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French Banking Federation Response to European Commission Consultation on an UE framework for simple transparent and standardised securitisations

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorized as banks and doing business in France, i.e. more than 390 commercial, cooperative and mutual banks. FBF member banks have more than 38,000 permanent branches in France. They employ 370,000 people in France and around the world, and service 48 million customers.

The French Banking Federation welcomes the opportunity to comment the Commission's Consultation Document « An EU framework for simple, transparent and standardised securitisation » in the context of the Capital Market Union (CMU). We understand the aim of contributing to the revival of the securitisation market in the EU, and by the way encourage banks to originate more credit in relation with the real economy in order to recover the growth in the EU.

We are pleased that European regulators now see securitisation as a useful tool in many ways and no longer the dangerous instrument which suffers of a bad image and will be severely penalised by the forthcoming Basel III revised securitisation framework. As rightly pointed out by the Commission, securitisation issuances in Europe are only a third of what they were before the crisis. The stigma attached to this financial process is unfairly harming Europe although default rates of EU securitisations have been incomparably lower than those in the US.

Therefore we fully support the Commission's views on the need to revive the securitisation market and the specific consultation on a framework for "simple, transparent and standard" (STS) securitisation as a way to repair the unjustified penalization of the EU market. However, we would caution that international standards in this area have been calibrated inappropriately for the European market, which is the reason why any revival of the securitisation market will not be possible without tangible and pragmatic prudential incentives for both originators and investors.

Our proposal seeks to provide answers to regulators' concerns on excessive reliance to credit rating agencies, and to propose concrete actions in order to implement a practical framework from 2016. To this end please find our key messages below:

1. **The scope of eligible STS securitisations should be the largest possible:** ABS, RMBS, ABCP, CLO…
2. **The rules for eligibility should be centred on a set of common core STS principles, complemented by additional "modular" conditions, as deemed necessary for each regulatory purpose:**

- STS principles should broadly define what constitutes an appropriately structured securitisation. The same principles should apply as widely as possible in all EU regulations.
- Such principles should not be overly detailed and prescriptive to avoid the risk of excluding the majority of securitisations for narrow technical reasons.
- Each regulation could add specific criteria to define eligibility for any given purpose: for example market liquidity conditions would be required for LCR HQLA eligibility of STS securitisations.

3. **An effective labelling process is key for making this new framework operational and robust**:
    - Supervisory competent authorities should be given the power to grant licenses to potential labelling agencies (PCS could be one of these authorized labelling agencies).
    - Such labelling agencies would ensure consistency, credibility, timely responses to originators, and quick confirmation of STS status of any given security for investors.
4. **Appropriate regulatory capital treatment of securitisation positions needs to be part of the equation to revive the market:**
    - The regulatory capital should be in line with that of equivalent underlying portfolios. To calculate risk weightings for banks, we propose a simple new approach, PCMA, calibrated on the performance of European securitisations. This approach is also independent of external ratings.
    - Besides risk weighting, the leverage ratio is nowadays of the upmost importance in terms of future financing capacity as a backstop and a reference for other prudential ratios such as TLAC. Exposures transferred by banks should be excluded from the total exposure value for leverage ratio calculation purposes.
5. **The question of a national or supranational backstop would be worth studying**
    - In the US, capital markets development was accelerated by the establishment of Government Sponsored Enterprises (GSEs) with a public guarantee that continue to allow removing extremely important amounts of residential loans from bank balance sheets through a securitisation process. In this regard, the opportunity of a European backstop for securitisation would be worth studying at the present time, as this could be a critical catalyst to develop a well-functioning securitisation market.

<u>PART 1 – Definition of a securitisation operation</u>

QUESTION 17:

To what extent would a single EU securitisation instrument applicable to all financial sectors (insurance, asset management, banks) contribute to the development of the EU's securitisation markets? Which issues should be covered in such an instrument?

A single EU securitisation instrument applicable to all financial sectors will certainly contribute to the development of the EU's securitisation markets. Harmonisation of rules is essential, accelerated publication of technical regulations and interpretations of rules will reduce uncertainty among investors and issuers. There must be a robust method for investors to be assured that a particular securitisation meets the qualifying rules, by having a checklist system that can be relied on, since the consequences of investing in a securitisation that later proves to be ineligible as a qualifying securitisation are too draconian for many investors to risk investing.

PART 2 : What are the impediments to issue securitisations ? issuers' viewpoint

QUESTION 18:

A. For qualifying securitisation, what else could be done to encourage the further development of sustainable EU securitisation markets?

We do not have any particular comments.

B. In relation to the table in Annex 2 are there any other changes to securitisation requirements across the various aspects of EU legislation that would increase their effectiveness or consistency?

The FBF believes that in the current interest rate environment, there is investor demand for securitised products because of the scarcity of the offer and the attractive yield compared to other investment products. The very low activity in the securitisation market is mainly due to a) lack of credit originated by banks and b) low incentive for banks to originate securitisation.

It is also our belief that should the credit production peak up again, the balance-sheet of European banks will not be capable of absorbing the new production: we believe securitisation is a powerful answer to help fund the economy, by transferring part of the new production to institutional investors, provided the current impediments are addressed.

Banks have currently no incentive to use securitisation as in most instances the underlying assets remain on the bank's balance sheet (even in the case of true sale). Securitising the asset pool and selling part of the tranches to outside investors most often does not improve the bank's leverage ratio, its RWA standpoint, LCR and NSFR, and leads to worse asset encumbrance ratio. It is in addition usually more expensive than covered bond or senior unsecured debt, and involves time and costs.

However, for simple cash securitisation where the risk and the economics of the securitised assets are properly transferred to the SPV, the investors in the securitisation do not have any recourse to the bank. This means that any tranche sold to third party investors is a definitive transfer of credit risk and funding risk. The economic size of the bank's total assets is therefore reduced and upon bankruptcy or stressed funding or credit conditions, the bank is not impacted beyond the tranches that have been retained.

Therefore banks should be allowed to deduct any securitisation tranches sold to third party investors from the total balance-sheet size used for the computation of the leverage ratio, considering that accounting view on a consolidated basis cannot be the right reference for assessing securitised assets for the leverage ratio.

Even if only senior tranches have been sold to investors, and junior tranches have been retained by the seller, the assets have been transferred to a SPV, their funding has been obtained from third party investors and they will be serviced by the seller or by a back-up servicer in case of problem with the seller. In this situation, if the bank has problems, these assets will not be concerned by any action on assets from the defaulting bank. The leverage ratio should exclude these sold assets and retain the only tranches retained by the bank or assets.

To this end we propose the following amendment to CRR article 429 (which was already amended by delegated regulation on leverage ratio) :

“15. Institutions that have securitized assets, and for which the Securitisation SPV is part of the regulatory scope of consolidation used for the risk-based framework may deduct from their total exposure the total amount of liabilities issued by securitization SPVs and not retained by such institution.”

Regarding LCR, there should be consistency between the foundation criteria for STS and for LCR to avoid unnecessary effort and complexity. Transactions qualifying for the STS label and for the additional “liquidity criteria” of LCR should *de facto* be qualified as 2A assets for LCR.

PART 3: What are the impediments of investing in securitisations ? investors’ viewpoint

QUESTION 13:

Are there wider structural barriers preventing long-term institutional investors from participating in this market? If so, how should these be tackled?

At present the investor base for securitisation products is essentially made up of banks, insurance companies and funds. This base could be expanded to include businesses which invest in securities and might have an interest in long-term investments, as well as companies with pension liabilities. To this purpose market conditions need to be adapted to attract such potential investors and improved for existing investors. It would doubtless be helpful if there was an active secondary market for securitisation products.

Moreover the high due diligence requirements imposed on investors, although justified, also create barriers to entry for new investors. Regulatory uncertainty and disparity among jurisdictions as to the interpretation of due diligence requirements also scares new investors away. This being said, the most obvious and onerous barrier to entry are the punitive capital charges imposed on securitisation investments.

