

EBA REPORT ON SECURITISATION RISK RETENTION, DUE DILIGENCE AND DISCLOSURE

UNDER ARTICLE 410(1) OF THE CRR

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Contents

List of figures	3
Abbreviations	3
Executive summary	4
Main analysis	6
1. Short overview of international and EU developments in the regulation of risk retention	6
2. Assessment of supervisory measures taken by competent authorities in 2014 on compliance with risk retention, due diligence and disclosure requirements	9
3. The EBA's recommendations for enhancing the regulation of risk retention, due diligence and disclosure in the EU	19
Conclusions	24

List of figures

Figure 1: Development of risk retention rules in the EU	8
Figure 2: Institutions exposed to securitisation (in the EU, in 2014) – number and percentage	10
Figure 3: Number of institutions with exposure to securitisation, and securitisation exposures, in 2014.....	11
Figure 4: Number of institutions with exposure to securitisation, and securitisation exposures, in the SSM, as of 30 June 2015.....	11
Figure 5: Overview of cases of non-compliance with risk retention, due diligence and disclosure requirements under Article 122 of CRD II and Part Five of the CRR, and the sanctions applied, since 2011	15

Abbreviations

ABCP	Asset-backed commercial paper
AIFM	Alternative investment fund manager
CA	Competent authority
CEBS	The Committee of European Banking Supervisors
CLO	Collateralised loan obligation
CRD II	Directive 2009/111/EC, Capital Requirements Directive
CRR	Regulation (EU) No 575/2013, Capital Requirements Regulation
ESAs	European Supervisory Authorities
IORP	Institutions for occupational retirement provision
IOSCO	The International Organisation of Securities Commissions
ITS	Implementing technical standard
RTS	Regulatory technical standard
SREP	Supervisory review and evaluation process
SSM	Single supervisory mechanism
STS	Simple, transparent and standardised (securitisation)
SSPE	Securitisation special purpose entity
UCITS	Undertaking for the collective investment in transferable securities

Executive summary

The European Banking Authority (EBA) presents the annual report on securitisation risk retention, due diligence and disclosure, as developed under Article 410(1) of Regulation (EU) No 575/2013 (the Capital Requirements Regulation, or CRR).

The report provides a review of the supervisory measures taken by competent authorities in the EU in 2014 to ensure compliance with securitisation risk retention, disclosure and due diligence requirements, in line with the mandate in Article 410(1) of the CRR. The EBA assessment specifically focused on the compliance with the risk retention rules.

Separately from the assessment of the supervisory measures in accordance with the CRR mandate, the report presents an analysis of how the EBA recommendations on the enhancement of the regulation of risk retention rules, due diligence and disclosure in the EU, as specified in the EBA report of December 2014, have been taken on board in the regulatory proposals of the new securitisation framework issued by the Commission in September 2015, and further amended by the EU Council compromise achieved in December 2015. The EBA notes with satisfaction that all the EBA recommendations specified in the EBA opinion and the report have been taken on board.

An assessment of the evidence provided by 21 competent authorities suggests that actions have been taken in most jurisdictions, including in countries with an active securitisation market, to enforce the risk retention, due diligence and disclosure framework and to ensure compliance with the applicable rules.

Since the introduction of the risk retention, due diligence and disclosure rules in the EU through CRD II in 2011, a very limited number of breaches of the requirements have been reported (10 cases of non-compliance with risk retention and due diligence have been reported in total). Sanctions in the form of additional risk weights as per Article 407 of the CRR were applied in one out of the 10 cases.

Based on the information provided by 21 competent authorities¹, 258 institutions assumed exposure to securitisation in 2014 either as an originator, a sponsor and/or an investor. The highest number of securitisation exposures was reported by Germany, the UK and France. With regard to the SSM, 15 326 securitisation positions were reported in total for 86 significant institutions supervised by the SSM, as of 30 June 2015.

A number of competent authorities have notified the EBA of the existence of an inactive or marginal securitisation market in their jurisdictions. Also, it appears that competent authorities are currently awaiting the finalisation of the ongoing negotiations at EU level on the new securitisation regulations, before developing and implementing fully-fledged frameworks for the

¹ Of the 21 responses received, four provided good in-depth detail into the respective competent authority's framework for supervision of the risk retention rules.

supervision of the risk retention, due diligence and disclosure requirements in their jurisdictions. In light of the above, assessments of compliance with the respective rules seem to be of a lower priority in the supervisory processes, and often seem to be managed on a flexible and case-by-case basis.

Based on the findings of the analysis, the EBA has identified a number of general best practices to help competent authorities in their supervisory assessments of compliance with the current rules in their jurisdictions, which are summarized in Section 2 of this report.

The EBA encourages all competent authorities to apply the best practices, in a proportionate way to the level of risk of the institution and to supervisory priorities, so as to ensure the proper supervision of credit institutions and investment firms originating and investing in securitisations, and to ensure the adequate assessment of compliance with the current securitisation risk retention, due diligence and disclosure rules. The competent authorities are encouraged to keep their supervisory practices under review, particularly in light of possible changes to the rules as part of the new framework on securitisation, in order to ensure that supervision continues to be coherent and proportionate, and taking into account that the new framework for qualifying STS securitisation suggests specific and enhanced regulatory and supervisory requirements, including in relation to risk retention, due diligence and disclosure.

Main analysis

1. Short overview of international and EU developments in the regulation of risk retention

1. The functioning of securitisation markets prior to the financial crisis was considerably affected by misaligned interests between the issuers of securitisations and the investors, and this is considered to have contributed substantially to the loss of investors' confidence in securitisation products. The issue has since been addressed at EU, US and international level, where the objective sought has been to align the incentives of the originators/sponsors of the securitisations and the investors by requiring the originators/sponsors to retain a financial interest—i.e. part of the credit risk of the underlying assets—and thereby keeping their 'skin in the game'.
2. The risk retention was endorsed by the **G20 leaders at the Pittsburgh Summit in September 2009** as an appropriate solution for inducing a stronger alignment of the interests of the originators/sponsors and investors. Retaining a long-term economic exposure to securitisation by securitisers has also been recommended by **IOSCO** in its reports dated from September 2009 and November 2012. The latter report further sets out specific recommendations relating to securitisation, and incentive alignment in the securitisation.
3. In the EU, retention rules were put in place in January 2011 through **Article 122a of CRD II** which allowed investor institutions to assume exposure to a securitisation only if the originator, sponsor, or original lender has explicitly disclosed to the institution that it will retain, on an ongoing basis, a material net economic interest of no less than 5%. **CEBS guidelines**² issued in December 2010 and applicable from 1 January 2011, provided guidance on the implementation of the risk retention rules.
4. On 1 January 2014, the risk retention provisions specified in CRD II were replaced by **Part Five Titles II and III (Articles 405-409) of the CRR**. Detailed rules on securitisation risk retention have been specified in the **EBA's RTS and ITS developed under Article 410 (2) and (3) of the CRR**³. The technical standards were issued in December 2013 and came into force in July 2014. CEBS guidelines were retrieved.
5. In the **US**, the risk retention rules were adopted **later than in the EU**. The 'Final Rule' with respect to the US risk retention requirements has been in effect since 24 December 2015 for deals backed by residential mortgage loans, while for all other asset backed securities it will be applicable from 24 December 2016.

