Intesa Sanpaolo Group's response to the
EBA Discussion Paper on the Draft Report on STS Framework for Synthetic Securitisation Under Art. 45 of Regulation (EU) 2017/2402
(EBA/DP/2019/01)

25 November 2019

Question 1: Do you have any comments on this introductory section of the Discussion Paper?

Intesa Sanpaolo (ISP) welcomes the opportunity to comment on the EBA Discussion Paper on "Draft Report on STS Framework for Synthetic Securitisation Under Art. 45 of Regulation (EU) 2017/2402". ISP recognizes and appreciates the extensive analysis made by the EBA in order to ascertain the feasibility and submit a recommendation to develop an STS framework for balance sheet synthetic securitisation.

We agree with the intent of limiting the application of an STS framework to balance-sheet synthetics with the exclusion of arbitrage synthetic securitisations.

Balance-sheet synthetic securitisations (further on, denominated just synthetic securitisations) play an essential role both as a tool for risk management purposes (as they allow for freeing up regulatory and economic capital) and as a tool for supporting new lending growth and revitalize the real economy since that released capital can be immediately redeployed. This aspect is particularly important when lending to borrowers that do not have a direct access to capital markets (e.g. SMEs and Midcap clients).

Being an effective instrument to support the real economy and preserve financial stability, a framework promoting further simplicity and standardization should be fostered in our opinion and, in that respect, we appreciate the effort from EBA in developing a sound framework for synthetic securitisations.

As originator, ISP has been successfully involved in the synthetic securitisation market for some years by executing credit risk transfer transactions - which have involved both private investors and public-type ones - designed at supporting lending to Italian businesses, especially the SME segment which, as a result of the crises, has experienced significant difficulties in access to credit.

Question 2: Do you agree with the analysis on the market developments? Please provide any additional relevant information to complement the analysis.

We agree with the analysis on market developments made in the DP. Based on our experience to date, protection sellers have been either hedge funds/asset managers which sell funded credit protection to the bank or public-type/supranational investors. As a latest market development, we note that insurance/reinsurance companies are now approaching the market by providing unfunded credit protection especially on those asset classes they are more comfortable with, such as mortgage loans.

Question 3: Do you agree with the analysis of the historical performance? Please provide any additional relevant information to complement the analysis.

We agree with the historical performance analysis of synthetic securitisation exhibited in the DP. Based on our experience to date as originator in a number of successful synthetic transactions, we have indeed experienced zero default and loss on senior tranches for all our executed transactions. It should be also noted that these results reflect the fact that the originator continues to service the underlying exposures following its credit and collection policies, i.e. applying its best practice as if the exposures were not hedged. Furthermore, the application of eligibility criteria during the selection process of the underlying exposures determines a securitized portfolio with generally better expected default/loss features than average, considering that exposures with extremely low ratings are generally not included in the portfolio.

Question 4: Do you agree with the analysis of the rationale for the creation of the STS synthetic instrument? How useful and necessary is synthetic securitisation for the originator and the investor? What are the possible hurdles for further development of the market?

We agree with the pros of the development of an STS framework for synthetic securitisations set out in the DP. Although we believe that synthetics are simple transactions (as they show low legal and operational complexity) and have already achieved a good level of standardization, yet we welcome the development of a harmonised STS framework which will help further fostering best practice and broadening the market, in favor of new originators and investors (which will still need to have a sufficient degree of expertise in analyzing the product).

Question 5: Do you agree with the assessment of the reasons that could eventually support a preferential capital treatment?

We agree with the pros set out in the EBA discussion paper. As explained above, we are strongly in favor of establishing an appropriate STS framework for synthetic transactions.

Yet we believe that the framework should be accompanied by preferential capital treatment for tranches that remain in the balance sheet of the originators to enable a full endorsement and widespread adoption of the requirements as:

- the establishment of a new framework will result in additional costs, also operational, and will place additional constraints on originators. In such a case, doing a non-STS transaction will be more economically viable than a STS one;
- as the historical performance analysis pointed out, synthetics are not inherently riskier than traditional securitisations hence the higher risk weights on the retained senior tranches will be not justified, determining an unlevel playing field between the two instruments;
- divergence with respect to art. 270 CRR which has introduced a preferential treatment on retained senior tranches of SME synthetics.