3.1 Insurers:

QUESTION 14:

A. For insurers investing in qualifying securitised products, how could the regulatory treatment of securitisation be refined to improve risk sensitivity? For example, should capital requirements increase less sharply with duration?

In today's version of Solvency 2 it is almost always more favorable for the insurance company to hold directly the assets than the senior tranche of a securitisation of the same assets. As a general principle the calibration of a securitisation and its underlying asset exposures should be based on the same approach.The capital charges for securitisations defined in the Solvency II implementing measures does not reflect the risks inherent to high quality securitisations. Calibrations defined for category 2 (others) significantly penalize such securities. In addition, similar good quality assets that are not defined in category 1 (high quality) because they do not satisfy all the conditions of this category defined in the delegated acts have a disadvantageous treatment.Indeed, assets with good quality can end up with a capital charge 3 times higher than their equivalent defined in Category 1. This treatment creates threshold effects leading to a risk of arbitration.

A securitisation should be deemed qualifying for a specific prudential treatment at transaction level, and not at tranche level. In addition, it makes economic sense that exposures to good-quality securitisations have lower capital requirements than exposures to low-quality securitisations. Currently Solvency II makes an explicit distinction between senior and non-senior tranches and significantly penalizes non-senior tranches vs senior tranches of the same transaction in terms of capital requirements.

B. Should there be specific treatment for investments in non-senior tranches of qualifying securitisation transactions versus non-qualifying transactions?

A securitisation is deemed to be of high quality or not at transaction level, but the capital charge should be defined at tranche level and not at transaction level.

<u>3.2 Banks:</u>

QUESTION 9:

With regard to the capital requirements for banks and investment firms, do you think that the existing provisions in the Capital Requirements Regulation adequately reflect the risks attached to securitised instruments?

A better treatment for senior tranches of securitisation under Solvency 2 and CRR still needs to be granted. CRR should review the capital charge for securitisation exposures for banks to avoid a penalizing situation compared with the direct detention of the securitised assets.

Indeed as identified by the EBA (see discussion paper on “simple, standard, and transparent” securitisations - October 2014), the existing CRR results in an overreliance on rating agencies for capital purposes. In particular, rating agencies have tightened their methodologies post-crisis while the capital charges based on ratings have not been updated. This has proved to be a major impediment to the revival of the European securitisation market. For instance, there has been very little public issuance of SME securitisations post crisis.

QUESTION 10:

If changes to EU bank capital requirements were made, do you think that the recent BCBS recommendations on the review of the securitisation framework constitute a good baseline? What would be the potential impacts on EU securitisation markets?

The Revised Securitisation Framework was published in December 2014 in order to address a number of weaknesses of the existing Basel II framework with the aim to provide developments such as (i) a higher risk management approach with the priority given to the available information at the level of the bank thus reducing reliance on external rating by giving the priority to the SEC-IRBA approach (ii) a higher risk sensitivity approach with the incorporation of additional risk drivers such as maturity or tranche thickness (iii) a more appropriate calibration of capital requirement based on the level of quality of underlying pool.

However even if such evolutions would seem to be appropriate, we think that further steps should be taken to adjust the current regulatory treatment to the underlying risks attached to securitised instruments.

Indeed the revised framework considerably increases the regulatory capital weightings given to all securitisation positions held by banks, whether they result from active investments made by the banks or are residual tranches kept by the banks after securitising some of their loan portfolios. The new weightings include surcharges of up to 150% on securitisation positions compared with the same non-securitised underlying loans, as well as higher RWA floors on the most senior tranches. Such massive surcharges make it even less likely than today that banks will use securitisation as a technique to transfer risk on their portfolios to increase their lending capacity, as the residual positions (which they must retain or cannot sell economically in the market) will be very costly. They will also reduce banks’ appetite to use securitisation as a technique to provide secured financing to clients (e.g. purchase of

Trade receivables) or to invest their excess liquidity in securitisations originated by other banks. The surcharges designed by the Basel Committee were largely based on the abysmal performance of US subprime portfolios from 2006-2008. It is key for the revival of the European market that securitisation surcharges (for banks, but also for other investors like insurance companies) be drastically reduced: the weightings should mainly reflect the risk of the underlying loans if a securitisation is deemed high-quality, with only a modest surcharge for model risk.

Through the concept of “high quality securitisation”, where the underlying risks can be assessed with more confidence, a more favorable prudential treatment must be considered (e.g reduction in Leverage Ratio for banks as well as a reduction in capital charge for insurers and bankers must be considered as crucial). In particular the calibration of capital for retail transactions remains particularly punitive with a capital surcharge of up to 150% in IRB mode and 100% in SA mode.

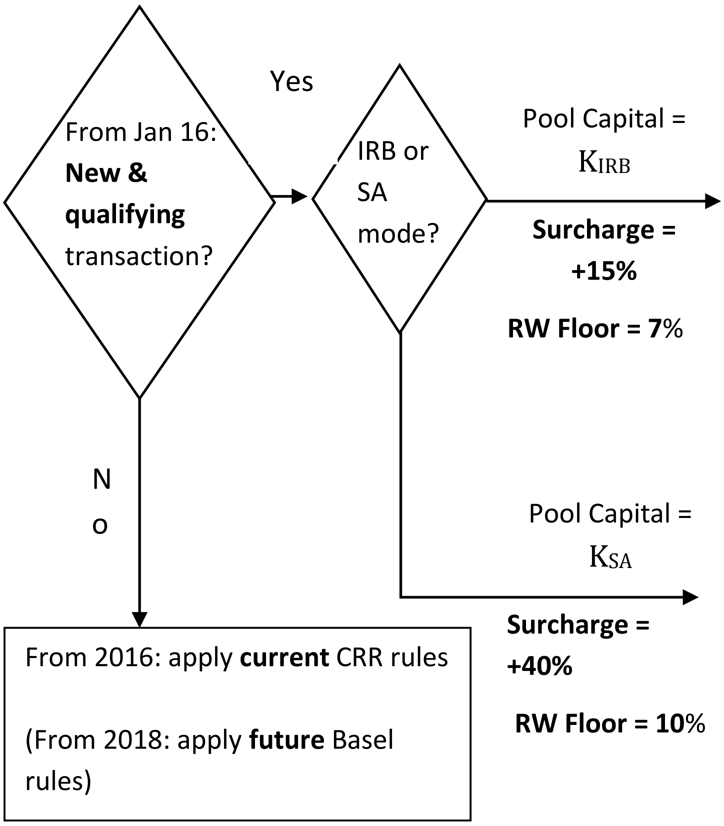
Even though the SEC-IRBA approach is at the top of the hierarchy, few investors will be able to use this approach. This will still lead to a “de facto” use of ratings and the issues identified by the EBA regarding overreliance on ratings will not be solved.

QUESTION 11:

How should rules on capital requirements for securitisation exposures differentiate between qualifying securitisations and other securitisation instruments?