² <https://www.eba.europa.eu/regulation-and-policy/securitisation-and-covered-bonds/cebs-guidelines-on-the-application-of-article-122a-of-the-crd>

³ <https://www.eba.europa.eu/draf-regulatory-technical-standards-rts-on-securitisation-retention-rules>

6. In September 2015, **IOSCO** published a **report on the progress of the implementation of retention legislation** of its members by 30 April 2015.⁴ The review found significant but mixed progress in implementing the IOSCO incentive alignment recommendations, and noted that EU jurisdictions were generally further progressed in their implementation than many jurisdictions with smaller securitisation markets.
7. With regard to the **EBA**, extensive work has been conducted by the EBA to enhance the risk retention rules in the EU. In particular, the EBA has issued:
 - a. **The EBA's RTS on securitisation retention rules, and ITS on the implementation of additional risk weights** in case of non-compliance with such obligations (developed in accordance with Articles 410(2) and 410(3) of the CRR, issued in December 2013, published in the Official Journal in March 2014, and in force since July 2014).⁵
 - b. **The EBA's detailed report and opinion on risk retention, due diligence and disclosure** including **recommendations** for ensuring the increased transparency and legal certainty of compliance with the retention rules, and a detailed assessment of the application and effectiveness of the rules in the EU (developed in response to the Commission's call for advice of December 2013, and issued in December 2014).⁶
 - c. **The ESAs' Joint Committee report and recommendations** regarding disclosure requirements and obligations relating to **due diligence, supervisory reporting and retention rules** in existing EU law (issued in May 2015).
 - d. Furthermore, the EBA has conducted multiple **studies** to feed into its annual reports to the Commission on **competent authorities' and institutions' compliance with the regulatory obligations on risk retention, due diligence and disclosure**. In total, three studies were developed by the EBA to date, which assessed compliance in 2011, 2013 and 2014 respectively.
8. In September 2015, the Commission issued a draft securitisation regulation, and a draft regulation for corresponding amendments to the CRR, with the view of boosting the securitisation market in the EU⁷.
9. According to the Council's compromise versions of the two draft regulations of December 2015⁸, the following **regulatory mandates have been suggested for the EBA in the area of risk retention** (it is to be noted that negotiations on the two draft regulations are still ongoing):

⁴ <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD504.pdf>

⁵ The EBA's final draft RTS and ITS: <https://www.eba.europa.eu/draf-regulatory-technical-standards-rts-on-securitisation-retention-rules> ; The Final RTS and ITS as adopted by the European Commission: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:JOL_2014_148_R_0002

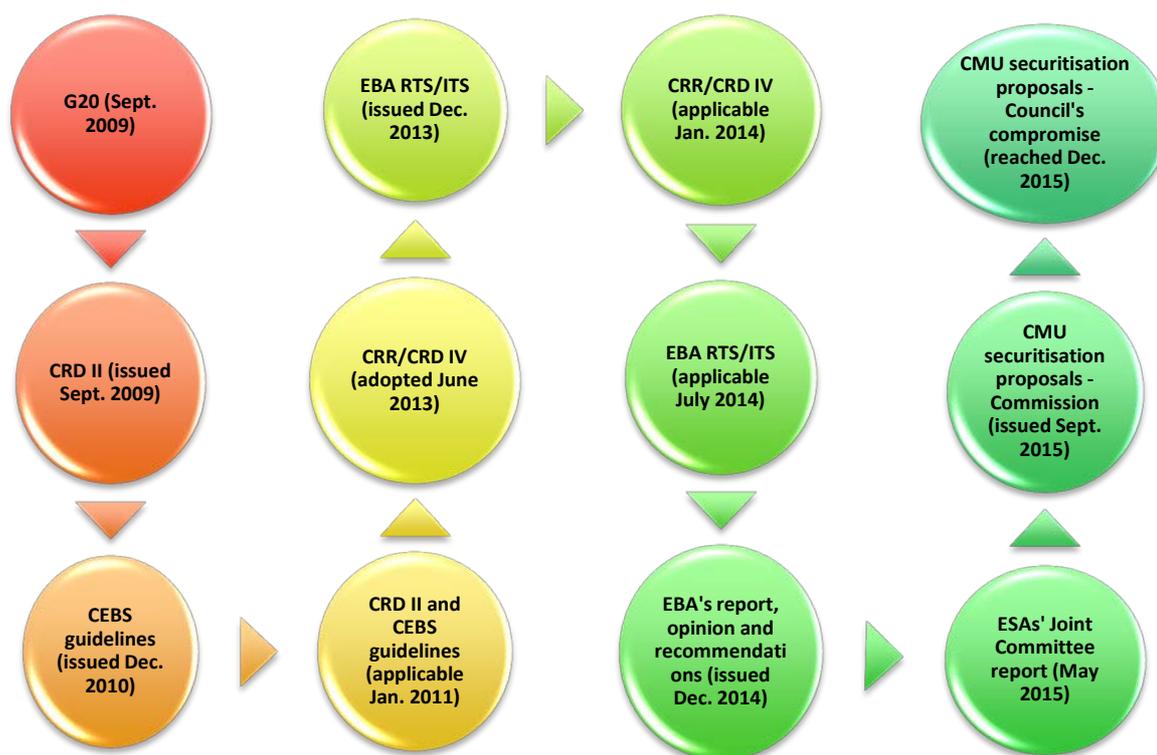
⁶ <https://www.eba.europa.eu/-/eba-calls-for-improving-the-well-functioning-of-the-securitisation-market>

⁷ <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015PC0472&from=EN>

⁸ <http://data.consilium.europa.eu/doc/document/ST-14537-2015-INIT/en/pdf>

- a. The EBA shall develop draft RTS to specify in greater detail the risk retention requirements, by six months after entry into force of the securitisation regulation, in close cooperation with the ESMA and the EIOPA (Article 4(6) of the draft securitisation regulation).
- b. The EBA may develop draft ITS to facilitate the convergence of supervisory practices with regard to risk retention, including the measures to be taken in case of breach of the due diligence and risk management obligations (Article 270a of the CRR amendments). No deadline is set for development of these ITS.
- c. Furthermore, the ESMA shall publish a report on the functioning of the due diligence, risk retention and transparency requirements and the level of transparency of the securitisation market in the EU, in close cooperation with the EBA and the EIOPA (Article 29(3) of the draft securitisation regulation).