We do not agree with the cons set out under paragraph 94. Indeed, it has to be noted that the risk weights entered into force with EU Regulation n. 2017/2401 applied to retained tranches are considerably higher than the ones under the previous regime,

and the introduction of the STS preferential treatment will not close the gap anyway. Still, the historical evidence supports the fact that these transactions have performed well and there is no evidence of opportunistic behaviours on balance sheet synthetics. Also, again we remain convinced that synthetic transactions are a valid product of credit risk management which can contribute effectively to the banking sector stability.

With reference to paragraph 93, we do not foresee negative implications in case of deviations from the BCBS framework, as non-compliance due to EU specificities has happened in a number of other occasions already (for example, as reported in the DP, the EU extends more favorable treatment to covered bonds than Basel).

Question 7: Do you agree with the criteria on simplicity? Please provide comments on their technical applicability and relevance for synthetic securitisation.

Criterion 2 – Representation and warranties
We generally make representations and warranties on the underlying exposures in the contractual agreement with the protection seller with reference to the eligibility criteria for the securitised portfolio and on the validity and enforceability af the financing agreements. Nevertheless, we deem important to notice that, in current market practice, the only consequence the originator faces in case representations and warranties in respect of the underlying exposures set out in the contract are not met is that - like the eligibility criteria not met - the protection could not be enforced following a credit event on those loans that were not compliant at the time they were included in the securitised portfolio (these would be considered as Excluded Reference Exposures). We do believe that this should be the only consequence which shall apply in case of misrepresentation.Finally, we suggest specifying that the representations and warranties need to be complied with at the transaction's closing date while the "Compliance of the exposure with all eligibility criteria set out in the securitisation documentation" should be met "as of the time the exposures are included in the portfolio.

Criterion 3 – Eligibilty criteria, no active portfolio management
We suggest to make reference to the rules in terms of implicit support under the SRT framework when referring to the possibility of the originator to remove underlying exposures from the securitised portfolio instead of denying *tout court* that possibility (except in case of substitution due to breach of representations and warranties and where replenishment periods apply).

In line with comment on Criterion 2, we also note that the eligibility criteria of the underlying exposures need to be complied with at inception only, therefore we suggest to remove "at all times" in the first sentence of the Criterion 3.For example, one eligibility criteria usually met at inception is that all exposures comprised in the portfolio have to be performing exposures, which will not necessarily be true on an on-going basis and that of course will not trigger a removal of the newly non-performing exposure from the portfolio.

Criterion 12 -At least one payment made
The EU Regulation (2402/2017) in art 20 sets out "The debtors shall, at the time of transfer of the exposures, have made at least one payment". Without any further

specification, that criterion will have the effect of excluding all transactions executed on a newly originated portfolio, in particular public-schemes "tranched cover" synthetic securitisations such as the ones sponsored by the Italian "Fondo di Garanzia per le PMI". This programme has been developed to support new lending to SME and Midcap, by providing junior guarantees (up to a maximum of 80% of the junior tranche) on specific newly granted portfolios with pre-agreed characteristics, which are ramped-up during a certain period of time (generally 18 months). As this kind of transactions serves primarily the purpose of directly supporting new lending to the real economy and considering that payments are made gradually when these exposures enter the portfolio, excluding them from the STS framework is counterintuitive. As such, we suggest this criterion explicitly carves out "transactions on ramped-up portfolios aimed at supporting new lending".

Question 8: Do you agree with the criteria on standardisation? Please provide comments on their technical applicability and relevance for synthetic securitisation.

Criterion 15 – Appropriate mitigation of interest rate and currency
In our experience, as the credit protection (funded and unfunded) and the underlying portfolio have so far been denominated in the same currency, no currency mismatch has arisen in our past synthetic securitisations.