Nota bene: We invite the Commission to refer to the uploaded FBF response in order to access the different graphs illustrating our proposal

- <u>The PCMA proposal overview</u>



PCMA Proposal in SA mode		
Sensitivity Steps	Mapping to Pool Capital Multiplier	Sensitivity Step Risk Weight
1 (Floor)	x4.00 and above	10%
2	x3.50 - x4.00	30%
3	x3.00 - x3.50	60%
4	x2.50 - x3.00	110%
5	x2.00 - x2.50	200%
6	x1.75 - x2.00	300%
7	x1.50 - x1.75	400%
8	x1.25 - x1.50	550%
9	x1.00 - x1.25	700%
10	x0.75 - x1.00	850%
11	x0.50 - x0.75	1000%
12	x0.25 - x0.50	1150%
13	x0.00 - x0.25	1250%

Qualifying securitisations should attract reasonably conservative capital surcharge and their capital should not be dependent on external ratings. We propose a practical solution that would achieve these goals: the capital would no longer be based on external ratings but on the pool capital multiplier approach (PCMA). The risk weight of a tranche would be simply read in a PCMA table. We propose the following PCMA tables:

PROPOSED PCMA APPROACH (IRB)[1]

Sensitivity Steps	Mapping to Pool Capital Multiplier	Sensitivity Step Risk Weight
1 (Floor)	x4.00 and above	7%
2	x3.50 - x4.00	12%
3	x3.00 - x3.50	25%
4	x2.50 - x3.00	55%
5	x2.00 - x2.50	110%
6	x1.75 - x2.00	185%
7	x1.50 - x1.75	280%
8	x1.25 - x1.50	400%
9	x1.00 - x1.25	535%
10	x0.75 - x1.00	700%
11	x0.50 - x0.75	900%
12	x0.25 - x0.50	1100%
13	x0.00 - x0.25	1250%

PROPOSED PCMA APPROACH (SA)[2]

Sensitivity Steps	Mapping to Pool Capital Multiplier	Sensitivity Step Risk Weight
1 (Floor)	x4.00 and above	10%
2	x3.50 - x4.00	30%
3	x3.00 - x3.50	60%
4	x2.50 - x3.00	110%
5	x2.00 - x2.50	200%
6	x1.75 - x2.00	300%
7	x1.50 - x1.75	400%
8	x1.25 - x1.50	550%
9	x1.00 - x1.25	700%
10	x0.75 - x1.00	850%
11	x0.50 - x0.75	1000%
12	x0.25 - x0.50	1150%
13	x0.00 - x0.25	1250%

[1] For instance, a senior tranche rated AA, because of the impact of sovereign caps in rating agencies methodologies, attaching at 24% is currently mapped to step 2 in the RBA and would attract a risk weight of 8% for a granular pool. Assuming pool capital of 6%, the attachment point of the tranche would be x4 pool capital; the tranche is mapped to sensitivity step 1 in the PCMA (IRB) and would attract a risk weight of 7%.

[2] For instance, in the PCMA (SA) a mezzanine tranche attaching at x1.75 and detaching at x2.75 pool capital would cover 100% of sensitivity step 6 with thickness of 0.25, 100% of step 5 with thickness of 0.5 and 50% of step 4 with thickness of 0.5. The PCMA (SA) tranche RW equals 202.5% RW calculated as follows: (100%*0.25)*300%RW+(100%*0.5)*200%RW+(50%*0.5)*110%RW

In IRB mode, the proposed PCMA results in an overall capital surcharge post-securitisation of 15% compared to pre-securitisation and a risk weight floor of 7% would apply. In SA mode, the proposed PCMA would result in an overall capital surcharge of 40% with a floor of 10%.

We propose that the PCMA approach be implemented as early as January 2016 for qualifying European securitisations. The proposed PCMA tables will replace the existing tables based on external ratings (see below). For non-qualifying securitisations, the current rules from the CRR (RBA/SA(RB)/SFA/IAA) will continue to apply between 2016 and 2018 when the new Basel framework will be implemented.

<table>
<tr><th colspan="5">CRR 575/2013, Article 261, IRB - Ratings Based Method</th></tr>
<tr><th rowspan="2">Credit Quality Steps</th><th rowspan="2">Mapping to External Ratings</th><th></th><th>Credit Quality Step Risk Weight</th><th></th></tr>
<tr><th>Senior</th><th>Non-Senior and Granular</th><th>Non Granular</th></tr>
<tr><td>1</td><td>AAA</td><td>7%</td><td>12%</td><td>20%</td></tr>
<tr><td>2</td><td>AA+ / AA /</td><td>8%</td><td>15%</td><td>25%</td></tr>
<tr><td>3</td><td>A+</td><td>10%</td><td>18%</td><td rowspan="3">35%</td></tr>
<tr><td>4</td><td>A</td><td>12%</td><td>20%</td></tr>
<tr><td>5</td><td>A-</td><td>20%</td><td>35%</td></tr>
<tr><td>6</td><td>BBB+</td><td>35%</td><td colspan="2">50%</td></tr>
<tr><td>7</td><td>BBB</td><td>60%</td><td colspan="2">75%</td></tr>
<tr><td>8</td><td>BBB-</td><td colspan="3">100%</td></tr>
<tr><td>9</td><td>BB+</td><td colspan="3">250%</td></tr>
<tr><td>10</td><td>BB</td><td colspan="3">425%</td></tr>
<tr><td>11</td><td>BB-</td><td colspan="3">650%</td></tr>
<tr><td rowspan="2">All other and unrated</td><td>B+ / B / B-</td><td colspan="3" rowspan="2">1250%</td></tr>
<tr><td>Below B- or unrated</td></tr>
</table>

<table>
<tr><th colspan="3">CRR 575/2013, Article 251, Standardised Approach</th></tr>
<tr><th>Credit Quality Steps</th><th>Mapping to External Ratings</th><th>Credit Quality Step Risk Weight</th></tr>
<tr><td>1</td><td>AAA / AA + / AA / AA-</td><td>20%</td></tr>
<tr><td>2</td><td>A+ / A / A-</td><td>50%</td></tr>
<tr><td>3</td><td>BBB+ / BBB / BBB-</td><td>100%</td></tr>
<tr><td>4</td><td>BB+ / BB / BB-</td><td>350%</td></tr>
<tr><td rowspan="2">All other</td><td>B+ / B / B-</td><td rowspan="2">1250%</td></tr>
<tr><td>Below B- or unrated</td></tr>
</table>

- The PCMA : a simple and transparent method that solves the issue of reliance on rating agencies for qualifying securitisations

In this proposal, to reduce the reliance on ratings for qualifying securitisations, we replaced the capital mapping based on ratings by a mapping based on the risk of the tranche. This is achieved by expressing the tranche attachment and detachment points as a pool capital multiple. In other words, the RBA table is replaced for qualifying securitisations by a table based on pool capital multiple. This is called the Pool Capital Multiplier Approach (PCMA). The PCMA table has 13 «sensitivity steps» which are different from the 12 «credit quality steps» of the RBA table.

The PCMA enables to remove the reliance on ratings for capital purposes. It solves the key issue of high volatility of capital due to rating agencies change in methodologies. Rating agencies will continue to play a role but will no longer be used for capital for qualifying securitisations. The PCMA is calibrated to have a smooth capital distribution so that there is a gradual capital increase between each step. This solves the issue of sharp capital moves in the existing RBA table and of the cliff effect resulting from the capital deduction below the BB- rating. In addition, the PCMA results in a capital framework for qualifying securitisation that is consistent with the capital framework before securitisation. This means that capital for qualifying securitisation would be comparable across European countries for a given asset class which is not the case with the current RBA approach.

The PCMA is simple to implement as it requires few inputs: the capital of the pool pre-securitisation, the attachment and detachment points of the tranches. Bank originators already know the pool capital. Investors can calculate the pool capital easily in standard mode based on information provided by originators. Investors may even be able to calculate the pool capital in IRB mode if they are authorised to do so by their regulators. Attachment and detachment points are easily calculated based on the securitisation structure.

- A capital surcharge calibrated for Europe

To overcome a key obstacle identified by the EBA for the revival of the market, i.e. the disincentive for investors and originators, there is a need to adopt the right calibration for the PCMA. This would attract back to the market both bank originators and institutional investors such as banks or their affiliates. Insurance companies could adopt a similar approach.

The key question in the calibration is that of the capital surcharge, i.e. by how much the capital post securitisation increases compared to the capital pre-securitisation. For qualifying European securitisations, there are strong reasons to have a commensurate surcharge in view of the quality of the structures and the satisfactory historical performance of the assets. Even taken into account the regulatory principle of prudence, surcharge levels for qualifying securitisations should remain reasonably conservative. In their paper : «How to Revive the European Securitisation Market : a Proposal for a European SSFA», Duponcheele, Linden & Perraudin, have used a sample of close to 2000 European tranches to calibrate the appropriate capital surcharge for qualifying securitisation. They found that for Europe a 15% surcharge was appropriate in IRB mode and 40% in SA mode.