Figure 1: Development of risk retention rules in the EU



2. Assessment of the measures taken by competent authorities on compliance with risk retention, due diligence and disclosure requirements in 2014

10. According to Article 410(1) of the CRR, the EBA shall report to the Commission annually on measures taken by the competent authorities to ensure institutions' compliance with the securitisation retention, disclosure and due diligence requirements specified in Part Five, Titles II and III, of the CRR.⁹
11. Since the introduction of the risk retention, due diligence and disclosure rules in the EU through CRD II in 2011, the EBA has conducted several studies to feed into its annual reports for the Commission on the competent authorities' compliance with the rules, with focus on their compliance with the risk retention rules.¹⁰ In total, three studies were conducted by the EBA to date, which assessed compliance in 2011, 2013 and 2014 respectively. An overview of the results from the latest study on compliance in 2014 is provided below.
12. In order to conduct the assessment as required in Article 410(1) of the CRR, the EBA developed a questionnaire that was distributed to competent authorities in September 2015. As a result, **21 competent authorities responded** to the EBA's questionnaire¹¹. Of the 21 responses received, four provided good, in-depth detail into the respective competent authority's framework for the supervision of the risk retention, due diligence and disclosure rules. The responses received included those from Norway and the European Central Bank's Single Supervisory Mechanism (SSM) which came into effect during November 2014—i.e. during the period of time covered by this study.
13. The study is based on the **data and information from national competent authorities as of end 2014**. The data normally cover all institutions in the respective Member States irrespective of whether or not they became supervised by SSM in November 2014. Separately, taking into account the SSM's entry into force on 4 November 2014, the **data provided by the SSM are as of 30 June 2015**. One should therefore take account of the limited comparability of data provided by national competent authorities and the SSM due to different cut-off dates and the overlapping scope of coverage.

⁹ Title II: Requirements for investor institutions (Article 405: Retained interest of the issuer; Article 406: Due diligence; Article 407: Additional risk weights); Title III: Requirements for sponsor and originator institutions (Article 408: Criteria for credit granting; Article 409: Disclosure to investors).

¹⁰ As specified in the formerly applicable Article 122a of CRD II and the CEBS Guidelines; and in the currently applicable Articles 405-409 of the CRR, and the EBA's RTS and ITS.

¹¹ Countries that responded to the EBA's questionnaire: Austria, Belgium, Croatia, the Czech Republic, Denmark, France, Germany, Greece, Hungary, Ireland, Italy, Lithuania, Luxembourg, the Netherlands, Norway, Portugal, Sweden, Slovenia, Spain, the UK, and SSM.

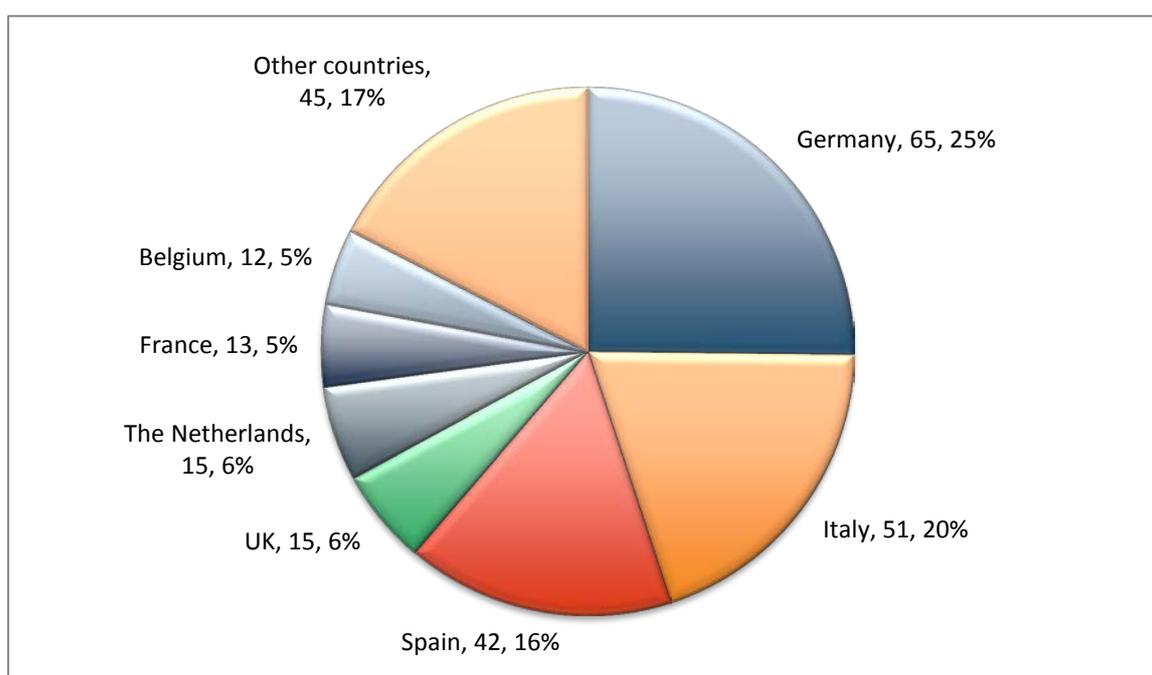
Countries from which no response was received: Bulgaria, Cyprus, Estonia, Finland, Latvia, Malta, Poland, Romania, and Slovakia.

