and complex. Drafting errors have occurred and do occur from time to time. Requiring issuers to produce a LWM (or to procure one produced on their behalf) facilitates a useful formal and transparent process for checking the liabilities waterfall documentation and to flush out errors and problems.

As an example:

A UK RMBS master trust issued in the 2000’s contained a series of circular references in liabilities waterfall documentation trigger clauses. Essentially in some circumstances it was not possible to ascertain with certainty how the transaction would perform with respect to the allocation of the cash flows to the various beneficiaries. Also it was not possible to fully model the liabilities waterfall accurately. The bonds were sold and apparently nobody noticed the errors. The transaction was, however, modelled by the usual providers to which many professional investors subscribe.

In 2011 the issuer was subsequently required to produce a LWM to meet Bank of England eligibility standards². It was only then that the error was discovered by an agent acting for the issuer, the problem fixed and the documentation changed.

Please see a report following an April 2015 industry seminar on this subject held under the Chatham House Rule [here](#).

We would be very happy to provide further information and examples on this subject.



¹ <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2015%3A472%3AFIN>

² <http://www.bankofengland.co.uk/markets/Documents/marketnotice121002abs.pdf>