Using such surcharge levels for qualifying securitisations in Europe would create the right incentives for originators and investors. The surcharge level for qualifying securitisations could be further refined by asset classes or using the retail/wholesale distinction from the revised Basel framework. The lower the surcharge, the more incentive there will be for originators and investors to participate in the European securitisation market. European legislators should decide on the appropriate level of capital surcharge by making a political decision that will enable the revival of the market and still have a prudent level of capital for qualifying securitisations. This decision will then drive the calibration of the PCMA as proposed in the following table[3]:

Sensitivity Steps	Mapping to Pool Capital Multiplier	Floor Target					
1 (Floor)	x4.0 and above	7%	7%	7%	10%	10%	10%
Sensitivity Steps	Mapping to Pool Capital Multiplier	Capital Surcharge Target					
		No Surcharge	+10% Surcharge	+20% Surcharge	+30% Surcharge	+40% Surcharge	+50% Surcharge
2	x3.50 - x4.00	8%	10%	15%	20%	30%	40%
3	x3.00 - x3.50	15%	20%	30%	40%	60%	80%
4	x2.50 - x3.00	35%	45%	65%	85%	110%	140%
5	x2.00 - x2.50	80%	100%	120%	160%	200%	240%
6	x1.75 - x2.00	140%	165%	205%	250%	300%	350%
7	x1.50 - x1.75	220%	260%	300%	350%	400%	450%
8	x1.25 - x1.50	310%	370%	430%	490%	550%	610%
9	x1.00 - x1.25	405%	495%	575%	645%	700%	750%
10	x0.75 - x1.00	560%	650%	730%	795%	850%	900%
11	x0.50 - x0.75	790%	870%	930%	970%	1000%	1030%
12	x0.25 - x0.50	1050%	1090%	1120%	1140%	1150%	1160%
13	x0.00 - x0.25	1250%	1250%	1250%	1250%	1250%	1250%
Non-Neutrality Ratio (excluding Floor)		1.00	1.10	1.20	1.30	1.40	1.50

- <u>January 2016 implementation is key</u>

[3] numbers can be slightly rounded up or down for the sake of clarity, without creating a material change to the calibration

Another major impediment to the revival of the market in Europe identified by the EBA is the regulatory uncertainty. The key to unblock the uncertainty is for the EC to adopt rules for European qualifying securitisations that can be implemented as early as January 2016 for new transactions.

Starting in January 2016 would enable a truly European solution for qualifying securitisations without the need for ratings. The removal of ratings will only be for qualifying securitisations. Rating agencies will still offer a safeguard against non-qualifying structures. By adopting an approach adapted to European assets in January 2016, Europe will create a level playing field with the US that have already adopted an approach without external ratings calibrated for US assets. Focusing on new production will clearly mean that the rules are designed for the revival of the market and not for legacy issues. Once the PCMA has been established in Europe for qualifying securitisations, it could be widened to "simple, transparent, and comparable" securitisations defined by BCBS-IOSCO globally. This would be similar to the US securitisation capital rules that have been subsequently adopted by Basel for global implementation in 2018.

Last but not least, implementation of the PCMA as of Jan 2016 will require only minor amendments to existing legislations keeping in mind that the current framework will change anyway by 2018.

- <u>Conclusion</u>

To sum up, the PCMA is a simple proposal that can revive the European market for qualifying securitisations. The PCMA enables to remove reliance on rating agencies for capital. If it is appropriately calibrated, it can incentive both originators and institutional investors to participate in the market. If it is enforced as early as January 2016, it will provide the necessary certainty that is needed to revive the market.

QUESTION 12: ***Given the particular circumstances of the EU markets, could there be merit in advancing work at the EU level alongside international work?***

Yes, the solutions put forward in our answer to question 11 should be put in place in the very short-term if we are to solve the root problem illustrated in our answer to question 9.

The EU should firstly and immediately solve the regulatory problem that impedes the use of securitisation as marketable instruments due to the disproportionate regulatory cost compared to the risk weight of the underlying asset pool. This specific problem should be solved in the very short term for STS securitisations. Then EU should closely monitor the performance of international works to ensure consistency within the EU regulatory framework. The Basel Committee will soon consider how to incorporate the 'high quality securitisation' concept into the Revised Securitisation Framework with a target implementation for 2018. This is too late for Europe's need to develop funding and origination markets, in particular for SMEs. It is important to act independently from the Basel calendar or other non-European calendar, and focus on quick implementation of European initiatives:

- Focus the STS initiative on new transactions. Legacy ABS more complex issues can be treated in a second step. These legacy transactions are not key in the revival of the funding of the economy through securitisation.
- Quick implementation as soon as January 2016. The EC should not be slowed by difficult discussion on details. The scope and details of STS framework and criteria could be reviewed and expended at a later stage.
- For STS, use a simple mapping table for capital requirements, which quickly addresses the issues mentioned by EBA and BCBS, without lengthy discussions on models.
- Use of an approach for capital which reduces the inappropriate over-reliance on agency ratings. This is a strong impediment to the market, in particular for South European countries.

<u>3.3 Asset Managers</u>:

QUESTION 15:

A. How could the institutional investor base for EU securitisation be expanded?

In the short term, it is important to reduce the constraints to the current investor based of Banks, Insurance and Money Market Funds. Although desirable, the investor base could be expanded progressively to other investors in a long term, on STS securitisations.

B. To support qualifying securitisations, are adjustments needed to other EU regulatory frameworks (e.g. UCITS, AIFMD)? If yes, please specify.

The current negotiation on MMF regulation will have to be amended in order for MMF to be able to invest into ABCP and securitisations as soon as they are qualified as STS.

<u>PART 4 – Simplicity and standardisation</u>

QUESTION 1:

A. Do the identification criteria need further refinements to reflect developments taking place at EU and international levels? If so, what adjustments need to be made?

The Commission proposes a modular approach for identifying STS securitisations that comprises foundation criteria and additional criteria. The foundation criteria would apply across the whole financial system, while the additional criteria could contain further requirements for high-quality securitisation in line with the needs of a given sector. In our view, this approach contributes to harmonised requirements across all sectors and counters fragmentation of the eligibility criteria for high-quality securitisation. For this reason, we are in favour of a modular approach.

However eligibility criteria for high-quality securitisation should be formulated so that they allow as little room as possible for interpretation and are practicable. Therefore we ask the Commission to take into account all reserves which were provided in the FBF response dated January 14, 2015 to EBA consultation on SST securitisation and especially appendix 3 pages 35 onwards[4]. In addition, the Commission should be aware that to issue a new securitisation requires time and costs for the originator. Therefore it is key that the process to identify and comply with such criteria is as simple and inexpensive as possible in order to have an efficient impact on the market.

B. What criteria should apply for all qualifying securitisations ('foundation criteria')?

We assume as a major target that qualifying transactions should also qualify for HQLA eligibility. Therefore the foundation criteria for STS and LCR (for HQLA) should be consistent:

Applying LCR delegated act article 13.2 criteria should ensure compliance with the spirit of most recommendations as proposed by the EBA in its discussion paper for criteria 1, 3, 4, 5, 6, 7, 10, 11, 12, 16, A.