Number of institutions involved in securitisation and number of exposures to securitisation

14. Based on the data provided by 21 CAs, **258 institutions assumed exposure to securitisation in 2014** either as an originator, a sponsor and/or an investor. 82 % of the institutions (213 in total) are concentrated in seven Member States: Germany (65 institutions), Italy (51 institutions), Spain (42 institutions), the UK (15 institutions), the Netherlands (15 institutions), France (13 institutions), and Belgium (12 institutions).

15. **Within the SSM, 86 significant institutions** supervised by SSM had securitisation exposures, as of 30 June 2015.

Figure 2: Institutions exposed to securitisation (in the EU, in 2014) – number and percentage



16. A number of Member States informed the EBA that **market activity in securitisation exposures did not exist in their respective jurisdictions** (Croatia, Denmark, Lithuania, and Slovenia), **or was marginal** (the Czech Republic, Greece, Portugal, and Sweden). The stated reasons included existence of more efficient funding tools (Denmark), and the persistence of an adverse economic environment since 2011 (Greece), inter alia. It was also noted that the institutions had a reduced securitisation portfolio and did not envisage investing in or originating transactions in the following years (Luxembourg). Some Member States specified that the current positions are, at least to a significant extent, legacy positions in run-off mode (Belgium and the Czech Republic).

17. Based on the data provided, the institutions assumed **23 420 securitisation exposures** in 2014.¹² The highest number of exposures were reported by Germany (9 109), the UK (6 274¹³) and France (5 612). Spain also reported a high number of positions (1 254), however it stated that a significant share of these positions was in multi-seller securitisations in which the bank participated as an originator and retained part of the bonds.

18. With regard to the **SSM**, significant groups reported **15 326 securitisation positions** in total for the 86 significant institutions supervised by the SSM as of 30 June 2015.

Figure 3: Number of institutions with exposure to securitisation, and securitisation exposures, in 2014

Member State	Number of institutions assuming exposure to securitisations	Number of exposures to securitisations assumed by institutions
Austria	2	8
Belgium	12	N/A ¹⁴
Croatia	0	0
Czech Republic	1 ¹⁵	N/A
Denmark	2	100
France	13	5 612 ¹⁶
Germany	65	9 109 ¹⁷
Greece	4	20
Hungary	1	1
Ireland	5	9
Italy	51	N/A
Lithuania	0	0
Luxembourg	11	556
Netherlands	15	N/A
Norway	5	177
Portugal	9	90
Slovenia	0	0
Spain	42	1 254
Sweden	5	210
UK	15	6 274+ ¹⁸

Figure 4: Number of institutions with exposure to securitisation, and securitisation exposures, in the SSM, as of 30 June 2015

	Number of significant institutions assuming exposure to securitisations	Number of exposures to securitisations assumed by those institutions
SSM	86	15 326

¹² This figure does not cover the whole EU: it is based on data provided by 16 competent authorities and covers 179 institutions in the 16 jurisdictions.

¹³ 6274 individual securities were held by seven largest UK institutions. The figure does not include UK institutions not regulated by the PRA.

¹⁴ As informed by the competent authority, some institutions have only a very limited number of exposures; others may have exposures to up to 50 different securitisation transactions.

¹⁵ As of 30 June 2015

¹⁶ This figure includes a proportion of 60% positions in the trading book that are related mainly to three institutions.

¹⁷ This figure includes securitisation positions held in both banking book and trading book.

¹⁸ Held by seven largest UK institutions. The figure does not include UK institutions not regulated by the PRA.

Supervisory frameworks for the assessment of compliance with risk retention, due diligence and disclosure rules

19. Of the responses the EBA received, four provided good, in-depth detail into the respective competent authority's supervisory framework for the assessment of compliance with risk retention, due diligence and disclosure rules (Hungary, Ireland, the Netherlands, the SSM). The EBA describes the observed supervisory practices as follows.
20. The competent authorities indicated that they **generally had not altered their supervisory frameworks** with respect to ensuring compliance with the relevant rules, since the previous compliance study of March 2014.
21. **Only one country introduced changes to its framework** (Germany). In addition to the rules already applicable, the revised German 'Audit Report Regulation' now includes a separate section that provides additional clarification in terms of the required reporting on compliance with Part Five of the CRR, to be provided in annual audit reports.¹⁹
22. A number of Member States with low exposures to securitisation informed that ensuring compliance with the rules under Part Five of the CRR **did not represent a supervisory priority** (Belgium, Norway, Spain and Sweden).
23. The EBA understands from the responses received that, in order to perform the necessary supervisory duties, **dedicated teams are set up by some competent authorities**, which are typically a small part of the supervision division.
24. In the SSM, the assessment of compliance and the resources committed to the assessment are responsibility of each Joint Supervisory Team of a significant entity/group, with the support of the ECB's horizontal functions. The assessments are therefore institution-specific and are mainly driven according to the risk and proportionality of the respective institutions. As part of the Supervisory Examination Programme for 2015, several Joint Supervisory Teams had planned or had already performed additional tasks related to securitisation analysis.
25. Supervisory assessments take place **on a yearly basis**. The assessments may be conducted **across all/a significant number of issuing institutions or on a sample basis**. Both originator and investor institutions are assessed under supervision. Supervisory assessments focus on more prescriptive requirements from the CRR, and in addition on more enhanced elements of oversight, such as on-site reviews of institutions. Information requests to the institutions being assessed are also made.

¹⁹ In particular, Section 37 of the Audit Report Regulation clarifies that the annual audit report shall also include (i) a description of the formal policies and procedures appropriate to the institution's trading book and non-trading book and commensurate with the risk profile of its investments in securitised positions for analysing and recording the information as required by Article 406 of the CRR (due diligence), (ii) a description of any deviating formal policies and procedures applied to the institution's securitisation positions held in the trading book and the non-trading book, if applicable, and (iii) a description of the institution's compliance with the requirements in accordance with Article 14 of the CRR (application of requirements of Part Five on a consolidated basis), if applicable.

26. The competent authorities have generally not been prescriptive in relation to the **internal controls** required of originator and investor institutions to ensure compliance, or the degree of the internal controls is assessed on a case-by-case basis.