However there may be cases in which a broader portfolio is comprised of a number of loans denominated in a currency that differs from the one used from the credit protection contract. Indeed, currency mismatch on hedges is taken into account by the originator when determining capital relief by applying an adjustment reflecting currency volatility as required under the Part Three, Title II, Chapter 4, Section 4 – Sub Section 1(Funded Credit Protection), articles 223, 224-227 and Sub Section 2 (Unfunded Credit Protection) article 233 of Regulation (EU) No 575/2013. Therefore we believe not appropriate to introduce a specific obligation to mitigate currency risk – which can be costly for the originator – as it is already reflected in capital relief calculation.

In relation to interest rate risk, we believe that no impact arises within the context of synthetic securitisations.
Specifically, as the interest cash flow arising from the underlying portfolio are not used or linked to the credit protection fee payable to investors, no interest risk exposure arises for investors.

For the originator, the credit protection payments should be treated and managed in the context of the ordinary treasury/asset-liability management activity. Considering the above we will suggest to remove Criterion 15 for the STS framework for synthetic securitisations.

Criterion 17 – Requirements after enforcement/acceleration notice
In case of an enforcement/acceleration notice on the transaction, the consequence will be a termination of the credit protection contract and the pay-back of the cash collateral received (if any). As such, we propose the Criterion 17 to be removed from the STS framework for synthetic securitisations.

Criterion 22 – Reference register
As long as the reference register introduced by Criterion 22 makes reference to a unique identification code which enables to "clearly identify, at all times, the

reference obligors" (but without disclosing their identity to the protection seller), we have no objection as this is common practice in the synthetic securitisation market. However, considering that many transactions are structured on "blind pools", it is essential that this reference register does not imply a disclosure on the name of the underlying obligor as it will contravene with confidentiality obligations which, for private transactions, need to be respected as per Art. 7(1) of the Securitisation Regulation. Therefore, a confirmation on this aspect will be welcomed.

Criterion 24 – Data on historical default and loss performance
We will suggest not to specify how the analysis on default, loss and delinquencies should be performed as there are cases where static vis-à-vis dynamic analysis can be more suitable.

Criterion 25 – External verification of the sample
We do not agree in requiring an external verification of the sample prior the transaction closing. As per market practice and in line with Criterion 33 in synthetic securitisations a verification agent is anyway required to look at exposures on which a credit event occurred, so we deem not necessary to provide for an ex ante verification as well. Also, as explained with reference to Criterions 2 and 3, the only consequence the originator faces in case the eligibility conditions set out in the contract are not met is that the protection could not be enforced following a credit event for those loans that were not compliant at the time they were included in the securitised portfolio (these would be considered as Excluded Reference Exposures). In light of the above and considering the additional time and costs to be borne by the originator for an ex-ante verification (in addition to the required on-going verification), we suggest amending this criterion to permit the portfolio eligibility verification activity to be performed only after the occurrence of a credit event. We also highlight that that approach – being market practice - is indeed more in the interest of the investors, which will have a verification analysis performed on exactly the loans that have defaulted over time.

Question 9: Do you agree with the criteria on transparency? Please provide comments on their technical applicability and relevance for synthetic securitisation.

Criterion 26 – Liability cash flow model
We will suggest to amend this Criterion by just requiring the originator to describe the waterfall in the transaction and in what circumstances (if any) the represented waterfall could change.
We believe it should be appropriate that sophisticated investors as the ones who invest in synthetic securitisations should be able to assess and evaluate the transaction by themselves, as the originator provides already for a number of information to investors – such as the amortization profile of the underlying exposures, the historical data on the performance of the reference asset class included in the portfolio, the waterfall of the transaction.

Question 10: Do you agree with the specific criteria for synthetic securitisation?

Criterion 30 – Credit Protection payments
In our experience and based on accountancy requirements, credit protection payments need to be based on actual realised losses. In addition, our experience is

that before the completion of the workout procedures, interim credit protection payments should be determined as best estimate of future actual losses i.e. calculated based on the impairment determined in the bank's financial statements. Therefore we suggest to amend the proposed Criterion by not requiring the interim credit protection payment to be "the maximum between the impairment considered by the originator in its financial statement […] and the LGD determined…" but leaving to the originator with the flexibility to choose between the two measures in line with what is deemed appropriate in order to satisfy accounting and internal policies requirements.