However we recommend reviewing some paragraphs of LCR article 13 :

[4]http://www.eba.europa.eu/documents/ddm/com.liferay.portlet.dynamicdatalists.model.DDLRecord/949551/view_uploadFiles

- 13.2(j) : it excludes all securitisations of French retail assets as the French legal system does not allow to check past entries into credit registers. It should be amended as follows:

(j) at the time of issuance of the securitisation or when incorporated in the pool of underlying exposures ~~***or at any time after issuance***~~*, the underlying exposures do not include exposures to credit-impaired obligors (or where applicable, credit-impaired guarantors), where a credit-impaired obligor (or credit-impaired guarantor) is a borrower (or guarantor) who,* ***<u>to the knowledge of the institution at the time of inclusion of the exposure in the securitisation</u>*** *:*

> *(i) has declared bankruptcy, agreed with his creditors to a debt dismissal or reschedule or had a court grant his creditors a right of enforcement or material damages as a result of a missed payment within three years prior to the date of origination, or;*
> *(ii) is on an official registry of persons with adverse credit history, or;*
> *(iii) has a credit assessment by an ECAI or has a credit score indicating a significant risk that contractually agreed payments will not be made compared to the average obligor for this type of loans in the relevant jurisdiction.*

- 13.2g(i) : it restricts mortgages' destination to be the financing of the acquisition of the main borrower's home, not buy-to-let. This restriction is not useful and difficult to control one by one and overtime in a securitized pool of assets.
- 13.2g(iii) : it excludes from commercial loans, leases and credit facilities to SMEs established to finance capital expenditures or business operations those which finance the acquisition or development of commercial real estate. Indeed the financing of such acquisitions is usually part of the financing package and it is practically impossible to segregate them within a securitized pool of assets.

Moreover these following criteria should not be "foundation criteria" but additional criteria for LCR eligibility:

- 13.11 and 13.12 on issuance size and duration;
- 13.2a and 13.2b: credit quality step 1 and senior positions.

In addition, some criteria (especially those related to transparency) as proposed by the EBA in its discussion paper could be added, provided they are reworded to remove unnecessary details or definitions which cannot apply to certain asset classes (because the criteria details are too specific), or specify that some criteria details are requirements only for some specific asset classes.

Although it is important to have the same foundation criteria for all STS securitisations, some criteria need to be more flexible based on the type of underlying asset, this is especially the case for ABCP (please refer to our answer to Q2).

Therefore we ask the European Commission to take into account all reserves and carve out and comments which were provided in the FBF response dated January 14, 2015 to EBA consultation on SST securitisation and especially appendix 3 pages 35 onwards (see attached file).

QUESTION 2:

A. To what extent should criteria identifying simple, transparent, and standardized short-term securitisation instruments be developed? What criteria would be relevant?

<u>ABCP conduit is a useful and safe funding tool for banks clients</u>

We agree with the statement in the consultation document that short-term securitisation instruments, such as Asset-Backed Commercial Paper (ABCP) “are important refinancing tools for non-financial companies”. Indeed the ABCP market is a key part of the securitisation market and provides an important source of funding to the real economy.

ABCP is also the principal way certain asset classes, such as trade receivables, are securitised, predominantly for corporates (banks’ clients), making it a significant contributor to working capital supporting trade and business. Many companies are using ABCP to fund their development since ABCP are funding the increase of their turnover.

Moreover it is important to have in mind that ABCP market is today mainly composed of multi-seller ABCP conduits (i.e. 82% of ABCP market according to Moody’s), which means that other controversial pre-crisis short-term instruments like Structured Investment Vehicles (SIV) and arbitrage conduits have now disappeared. Multi-seller ABCP conduits benefit from a 100% liquidity facility provided by a bank (subject to the bank having an appropriate liquidity buffer, which is a regulatory requirement in some jurisdictions) which ensures the protection of ABCP investors. In this sense, multi-seller ABCP conduits are more akin to a short-term covered bond, in that there is full recourse to the sponsor bank, as well as ultimately to the underlying assets. In this respect the statement made page 3 of the consultation where, when comparing covered bonds to securitisation, it is stated that ‘This is in contrast to securitisation which offers recourse only to the underlying assets’ is not true. That is the reason why it is important to make a distinction between criteria to define simple, transparent, and standardized (STS) securitisation and those for qualifying ABCP.

<u>Criteria identifying STS short-term securitisations</u>

In applying the STS concept to ABCP conduits, we must consider two different kinds of securitisation exposures:

- the exposures of sponsor banks under liquidity facilities, which are exposures to the conduit's underlying transactions ;
- the exposures represented by the ABCP itself that are very different from exposures to the underlying transactions, as they rely on the sponsor-provided liquidity facilities for timely payment, and not on the value or liquidity of the underlying assets.

A better treatment for both ABCP exposures is essential since (i) the banks need regulatory incentives to provide liquidity facilities to ABCP conduits and continue to offer this type of funding to their clients and (ii) ABCP investors can invest only in instruments defined as eligible and liquid. Excluding one of these exposures from the STS framework may simply kill the ABCP market and all the support it brings to the real economy.

Based on that we can formulate a STS framework for multi-seller ABCP conduits:

<u>STS framework for the liquidity facilities provided to a multi-seller ABCP conduit</u>

Liquidity facilities granted by banks in the context of an ABCP program are subject to capital charge requirements under Basel II securitisation framework, mainly because the underling risk is on the securitisation tranche financed in the ABCP conduit (i.e. assets of the ABCP conduit).

Thus to include these liquidity facilities in the STS framework, we have to apply the criteria to the conduit assets themselves, as "stand alone" ABS transactions, except that many of them are privately negotiated. For example, such a transaction may not have a formal offering document or an independent entity with fiduciary responsibilities, though the sponsor bank and other parties have at least as much information about and control of the transaction and the underlying assets as investors in widely-offered ABS. The Authorities should include multi-seller ABCP conduits transactions in the STS framework even if these deals are not public.

The following criteria can be proposed for liquidity facilities granted to ABCP programs:

- In the case of a publicly rated transaction, the proposed framework should apply (see criteria proposed in answer to question 1) ;
- In the case of a private transaction, even if many of the proposed criteria will work, some of them need to be modified or made more flexible like the following ones :
    - Admission to trading on regulated market is not applicable ;
    - Information on originators and underlying assets should not be published or included in a formal prospectus, so long as it is made available to the sponsor bank ;
    - Criteria on homogeneity of underlying assets should not exclude multi-country/currency transactions as it is often the case in trade receivables deals;

It is also very important at the level of the Commission that the implementation of STS criteria for qualifying ABS and those for qualifying securitisation transactions financed in ABCP conduits is done in the same timing. Indeed as proposed here, the criteria are mainly the same.

STS framework for the ABCP issued by a multi-seller conduits

Investors in ABCP are of different nature, mostly money market funds (MMF) in Europe, but also banks and insurance companies. As ABCP are securitisation positions, investors have to treat them accordingly to their own regulatory environment. ABCP have then to cope with the CRR, Solvency II, AIFMD and the MMF regulation. For example, in the MMF reform in Europe, only “liquid ABCP” are eligible. That is why it is important not to exclude ABCP from the STS framework, but also align the definitions of qualifying ABCP in the different regulations.

The following criteria are relevant for ABCP:

- The ABCP conduit must be a multi-seller ABCP conduit ;
- The liquidity line granted to the ABCP conduit must be fully supported by the sponsoring bank (i.e. where the sponsor provides support to an extent that leaves the CP effectively exposed to the default risk of the sponsor, instead of the underlying pools of assets) ;
- The bank providing that support should be subject to short-term liquidity standards as provided in the Basel III framework (as enacted in the relevant jurisdiction) ;
- The ABCP's remaining term to maturity should be no more than 397 days ;
- The ABCP should be rated with one of the two highest short-term credit grades (equivalent to A-2/P-2 or higher) ;

We think that, considering bank’s support, these criteria are sufficient for STS ABCP (no reference to the assets).

In terms of disclosures, investors reports should be made available each month with credit risk information on each underlying conduit assets, taking into account confidentiality of these transactions for the banks clients.

Risk retention requirements must be fulfilled in terms of retention and disclosures.