Procedures and methodologies of the supervisory assessments

27. The competent authorities indicated examples of the **procedures undertaken within their supervisory assessments**, which include but are not limited to:

- Verification that investor institutions receive documentary evidence that the retention requirement has been met by one of the retainers, name of the retainer and that evidence has provided to the competent authority to show that the retention requirement of Article 405(1) of the CRR has been complied with.
- Verification that exposures classified by the institution as exempt under Article 405(3) of the CRR meet the required conditions for exemption. The prospectus or offering circular may provide this information and the institution should have had this information to inform its investment decision.
- Institutions should be in a position to demonstrate that they have undertaken appropriate due diligence prior to investing by considering the information set out in Article 406(1) (a)-(g) of the CRR. The institution should be in a position to demonstrate that the investment decision is in line with its risk appetite.
- Verification that institutions regularly perform stress tests appropriate to their securitisation positions.
- Verification that institutions, other than when acting as originators, sponsors or original lenders, have established formal procedures appropriate to their trading book and non-trading book and commensurate with the risk profile of their investments in securitised positions.
- Verification that the institutions considered the experience of the retainers in previous securitisations, their regulated status, their reputation etc.
- Institutions should be in a position to demonstrate that the required information has been received and assessed by an appropriate function—e.g. credit risk.
- Institutions should be in a position to demonstrate the ongoing monitoring of their securitisation exposures for material changes and determining follow-up action if required—e.g. if there were a material increase in credit risk, what options were considered and what decisions were taken.
- Institutions acting as retainers should be in a position to provide documentary evidence that they are meeting the relevant Articles of the CRR and the EBA's RTS.

28. It appears to be the case that **formal methodologies and frameworks** generally exist for the purposes of conducting supervisory assessments. However this is generally not the case at the enforcement stage, possibly due to the expected lack of infringement cases to be dealt with. The competent authorities seem **not to have formulated a specific definition of the ‘material infringement’ for the application of additional risk weights**, and the materiality of infringement would be assessed on a case-by-case basis, or generally in conjunction with an assessment of materiality of the other risks arising for the institutions. In general **infringements appear to be dealt with on a case-by-case basis** and opportunities to rectify these are given to infringing institutions before sanctions are applied.

29. In the SSM, the focus on supervision in the previous year was on new transactions issued during the year. Legacy transactions were considered to be a lower priority.

Non-compliance with Articles 405-409 of the CRR

30. **All competent authorities, with the exception of one, reported that no cases of non-compliance with Articles 405-409 of the CRR were found. One Member State found two cases of non-compliance.** More concretely, the Member State notified the EBA that **two institutions acting as investors were found to be infringing the due diligence requirements:**

- In one case, the infringement relates to an investor that had outsourced the investment to a third party, where the competent authority is of the opinion that the institution was not sufficiently in control of the investment. In 2014, a capital charge of 25% was applied during the institution’s SREP process. After closer investigation, this add-on was not considered sufficient and was not in line with the EBA’s ITS Chapter 1, Article 2. A deadline of 1 February 2016 was communicated to the institution by which to have implemented all the necessary measures. The competent authority will visit the institution to investigate whether the requirements have been met; otherwise an additional risk weight charge will be imposed.
- The other institution that the competent authority found to be non-compliant has only recently drafted policies and procedures to comply with the requirements and is still in the progress of finding a supplier for the purpose of running stress tests. It was envisaged that the institution would implement all the necessary policies, procedures and processes by year-end 2015. The competent authority will repeat the investigation in Q1 2016 and assess whether all the requirements are met; otherwise a capital charge will be imposed.

Figure 5: Overview of cases of non-compliance with risk retention, due diligence and disclosure requirements since 2011 under Art. 122 of CRD II (in 2011 and in 2013) and Part Five of the CRR (in 2014), and sanctions applied

Assessment period	2011	2013	2014
Date of the EBA's analysis	July 2012	March 2014	February 2016
Number of responding Members States	27 out of 27	24 out of 28	20 out of 28
Non-compliance with the risk retention requirements			
Number of Member States with cases of non-compliance	2	0	0
Number of non-compliant institutions	2 (one case in each Member State)	0	0
Details on non-compliance	One case related to the use of the flexibility in the CEBS guidelines regarding limited market-making activities of groups outside the EU. The second case related to a credit institution investing in a securitisation where the originator did not have a net economic interest of at least 5%.	N/A	N/A
Sanctions applied	No sanctions were applied. <ul style="list-style-type: none"> No sanctions were applied in the first case. In the second case, the additional risk weights were applied by the credit institution itself and were not imposed by the competent authority. The securitisation position was held for three days and therefore additional risk weights were applied for three days. The position was sold after three days. 	N/A	N/A
Non-compliance with due diligence requirements			
Number of Member States with cases of non-compliance	1	2	1
Number of non-compliant institutions in those Member States	3 (all three in the same Member State)	3 (two in one Member State, one in another Member State)	2 (both cases in the same Member State)
Details on non-compliance	Minor weaknesses regarding the documentation of the due-diligence in two credit institutions and the stress-testing procedures in one institution were identified.	In one Member State, two non-compliant cases were identified with regard to the implementation of Article 122a of CRD II. In one of these two cases, an institution did not regularly perform its own stress tests as required by Article 122a (4). As the institution adjusted its internal procedures and included securitisation positions in its regular stress testing	In one case the infringement relates to an investor that had outsourced the investment to a third party and where the competent authority is of the opinion that the institution was not sufficiently in control of the investments. The other institution that the competent authority found to be non-compliant has only recently drafted policies and procedures to comply with the requirements and is still in

		<p>at short notice, the CA abstained from imposing an additional risk weight in this case.</p> <p>In the other of these two cases, an institution’s internal procedures did not ensure that investors had access to all the materially relevant data as referred to in Article 122a (7) of CRD II with regard to every single transaction where the institution acted as originator. Following the findings, the institution has adjusted internal procedures to ensure the disclosure of all materially relevant data to investors at short notice. As the non-compliance only related to some but not all of the materially relevant data, this was not considered to be a material infringement of the requirements in accordance with Article 122a (7) of CRD II requiring the imposition of an additional risk weight.</p> <p>One institution in another Member State was found to be non-compliant with Article 122a (7) of CRD II, as noted during an on-site mission on ABCP conduits. The mission did not find any proof that the bank, acting as an ABCP sponsor, fulfilled its disclosure obligations towards investors. No sanctions had been decided at the time of notification.</p>	<p>the progress of finding a supplier for the purpose of running stress test. It was envisaged that the institution would implement all the necessary policies, procedures and processes by year-end 2015.</p>
<p>Sanctions applied</p>	<p>No sanctions were applied.</p>	<p>No sanctions were applied.</p> <ul style="list-style-type: none"> The relevant competent authorities did not consider the breach as a material infringement of the requirements in accordance with Article 122a (7) of CRD II and did not impose any additional risk weights. 	<p>Sanctions were applied in one case, and are considered to be applied in the second case.</p> <ul style="list-style-type: none"> In case of the first institution, a capital charge of 25% was applied in 2014 during the institution’s SREP process. After closer investigation, this capital charge was not considered sufficient and was not in line with the EBA’s ITS Chapter 1 Article 2. A deadline of 1 February 2016 was communicated to the institution by which to implement all the necessary measures. The competent authority will visit the institution thereafter to investigate whether the requirements have been met, otherwise an additional capital charge will be imposed. In the case of the second institution, the competent authority will repeat the investigation in Q1 2016 and assess whether all the requirements are met, otherwise a capital charge will be imposed.
<p>State of play</p>			
<p>State of play of compliance with relevant requirements</p>	<p>27 Member States fully compliant with the applicable rules (Article 122 of CRD II), 19 Member States implemented the CEBS guidelines, 8 Member States intended to implement</p>	<p>11 Member States implemented supervisory practices to ensure compliance with the new rules (CRR – Art. 405-410)</p>	<p>One Member State introduced changes to its supervisory practices.</p>