Criterion 32 – Credit Protection premium

We propose to delete second paragraph of the Criterion which requests to provide "all relevant information" that has been used to price the credit protection agreement as the transaction price will be determined based on a market-based process and negotiations between the parties. By all means the investors will be provided with all information they would need and require in order to make an appropriate and informed pricing offer on the transaction, in line with what is required by art. 7(1) of the Securitisation Regulation.
In terms of upfront premium payments, we by all means agree with the provision. However, it would be useful to understand if a caveat on the public-scheme programme described in Criterion 12 could be added as it requires by laws the bank to pay by law an upfront fee of 3% on the provided guarantee by the "Fondo di Garanzia per le PMI", considered the limited value of the required premium itself.

Question 11: Do you agree with the criterion 36 on eligible credit protection agreement, counterparties and collateral? Please provide any relevant information on the type of credit protection and different collateral arrangements used in market practice and their pros and cons for the protection of the originator and investor.

Criterion 36 – Eligible credit protection agreement, counterparties and collateral
We flag some issues about the requirements set out in Criterion 36 regarding eligible protection providers and high-quality collateral.

Unfunded credit protection
We disagree with the exclusion of unfunded credit protection providers not qualifying for 0% risk weighting, such as insurance/reinsurance companies. Indeed, the CRR already provides a mechanism to ensure that the additional risk associated with unfunded credit protection provided by private entities is properly taken into account by the originator through the higher risk weights which apply to such protection. As such, we deem not necessary for the STS framework to exclude such protection providers entirely.

Cash collateral
We strongly request to permit cash collateral to be held with the originator. This is an established market standard in order for the originator to have a 0% risk weighting on the guaranteed tranches. If the originator is required to hold the cash collateral on a third-party bank that will determine a counterparty risk for the originator and consequently will worsen the economics of the transaction. At the same time, on the

investor's point of view this would not eliminate the credit risk completely as it will also bear the third-party bank's counterparty risk.

It should also be considered that synthetic transactions are finalized with sophisticated investors who, before investing, will analyze in dept the originator's policies when originating, modelling and servicing the underlying exposures, as extensive due diligences are performed by potential investors, as also requested by art. 5 of the Securitisation Regulation. The investor in synthetic transaction is fully capable of understanding and pricing the originator creditworthiness in the transaction, and if necessary, specific risk mitigants can also be negotiated between the parties (i.e. rating trigger events, where the cash collateral needs to be moved away from the bank in case the bank is downgraded under contractually agreed rating levels). As such, we do not deem necessary to impose any requirement on where the cash collateral should be held and we believe that such a decision should be left within the parties.

Question 13: Do you see a justification for possible introduction of a differentiated regulatory treatment of STS synthetic securitisation? If yes, what should be the scope of such treatment and how should it be structured - for example only for senior tranche retained by the originator bank, or more limited/wider?

As detailed in the response on Question 5, we believe that a preferential capital treatment should be granted to STS synthetic securitisations as it will greatly contribute to the development of an STS label and its adoption among originators. As noted, the endorsement of the STS framework will result in additional costs and requirements on the originators and as such a preferential treatment is welcome. Additionally, the risk weights currently applied to retained senior tranches seem not to be representative of the actual risk transferred out of the bank, as witnessed by the historical analysis on performance of synthetic transactions that has shown that these have performed even better than traditional ones (as reported in the Discussion Paper). For such reasons we strongly suggest that a preferential treatment should be granted to STS synthetic transactions and we will not object that it could be limited to the retained tranches of the originators.

Question 14: What would be the impact if no differentiated regulatory treatment is introduced? In that case, is the introduction of the STS product without preferential treatment relevant for the market?

Please see our comments to Question 5 and 13. In particular, we are concerned that in case no preferential treatment is introduced some repercussions on the endorsement of the STS framework will occur, considering the additional costs and requirement to complying with the new standards.

Question 16: Should a separate explicit recommendation be included in the Recommendations section on whether or not such treatment should be introduced?
Yes, for the reasons stated above.