B. Are there any additional considerations that should be taken into account for short-term securitisations?

Regarding ABCP conduit activity, there are some other considerations to have in mind and that should be taken into account to keep ABCP market attractive:

CRA 3 requirements

ABCP transactions are expressly included in the scope of CRA 3 and more precisely fall under disclosures requirements for Structured Finance Instruments (SFI) described in Article 8(b). Even if ECB template does not currently exist, which means that so far we do not know exactly the level of detail ABCP issuer would have to disclose, we think that disclosing for each conduit program loan level data information is not relevant because: (i) underlying assets are mainly of short maturity (i.e. trade receivables) and then providing such reporting could be very challenging operationally speaking,(ii) thanks to the first recourse on the bank sponsor, investors do not really need so detailed information on the underlying pool of each transaction to perform their risk analysis and (iii) finally in many cases, these issues will be such that it may not be possible for the information to be publicly disclosed without significant business risks arising for the relevant originator.

For all these reasons, we consider that ABCP conduits and corresponding private underlying transactions should be outside the scope of article 8b of CRA 3 from a wider policy perspective, as well as from a technical perspective as we have outlined above. At least disclosures for ABCP transactions should be limited to investor reports.

Use of Internal Assessment Approach (IAA) outside ABCP conduits

In the current securitisation framework, but also in the last proposal made by the Basel Committee, IAA is limited to unrated transactions financed through an ABCP conduit. We consider that this approach should be made available once validated by the supervisor for unrated securitisation exposures funded directly by banks in addition to those held in bank-supported ABCP conduit programs, since the underlying risk is the same.

The IAA requires a great deal of detailed information and analysis and is subject to a high level of regulatory supervision.

Banks, whether or not they sponsor ABCP conduits, often enter into securitisation transactions with their customers that are identical to those typically entered into by ABCP conduits, except that funding is provided by the bank directly rather than by the conduit issuing ABCP supported by bank facilities. It is increasingly common for a receivables securitisation facility to be provided by a lender group consisting of one or more ABCP conduits, supported by their sponsor banks, and one or more banks providing funds directly. It is anomalous that, in those cases, the ABCP sponsor banks may use the IAA to determine their capital requirements while the other banks, having essentially the same exposure (though funded rather than unfunded), may not. We believe that banks that develop the necessary models and obtain supervisory permission should be permitted to apply the IAA to unrated securitisation exposures in appropriate conditions whether or not it funds those exposures through an ABCP conduit.

MMF Reform in Europe

After EU Parliament ECON Commission vote in February 26, 2015, MMF can invest in eligible securitisation positions. “Asset Backed Commercial Papers shall be considered to be eligible securitsations provided that they are liquid as referred to in Regulation (EU) No 575/2013 and that the underlying exposures are of high credit quality.” (Art 10 1b. of MMF reform).

It is clearly explained that “the Commission shall by [6 months following publication of this Regulation] adopt delegated acts specifying the criteria for identifying debt of high credit quality and liquid asset backed commercial papers with regard to paragraph 1a. In doing so, the Commission shall ensure consistency with and support the respective work streams of EBA.”.

For that reason and because MMF are major investors for ABCP conduits in Europe, we ask the Commission to accept STS framework as a sufficient criteria to be eligible under MMF regulation. In this respect, we noticed that European Commission has not mentioned the MMF reform in Annex 2 of the consultation whereas it is an important project currently under discussion.

Eligibility of qualifying ABCP to the HQLA buffer under LCR

As we know that the liquidity of a market is also driven by the regulatory treatment applied to a financial instrument, like what happened to covered bonds in Europe, we think that if an ABCP is considered as liquid and of high quality by the regulator for the purpose of the STS framework, it is also important to provide it not only a lower capital charge, but also add this ABCP in the liquidity buffer of the Liquidity Coverage Ratio (LCR).

Thanks to this, the ABCP will attract also banks investors and at the end reduce the cost of fund for banks clients.

Other short term securitisations

Criteria should allow a revolving period in line with criterion 10 of the EBA discussion paper in order to facilitate the use of short term assets (for ex. consumer loan ABS or auto ABS).

PART 5 – Transparency and risk management

QUESTION 3:

A. Are there elements of the current rules on risk retention that should be adjusted for qualifying instruments?

From our perspective, rules should be applicable whether the securities are qualifying or not and we do not believe that alternative or additional forms of risk retention should be considered at this time. This view was also expressed by the EBA in its recent report on risk retention, due diligence and disclosure. Indeed risk retention is an important mean of aligning the economic interests of those originating exposures underlying a securitisation transaction and the investors in that transaction. The CRR requirement for the retention of a material net economic interest in a securitisation is effective and appropriate but could be improved by clarifying that asset managers who manage securitisation vehicle on behalf of insurers should be considered as sponsor, because the current rule requires that a 5% retention shall be held by an entity qualifying either as "sponsor", "initiator" or "original lender", which excludes asset managers unless it has in its group a related entity complying with CRR definition.

We also note that the EU is at disadvantage compared to the US regarding retention requirements, as the US future regulation have lower retention requirements for certain asset classes (for example autoloans, mortgages not subprimes, commercial real estate loans).

Last point, in connection with SME funding. Companies sell receivables to the bank after deduction of a discount on the purchase price (first loss piece). Under current prudential rules, the bank must prove that the company retained at least 5% of the receivables (i.e. the purchase price discount is at least 5%). This is where accounting rules collide with prudential rules.

Article 122a of CRD II, in conjunction with Recital 25, had already resolved this problem by stipulating that the retention requirement was not to apply to purchased receivables (see Art. 122a, par. 3, 2nd sentence of CRD II). Recital 58 of the current CRR is identical in wording with the earlier rules. CRR does not provide for any specific exemption in this connection, however. Since the recital is not legally binding, companies and banks currently face the problem that the bank is required to demonstrate a retention amount of 5%, which is at odds with the company's objectives.
We are therefore in favour of readopting the earlier rule. However we stress the need to keep the distinction between refundable and non-refundable purchase discounts introduced by the CEBS. See Article 122a, 2010 CEBS Guidelines ("Guidelines to Article 122a of the CRD"), which sets:

59. ***Whereas both Recital 25 and Paragraph 3 outline the non-applicability of the provisions of Article 122a to purchased receivables (with Recital 25 explicitly specifying those purchased receivables that are "transferred at a discount")****, should such exemptions not apply for any reason to* ***transactions in which the receivables are sold with a <u>refundable</u> purchase discount****, then such <u>refundable</u> purchase discount would qualify as a first loss tranche under option (d). See also clause 60 below for further clarification on meeting the retention requirement under option (d) by way of sale of exposures at a discount.*

B. For qualifying securitisation instruments, should responsibility for verifying risk retention requirements remain with investors (i.e. taking an "indirect approach")? Should the onus only be on originators? If so, how can it be ensured that investors continue to exercise proper due diligence?

As of today, originators already disclose to investors that they comply with the risk retention rules. For qualifying securitisation instruments, it could be contemplated that investors would rely only on the originator disclosure. Even if the onus for verifying risk retention requirements were to become the responsibility of the originator, investors will continue conducting their credit assessment on the securities.

To make it clear, we could adopt the December 2014 EBA recommendation 1 which adds a direct approach to the current indirect approach:

"Taking into account the positive impact of the current framework on EU markets, the EBA recommends keeping the indirect approach for now and implementing a complementary direct approach: in addition originators/sponsors/original lenders should be obliged to publicly disclosed on the detailed retention form using a standardised format to create more transparency and certainty for the investors and to thereby facilitate the investors' due diligence."

QUESTION 4:

A. How can proper implementation and enforcement of EU criteria for qualifying instruments be ensured?

An important step to implement an efficient qualification process for the STS securitisations would be the existence of one or several independent "notified bodies" or agencies that would certify the qualifying instruments across the entire European Union. This would ensure a homogenous interpretation and application of the EU criteria for qualifying instruments, across all European Union jurisdictions and over the life of each transaction. Moreover the eligibility of the securitisation could be made available to the market as a whole, in a similar way to the list of ECB eligible assets on the ECB website, thus saving the originator and/or investors the time and effort in checking the eligibility themselves.