Recommendations on best practices

31. Based on the findings of the analysis, the EBA has identified a number of general **best practices** to help competent authorities in their supervisory assessments of compliance with the current risk retention, due diligence and disclosure rules in their jurisdictions. More concretely, the competent authorities are encouraged, in a proportionate way, to:

1. Dedicate sufficient resources, and establish dedicated teams of specialists with expert knowledge of securitisation, to ensure compliance with the risk retention, due diligence and disclosure requirements.
2. Develop specific formal methodologies and procedures for assessing, documenting and recording compliance with the applicable rules, with an enhanced element of on-site verification as necessary, to allow for the consistent treatment and gathering of information on compliance/non-compliance.
3. Execute the supervisory assessments on at least an annual basis.
4. Cross-check the information reported by the institutions with other sources of available information, such as COREP reports, available loan by loan data, and other relevant sources.
5. Define specific internal controls required from originator and investor institutions to ensure compliance with the requirements.
6. Develop formal procedural frameworks for the assessment of infringements and the application of additional risk weights. The procedures should specify how the materiality of infringements is considered, and should clarify whether thresholds are applied for the application of additional risk weights. They should also include follow-up procedures to check the status of the compliance of the relevant institution with the requirements regularly, after diagnosis, and after redress of the infringement. The procedures should allow for appropriate flexibility and a case-by-case approach where appropriate.
7. Intensify supervisory assessments of institutions previously found to have infringed the requirements.

32. The competent authorities are encouraged to keep their supervisory practices under review, particularly in light of possible changes to the rules as part of the new framework on securitisation, in order to ensure that supervision continues to be coherent and proportionate, and taking into account that the new framework for qualifying STS securitisation suggests specific and enhanced regulatory and supervisory requirements, including in relation to risk retention, due diligence and disclosure.

Current regulatory developments

33. The securitisation regulation and related proposed amendments to the CRR are currently being negotiated at EU level. With this in mind some competent authorities indicated that they are **awaiting the outcomes of such negotiations** before developing, and thereafter implementing, a fully-fledged supervisory framework for the supervision of the risk retention, due diligence and disclosure requirements.
34. Some competent authorities have recognised that recent regulatory initiatives may spur demand in securitisation activity. While for some competent authorities supervision is not currently of their highest priority, they stand ready to adopt more comprehensive frameworks and direct more resources to the activity should the institutions increase their exposure to securitisation positions in their respective jurisdictions.
35. The ECB/SSM assumed its supervisory responsibilities on 4 November 2014. As such it has a limited history of supervisory activity. However it has started to conduct supervisory activities. It may consider reviewing its supervisory actions, in light of the publication of the new securitisation regulation.

3. The EBA's recommendations for enhancing the regulation of risk retention, due diligence and disclosure in the EU

36. Separately from assessment of supervisory measures taken by competent authorities in 2014 on compliance with Part Five of the CRR in accordance with Art. 410(1) of the CRR, this section of the report provides a summary of how the EBA recommendations on regulation of risk retention rules, due diligence and disclosure in the EU, as specified in the EBA technical advice of December 2014, have been taken on board in the regulatory proposals of the new securitisation framework.
37. In December 2013, the EBA received a call for advice from the European Commission, requesting technical advice on the appropriateness of the rules provided in Part Five, Titles II and III, of the CRR in the light of recent international developments.²⁰ Following the assessment, the EBA published a detailed report²¹ in December 2014 with a number of recommendations for enhancing the current requirements on risk retention, due diligence and disclosure.
38. The European Commission subsequently included the recommendations in its proposals for a new securitisation framework published on 30 September 2015. Also, the EBA notes that the recommendations have remained integrated in the EU Council's compromise of the securitisation proposals adopted in December 2015.
39. The overview of the recommendations and how they have been considered in the Commission's and Council's drafts of the securitisation regulation, is provided below.

Recommendation 1: Implementation of a complementary direct approach to risk retention

40. Currently, the EU risk retention rules follow an indirect approach—i.e. they place the onus on the investors rather than on the originators, sponsors and original lenders to check that the transactions comply with the risk retention and reporting rules. In the same vein, failure to comply with the rules leads to sanctions (usually additional capital risk weights) on investors only. The EBA recommends introducing a direct approach, as complementary to the currently applicable indirect approach, which would place the retention requirement obligation directly on the originators, sponsors and original lenders. The EBA believes this will reduce compliance costs and improve legal certainty for investors, thereby encouraging new securitisation investors to invest.
41. ***The EBA's recommendation has been taken on board. The Commission's and Council's proposals repeal the existing risk retention requirements laid down in different pieces of sectoral legislation and replace them with a single article, providing for a 'dual' approach. A new direct obligation is set for originators, sponsors and original lenders to retain risk. This***

²⁰ A further call for advice was received from the Commission in January 2014 specifying the request.

²¹ <https://www.eba.europa.eu/-/eba-calls-for-improving-the-well-functioning-of-the-securitisation-market>

direct approach complements the existing indirect approach, which continues to apply and requires institutional investors to check whether the originators, sponsors or original lenders have retained risk. For securitisations in situations where the originator, sponsor or original lender is not established in the EU, the indirect approach continues to apply.

Recommendation 2: Keeping the current forms of retention

42. The EBA believes that, other than the five forms of risk retention already available,²² no other form should be considered at this time, as based on feedback from stakeholders and supervisors the options currently available seem to work well and are deemed sufficient.