The certification by an independent third party would also provide comfort to the regulator in terms of the quality, consistency and impartiality of the analysis. A situation of this kind exists between the ECB and the European DataWarehouse, which certifies the quality of the loan level data for all ECB eligible ABS.

B. How could the procedures be defined in terms of scope and process?

Regulatory competent authorities should be in charge of defining the global framework regarding eligibility criteria of STS securitisations on one hand as well as criteria for the agreement of labelling agencies on the other hand. Besides, supervisory competent authorities should be given the power to grant licenses to potential labeling agencies (PCS could be one of these authorized labelling agency). These approved third parties would provide the STS label under the guidelines defined by the Commission and will be subject to the oversight of the competent authority.

C. To what extent should risk features be part of this compliance monitoring?

As explained in the answer to question 1 and in the FBF answer to the EBA discussion paper (January 2015), the STS foundation criteria should be the common criteria of the modular approach, and risk criteria (and criteria for liquidity) should be separate. The risk criteria should be used only in the selection of the STS securitisations which could benefit from a better capital treatment. Because the criteria are separate, the FBF believes that it would be consistent that the STS certification / labelling process for "foundation" STS does not take into account the risk features which therefore would not be part of the compliance monitoring. Checking the risk criteria should ultimately be the responsibility of the investors, even though third parties could also provide the service of verifying the compliance to the risk criteria.

We recommend that risk criteria, as proposed by the EBA, should be as follows:

> **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.
>
> **B (Granularity):** Retail pools should be such that the largest aggregate exposure to a single obligor does not exceed 1% of the value of the aggregate outstanding balance.
> Consistently with BCBS "Revision to the Securitisation Framework" (11^{th} December 2014), for wholesale assets, pools are deemed granular when the effective number of loans N is equal or

above 25[5]. For trade receivables, the borrower concentration is a risk only on the part which is in excess of the risk fully funded by the originator. The concentration can be authorized depending on the size of the credit enhancement and the credit quality (rating) of the borrower.

C. The underlying exposures should fulfil each of the following criteria:

i) They have to be exposures to individuals or undertakings that are at time of origination 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 of the funded loan equal to or smaller than: a) 60% 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. The risk weights limits should be adjusted with any change of the local regulatory risk weights.

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 more than 5% of the loans in the securitised portfolio should be characterised by a loan-to-value ratio higher than 100%.

QUESTION 6:

A. For qualifying securitisations, what is the right balance between investors receiving the optimal amount and quality of information (in terms of comparability, reliability, and timeliness), and streamlining disclosure obligations for issuers/originators?

We are in favour of disclosing information that investors need to be able to evaluate the risks and risk concentrations involved in a securitisation and make an informed decision about investing in a securitisation tranche. It is already standard practice that bank originators provide investors with all the information they request. Transparency requirements should therefore be appropriate, practicable and serve a useful purpose. That is the reason why we believe that excessive transparency requirements with no added value for investors would be counterproductive and merely make transactions more expensive. Highly bureaucratic and resource-consuming processes could undermine the purpose of this initiative. Moreover most of the disclosure obligations required from public issuers/originators (loan level data, investor reports, prospectuses) already complies with the level of information required by the EBA and the BCBS-IOSCO consultative documents.

B. What areas would benefit from further standardisation and transparency, and how can the existing disclosure obligations be improved?

Regarding the legal aspects, the prospectus directive has been applicable to securitisations prospectuses for several years, ensuring at least the same minimum level of standardization and transparency for the investors. In addition, the preliminary version of the prospectus is distributed to

[5] BCBS 11 December 2014 (page 19) : The effective number of exposures (N) is defined as :

$$\mathrm{N} = \frac{(\sum_i EAD_i)^2}{\sum_i {EAD_i}^2}$$

investors during the marketing phase, i.e. in advance of the closing date. As suggested in the FBF answer to the BCBS-IOSCO consultative document, it would be advisable to disclose the rest of the legal documentation on the closing date when in agreed form.

C. To what extent should disclosure requirements be adjusted – especially for loan-level data1 – to reflect differences and specificities across asset classes, while still preserving adequate transparency for investors to be able to make their own credit assessments?

The European DataWarehouse has already defined dedicated templates for each type of asset class reflecting the characteristics of the underlying receivables (residential loans, SME loans, consumer loans, etc.). Investors are used to assess securitisations portfolios by asset class and by jurisdiction. Loan-level data designed per asset class are helping them to fine-tune their credit review.

QUESTION 7:

When considering whether or not to invest in a securitised instrument, investors typically look at the credit rating issued by credit rating agencies. Current methodologies employed by the majority of credit rating agencies take into account country risk in determining the appropriate credit rating. As a result, some securitisations do not qualify for the highest credit ratings for the simple reason that they are issued in a specific Member State.

Reducing reliance on ratings would mitigate the negative impacts of country ceilings employed in rating methodologies, in line with the aims and objectives of the Credit Ratings Agencies III Regulation (which encourages investors to make their own assessments of creditworthiness).

A. What alternatives to credit ratings could be used, in order to mitigate the impact of the country ceilings employed in rating methodologies and to allow investors to make their own assessments of creditworthiness?

When investing into securitisations, the potential investors should make their own analysis, and not rely only on rating agencies.
It is particularly the case for simple, transparent and standardised securitisation which should cover about 80% of the market, as most European securitisation are good quality.

To reduce reliance to credit ratings agencies, the potential investors would need to have access to:

(a) detailed and standardised data on the assets, on the underlying pool performance. The data should be available at closing and on a periodic basis.
(b) a model to calculate expected and unexpected losses of the tranche using the data and assess the risks of the in various stress scenarios.

Access to data is already possible for some public transactions and for example for the transactions which participate to the European DataWarehouse. Cash Flow Models also already exist for many ABS, and systems developed by third parties that can be used to assess scenarios.
It is important that investors can understand the impact of macroeconomic scenarios on the securitisation, rather than rely on the rating agencies models that are only used to rank the risks.

The ratings are used as qualitative information on the risk of the securitisation and to put the security into pricing buckets. It provides a benchmark that should be used only as a complement and additional safety belt for the investors who should in any case make their own assessment (including the less sophisticated investors).
For less sophisticated investors, data on the resilience of the tranche to standard stress scenarios (by asset classes) could also be published by the originators. Models such as PCMA can also be used to assess the expected and unexpected losses of the securitised assets. This can be used by sophisticated investors.

For capital purposes, the external ratings are not always a good means of assessing capital anyway, as the credit rating agencies approach is focused on the 1st loss or expected loss, rather than on the unexpected loss; the CRA models objective is to rank the risk, and CRA ratings are not meant by rating agencies to quantify expected and unexpected loss in macro-economic scenarios. Capital is too dependent on the rating agencies methodologies, and this is damaging for example for good quality European SMEs. An approach based on the K_{IRB} or on K_{SA} but better calibrated by European asset classes, such as PCMA, should be used.

The country ceiling approach used by the rating agencies distorts the analysis of the securitisation and it is more difficult for potential investors to assess the resilience of the securitisation and of the structure using only the rating agencies current ratings as only the final rating is provided. The access to the data described above would allow the investors to make their own assessments of the risks of the securitisation, using also their own analysis of the country-specific risks.
At the very minimum, the rating agencies should provide the information on rating without applying the country ceiling. This does not solve all problems, but it would be marginally more transparent for potential investors (see question 7B).

B. Would the publication by credit rating agencies of uncapped ratings (for securitisation instruments subject to sovereign ceilings) improve clarity for investors?

The publication of uncapped rating would add transparency for the investors, as it would reduce the dependence of the analysis to the rating agencies sovereign cap methodology, and also provide the investors with a better understanding of the proper risk attached to the bond itself independently of sovereign rating consideration.
However, as said above, this would only marginally improve the transparency: in particular for capital purposes in the case of simple, transparent and standardised securitisation transactions, alternative approaches could be taken with no link to rating agencies, by using the European SSFA based on the PCMA described in Q11. Non sophisticated investors could use a standard SSFA model calibrated by asset classes. Putting such approaches higher than the RBA in the hierarchies of approaches would reduce reliance on rating agencies.

PART 6 – Others issues

QUESTION 5:

A. What impact would further standardisation in the structuring process have on the development of EU securitisation markets?

See response to question 5B.

B. Would a harmonised and/or optional EU-wide initiative provide more legal clarity and comparability for investors? What would be the benefits of such an initiative for originators?

Standardisation in the structuring process is difficult to achieve in the EU especially as for any given loan type, national loan markets enjoy very diverse characteristics, and national securitisation laws themselves are not unified. The standardization will therefore remain gradual and limited. As convergence of securitisation laws in EU could be seen positively, we must remain careful that standardization is a two-edge sword as it clearly facilitates analysis and comparison for investors but may add complexity or even dissuade some issuers, if the template does not match their target structure or internal or local constraints.

C. If pursued, what aspects should be covered by this initiative (e.g. the legal form of securitisation vehicles; the modalities to transfer assets; the rights and subordination rules for noteholders)?

Such initiative might cover:

- Alignment of securitisation laws / vehicles as of their main aspects
- Asset transfer modalities (given that true sale should remain the basis)
- Minimum disclosure (already covered by the Prospectus directive)
- Proposed presentation templates with fixed sections (ex. Asset description, Payments, Definitions, etc…) to harmonize as much a possible the structure of the prospectus.

D. If created, should this structure act as a necessary condition within the eligibility criteria for qualifying securitisations?

Such harmonizing work should be construed as a complement to investor incentive but not as a prerequisite for qualifying securitisations. European Commission should take into account the fact that when structuring a transaction; a structurer has to use the legal framework of the various countries involved (laws of the assets/ debtors, laws of the sellers, law of the local SPVs). Unlike the US, Europe has various legal environment and those have to be respected to get legal validity for the structures.

QUESTION 8:

A. *For qualifying securitisations, is there a need to further develop market infrastructure?*

A central repository for all documentation and data related to STS securitisation instruments could help to ensure that investors have ready access to information. The European Data Warehouse is an example of such a central repository. Indeed, the availability of a unique loan by loan data repository and recognized independent cash flow analysis firms should help answering to investor needs.

From our perspective there is scope to further develop market infrastructure for securitisations in general and high-quality securitisations in particular. A certain degree of marketability in the securitisation segment is essential to enable the investment objectives to be met. The ability to liquidate an instrument also plays a role in the context of the delegated act on the LCR. If a securitisation can be traded on an exchange, it will attract a broader range of investors. This could play a valuable part in promoting the securitisation market.

If a secondary market for securitisation instruments is to be promoted, however, it should be ensured that the capital requirements for high-quality securitisations in the trading book are not increased. The Basel Committee on Banking Supervision is planning a substantial rise in capital charges for trading book securitisation exposures as part of its fundamental review of the trading book. Capital requirements for securitisation positions in the trading book are to exceed those for positions in the banking book. If these proposals were implemented in European law, they would frustrate efforts to promote the securitisation market.

B. ***What should be done to support ancillary services? Should the swaps collateralization requirements be adjusted for securitisation vehicles issuing qualifying securitisation instruments?***

Securitisation vehicles should remain exempt of collateralization. However securing a high level of rating (AAA or AA) generally requires a highly rated swap provider or guarantor, and potentially asymmetrical potential collateral posting on the part of the swap provider. The availability of public or supranational swap providers or guarantors with AAA or AA rating, providing low cost service, would largely benefit the securitisation market.

Also, the availability of public national or supranational back up servicers providing a low cost / good standard back up service would benefit the market; noting that due to local loan specificities throughout Europe, national servicers would probably be an advisable solution.

C. What else could be done to support the functioning of the secondary market?

In order to favor a better secondary market, qualifying securitisations should be recognized as HQLA for LCR and be also eligible to Eurosystem refinancing as a lot of investors do not buy ABS or ABCP because they are not eligible to central bank refinancing operations'. It is key for the securitisation market revival and liquidity that Central banks make this statement.

That is the reason why convergence of criteria is key. Additionally, recognized public or supranational guarantors could add secondary market liquidity, although the guarantee cost has to remain limited; alternatively, the holding of securitisations portfolios by public or supranational actors, especially if they are both active buyers and sellers, could add to the market liquidity.

Moreover, the revival of a European securitization market needs a level playing field with other instruments using collateral for funding purposes, like covered bonds. But this is far from being achieved by the latest regulatory developments, e.g. CRD4/CRR. For instance, article 207 of CRR describes requirements for financial collateral and paragraph 2 introduces a clear dissymmetry between the two issuing vehicles:

"2. The credit quality of the obligor and the value of the collateral shall not have a material positive correlation. Where the value of the collateral is reduced significantly, this shall not alone imply a significant deterioration of the credit quality of the obligor. Where the credit quality of the obligor becomes critical, this shall not alone imply a significant reduction in the value of the collateral.

Securities issued by the obligor, or any related group entity, shall not qualify as eligible collateral. *This notwithstanding, the obligor's own issues of covered bonds falling within the terms of Article 129 qualify as eligible collateral when they are posted as collateral for a repurchase transaction, provided that they comply with the condition set out in the first subparagraph."*

So securities issued following securitization of assets originated by a related entity are not eligible as collateral for CRR purposes, but covered bonds are, even though the reliance of a covered bond rating on the rating of the sponsor is much more significant than for a securitization since covered bonds are double recourse vehicles. Moreover, this condition also introduces a difference of treatment between ECB and other entities since ECB accepts own securitizations as collateral for monetary policy refinancing operations (under some conditions), whereas another entity cannot because of CRR. Our suggestion would be to introduce an exemption in article 207 for securitisations, similar to the one on covered bonds, under criteria that are close to the ones used by ECB.

QUESTION 16:

A. ***What additional steps could be taken to specifically develop SME securitisation?***

SME loan backed securitisations were the second largest asset class for European issuances prior to the crisis. SME securitisation volumes have since collapsed due to severe changes in rating methodologies and compulsory reference to external ratings in Europe, while at the same time European authorities have explicitly favored the treatment of on-balance sheet SME loans. The regulatory gap before and after securitisation grew to such an extent that those securitisations have almost stopped being issued. Therefore to revive the market in SME securitisations, references to external ratings should be removed, to better align their regulatory treatment with the regulatory treatment of on-balance sheet SME loans. This is particularly important for Europe, as even though some mid-sized companies may be able to move to capital markets, small and most mid-sized companies will continue to rely on bank lending for structural reasons (of which cultural ones, such as lack of appetite for opening up their capital, are not the least).
European Commission should encourage initiatives currently under way such as the ones developed by EIB and EIF. SME securitisation should be seen not only as securitisation of SME loans but securitisation of all types of SME assets including trade receivables. Current development of on line factoring platform show that huge needs exists that are not yet fulfilled.

B. Have there been unaddressed market failures surrounding SME securitisation, and how best could these be tackled?

We do not have any particular comments.

C. ***How can further standardisation of underlying assets/loans and securitisation structures be achieved, in order to reduce the costs of issuance and investment?***

We do not have any particular comments.

D. ***Would more standardisation of loan level information, collection and dissemination of comparable credit information on SMEs promote further investment in these instruments?***

Developing loan contracts standardization on a national or European scale, and harmonizing bankruptcy laws throughout EU could clearly help, but these are long term initiatives. Additionally, the availability of public or supranational guarantors could help, although the guarantee cost has to remain limited. Provided such guarantees are actually attractive, guarantors could also impose some degree of standardization to the benefiting loans. European DataWarehouse has actually already created functioning standards for loan level data. Obviously standardization of loan level information can benefit investors, even though they should keep in mind that same figures are not readily comparable in the different national markets given their diversity and the difference of legal environments.