43. The EBA also assessed the possibility of including an ‘L-shape’ form of retention, which is a combination of the vertical slice option and the first-loss tranche option.²³ The combination of horizontal and vertical risk retention may mitigate some of the costs related to the first-loss option. Furthermore, the L-shape option as an alternative form of retention has the potential to lower funding costs, which could be beneficial for different types of transactions that do not fit neatly into the traditional model of securitisation, such as some managed CLO transactions. However, providing wider choice with an additional form of retention has its drawbacks: by giving originators and sponsors the choice of how to retain risk, their chosen L-shape form of retention may not be as effective in aligning interests and mitigating risks for investors. It may also complicate the implementation of risk retention as well as investors’ processes for due diligence and the ongoing measurement of compliance due to the wider choice that originators, original lenders and sponsors would enjoy. As such, the EBA believes no other form should be considered at this time.

44. The EBA’s recommendation has been taken on board. *The existing five forms for retaining risk as specified in the CRR have been left largely untouched. The details of these are to be specified in the RTS, that the EBA is supposed to develop by 6 months after entry into force of the securitisation regulation.*

Recommendation 3: No alternative mechanisms to achieve the alignment of interest

45. The EBA considered a wide array of alternative mechanisms for achieving the alignment of interests between the issuers of securitisation and the investors, including ‘natural’ incentives encouraging market participants to effectively screen borrowers, more formal mechanisms (such as due diligence and disclosure requirements, and transaction and asset underwriting standards), and some specific mechanisms for certain structures (such as performance-based fee arrangements commonly used in managed CLOs). While these alternative mechanisms are considered helpful as a complement to risk retention requirements, the EBA does not believe that there is sufficient evidence supporting their use as a substitute, or demonstrating that they are equivalent to the current retention options in place.

²² The five types of the retention are known as vertical slice; first loss tranche; seller’s share; on-balance sheet/randomly selected exposures; and first loss exposure in each asset.

²³ The ‘L-shape’ form of retention is one of the possible options of risk retention allowed in the Final Rule applicable in the US.

46. The EBA's recommendation has been taken on board. No alternative mechanisms are allowed.

Recommendation 4: Retention on a consolidated basis

47. The CRR allows retention on a consolidated basis, but prescribes that the entity retaining the net economic interest needs to be within the scope of supervision on a consolidated basis. The EBA considered whether the scope of consolidation could be expanded (for example, to a scope in accordance with the accounting framework), and believes that the scope of consolidation should remain restricted to the scope of supervision only; otherwise it would not be possible to enforce the disclosure requirements. Furthermore, retention within the scope of supervision on a consolidated basis will, in the EBA's view, ensure transparency on retainers and disallow the possible use of regulatory arbitrage relating to the retention position. Last but not least, this approach is also consistent with the EBA's findings in the report to the Commission on the perimeter of credit institutions established in the EU Member States since October 2014.

48. The EBA's recommendation has been taken on board. The currently applicable rules on consolidation remain the same—i.e. the consolidation should be accomplished with regard to the scope of supervision on a consolidated basis. However, there is one change in the securitisation regulation compared to the currently applicable rules, according to which it is no longer required that the exposures be originated by "several" different entities within the group (they can now be originated by "one or more" entities included in the scope of supervision). This should accommodate more usual scenarios involving the securitisation of assets from "one or more" relevant entities within the group.

Recommendation 5: No exception from the retention rules

49. The EBA believes that there are sufficient ways of complying with the retention rules; therefore, it does not recommend allowing for any further exemptions and/or exceptions on top of those currently applicable. The EBA believes that providing further exceptions could lead to abuse of the rules and that securitisation transactions could specifically be structured to meet the possible exemptions. However, the EBA recommends further assessing the possibility of introducing an 'exceptional circumstances' provision, whereby, under certain circumstances (such as the insolvency of the retainer), the retainer could be changed during the life of a securitisation transaction to ensure that the retainer is always the most appropriate entity to which the interests of the investors should be aligned.

50. The EBA's recommendation has been partially taken on board. The securitisation regulation retains the few exceptions from the retention rules, as currently applicable, in the following cases: (i) when the securitised exposures are fully, unconditionally and irrevocably guaranteed by public authorities, and (ii) when the transactions are based on a clear, transparent and accessible index. The securitisation regulation stipulates that in the RTS on details of risk retention, to be delivered by the EBA in cooperation with ESMA and EIOPA, the EBA shall, *inter alia*, specify in greater detail the conditions for exempting transactions based on a clear,

transparent and accessible index. The securitisation regulation does not, however, include the new exception to risk retention rules for application in the case of exceptional circumstances that the EBA suggested considering in its recommendation.

Recommendation 6: Addressing the loophole in the definition of ‘originator’

51. The EBA has identified some practices that raise concerns. It has emerged that some transactions have been structured so as to meet the legal requirements of the CRR but actually do not always meet the ‘spirit’ of the CRR and do not align the interests of the most appropriate party to act as retainer (originator, original lender or sponsor) with the interests of the investors. In particular the EBA identified that this can happen due to the wide scope of the definition of ‘originator’ in the CRR. As a result, it is possible to establish, for example, an ‘originator SSPE’ with third-party equity investors solely for the purpose of creating an ‘originator’ that meets the legal definition of the CRR and which will become the retainer in a securitisation (e.g. solely for the purpose of buying a third party’s exposures and securitising the exposures within one day).

52. The EBA considers these types of structures to be non-compliant with the ‘spirit’ of the retention requirements, and suggests that the definition of the ‘originator’ should be narrowed—i.e. originators should only be entities of real substance and should hold economic capital against the assets for a minimum period of time before securitising them.

53. ***The EBA’s recommendation has been taken on board.*** *The securitisation regulation does not amend the definition of ‘originator’; however, it specifies that “for the purpose of [risk retention], an entity shall not be considered to be an originator where the entity has been established or operates for the sole purpose of securitising exposures”. The text of the regulation does not specify the ‘sole purpose’ further; however, the explanatory memorandum of the Commission’s proposal of September 2015 states that “an entity established as a dedicated shelf for the sole purpose of securitising exposures and without a broad business purpose cannot be considered as an originator... The entity retaining the economic interest has to have the capacity to meet a payment obligation from resources not related to the exposures being securitised”.*

Recommendations 7 and 8: Disclosure and due diligence requirements

54. The EBA considers that the disclosure and due diligence requirements in the current framework (CRR Article 409 and RTS Articles 22-23 for disclosure, and CRR Article 406 and RTS Articles 15-16 for due diligence) are sufficient and fit for purpose in ensuring investor protection and enabling investors to conduct appropriate due diligence. The EBA therefore does not call for specific changes to the existing rules. However, it considers that the alignment of the different EU requirements in these areas would be helpful.

55. ***The EBA’s recommendation has been taken on board.*** *The securitisation regulation repeals the existing due diligence and disclosure requirements laid down in different pieces of sectoral legislation, and replaces them with a single uniform regulatory framework for securitisation,*

which will be applicable on a cross-sectoral basis (i.e. to cover credit institutions, investment firms, insurers, AIFMs, UCITS management companies, certain internally managed UCITS, and IORPs).

Recommendation 9: Adequacy of the level of additional risk weights and administrative measures

56. The EBA considered the adequacy of the current sanctions, in terms of the additional risk weights (according to Article 407 of the CRR) and administrative measures (according to Article 67 of CRD IV) imposed upon institutions for breaches of retention, due diligence and disclosure rules. In the EBA's view, the current sanctions are appropriate, and serve as an adequate deterrent from violating the respective requirements.

57. The EBA's recommendation has partially been taken on board. *The EU Council's compromise of the securitisation regulation sets out the administrative measures that the competent authorities should have in case of breaches of the regulation's provisions by originators, sponsors, original lenders, SSPEs and third parties authorised to assess the compliance of securitisations with STS criteria. The administrative measures differentiate between those measures only relevant for breaches of STS requirements, and general breaches of retention, due diligence and transparency requirements, which are also applicable to non-STs securitisations. It is also to be noted that the suggested measures are substantially stricter and higher compared to the current rules, as well as compared to the rules applicable to other funding instruments. The administrative measures for investors have not been included in the securitisation regulation. The securitisation regulation does not seem to amend the requirement to hold additional risk weights to be imposed on institutions in breach of securitisation regulation (Article 207a of the draft regulation on amendments to the CRR is the same as the currently applicable Article 407 of the CRR).*

Recommendation 10: Convergence of the retention rules regulatory frameworks

58. At an international level, the thrust of the regulations of retention, disclosure and transparency is similar. However, the EBA has noted several differences and therefore supports further consistency and convergence between different regulatory regimes across the globe, also with the view of enhancing the competitiveness of the EU financial industry.

59. IOSCO also concluded in its report from September 2015 that significant but mixed progress in implementing the retention legislation had been reached by its members by 30 April 2015, and noted that EU jurisdictions were generally further progressed in their implementation than many jurisdictions with smaller securitisation markets.

Conclusion

60. Following the review of the responses to the EBA's questionnaire submitted by 21 competent authorities in September 2015,²⁴ the following **main conclusions** can be drawn on the measures taken by the competent authorities to ensure compliance with the risk retention, due diligence and disclosure requirements as prescribed in Part Five of the CRR:

- It appears that **institutions are generally undertaking the appropriate actions** to comply with the requirements. Also, it appears that, in most jurisdictions, including in the countries with an active securitisation market, **competent authorities have taken supervisory measures** to implement the framework on assessing compliance with the risk retention, due diligence and disclosure rules.
- Since the introduction of the risk retention, due diligence and disclosure rules in the EU in 2011, **only a very limited number of institutions were found to be non-compliant**. In total, 10 cases of non-compliance have been reported: two institutions were non-compliant with the risk retention rules (in 2011), and eight institutions were non-compliant with the due diligence requirements (three in 2011, three in 2013, and two in 2014).
- **Sanctions in the form of additional risk weights (as per Article 407 of the CRR) were applied in one out of these 10 cases**. In one case, the sanctions are to be assessed in Q1 2016. In another case, the additional risk weights were applied by the credit institution itself and were not imposed by the competent authority. In the remaining seven cases, no sanctions were imposed.
- **In 2014, 258 institutions assumed exposure to securitisation** either as an originator, a sponsor and/or an investor. 82 % of the institutions (213 in total) are concentrated in seven Member States: Germany (65 institutions), Italy (51 institutions), Spain (42 institutions), the UK (15 institutions), the Netherlands (15 institutions), France (13 institutions), and Belgium (12 institutions). **Within the SSM, 86 significant institutions** had securitisation exposures, as of 30 June 2015.
- The institutions assumed **23 420 securitisation exposures** in 2014.²⁵ The highest number of exposures were reported by Germany (9 109), the UK (6 274²⁶) and France (5 612 positions). With regard to the **SSM, 15 326 securitisation positions** were reported in total for the 86 significant institutions supervised by the SSM as of 30 June 2015.

²⁴ The responses include various degrees of comprehensiveness and completeness of the answers.

²⁵ This figure does not cover the whole EU: it is based on data provided by 16 competent authorities and covers 179 institutions in the 16 jurisdictions.

²⁶ 9 274 individual securities held by seven largest UK institutions. The figure does not include UK institutions not regulated by the PRA.

- A number of competent authorities have noted existence of an **inactive or marginal securitisation market in their jurisdictions—a trend persisting from 2011**. Some of the reasons stated include the existence of more efficient funding tools, and an adverse economic environment. Some competent authorities noted that institutions reduced securitisation portfolio and did not envisage investing in or originating transactions in the following years, and that the current positions are legacy positions in run-off mode.
- A number of competent authorities have stated that they are **awaiting finalisation of the ongoing negotiations at EU level on the new securitisation regulation**, before developing and implementing fully fledged frameworks for the supervision of the risk retention, due diligence and disclosure requirements.
- In light of the points above, the assessment of compliance with the respective requirements seems to be of a **lower priority in the supervisory processes of a number of competent authorities** and the processes often seem to be managed on a flexible and case-by-case basis.
- All in all, the findings of the study have been similar to those of the previous year, with the exception of the establishment of the SSM which assumed competency in this matter in November 2014.

Based on the findings of the analysis, the EBA has identified a number of general best practices to help competent authorities in their supervisory assessments of compliance with the risk retention, due diligence and disclosure rules in their jurisdictions. The EBA encourages all competent authorities to apply the best practices in a proportionate way, so as to ensure the proper supervision of credit institutions and investment firms originating and investing in securitisations, and ensure adequate assessment of compliance with the current securitisation risk retention, due diligence and disclosure rules.