BANKING STAKEHOLDER GROUP

Replies to Questions

DISCUSION PAPER

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on the EBA's approach to Significant Risk Transfer in Securitisation

Replies to Questions

BY THE EBA BANKING STAKEHOLDER GROUP

Foreword and background

The BSG welcomes the EBA proposals that aim at enhancing the process of the SRT assessment. And we would like to highlight the efforts of the EBA to exchange with professionals on this topic.

Our general comments are on the following technical points:

- Excess spread should not be considered as a securitisation position and subject to Pillar 1 own fund requirements.

- It is important to provide enough flexibility to use other alternative amortisation structures than pro-rata amortization.

- The design of the new proposed tests (mezzanine tranches, thickness of the first loss) might be corrected to avoid discarding the achievement of SRT for operations that show viable features to achieve it.

Replies to Questions

1. Overview of market and supervisory practices with respect to SRT

Question 1: Does the data on synthetic and traditional SRT securitisation transactions correspond with your assessment of the SRT market activity in the EU? Do you have any observations on these data?

The data provided by EBA on synthetic and traditional SRT securitisation transactions is broadly accurate.

Question 2: Are you aware of any material supervisory practices that have not been covered in the EBA analysis?

The BSG shares the opinion (paragraph 70) that lengthy feedback procedures may result in a high degree of uncertainty for the market, and that it is highly important to receive feedback from the regulatory authority ahead of the closing of the transaction.

The requirements for achieving SRT are useful so long they are not too burdensome.

2. Assessment of SRT and EBA proposals for discussion

Question 3: What are your views on the proposals on the standardisation of the SRT assessment process set out above? Are any other changes necessary to further improve the process?

The BSG appreciates the proposals on the standardization of the SRT assessment process. It is important to emphasize, that once the proposals on response deadlines are agreed, they would be binding to the relevant regulators and do not provide them further flexibility, e.g. ex-ante notification period should not be extended by responsible regulator: “ex ante notification by the originator of the SRT transaction at the latest 1 month before the expected issuance”. This prevails in particular when considering that the ECB has currently set a period of 3 months.

The BSG further welcomes the EBA’s proposal, that the competent authority should provide an explicit point in time feedback to the originator, even where there is no permission required (e.g. quantitative test).

The preferred solution regarding the assessment process would be the following:

- The originator shall notify the competent authority no later than 45 days before the expected closing date;
- The competent authority should provide a notification on SRT compliance and non-objection/objection at least 14 days before the expected closing date (and no later than 45 days after the first notification by the originator);
- A non-response can be considered like a non-objection by the originator.

Question 4: Could you provide suggestions as to whether and how the template for SRT notification by the competent authority to EBA provided in Annex I of the EBA Guidelines should be amended to reflect the new EU securitisation framework and the STS securitisation product?

The BSG does not envisage further amendments.

Question 5: Should a standardised SRT notification template be developed, for submission by originators to competent authorities, in order to facilitate the SRT assessment process? If yes, should this template be different for traditional and synthetic securitisation? (Please provide examples of templates, as appropriate).

The BSG supports the development of standardised templates, with however flexibility to accommodate the full range of transactions (with different asset classes, features, geographies, local laws, etc.) in respect of which it might need to be used.

We support the development of separate templates for traditional and synthetic securitisation. This would help to reduce confusion and streamline the review process.

Question 6: Could you provide suggestions as to how a template for monitoring SRT compliance should look like (e.g. by potential amendments of the current COREP templates)?

The multiplication of ad hoc reporting by institutions creates operational risk. We suggest the EBA to incorporate the SRT monitoring reporting into the COREP framework.

Question 7: Do you agree with the assessment of the SRT implications of all the identified structural features? Are any material aspects missing from this representation?

Yes, the list of structural features with SRT relevance is exhaustive. However, the approach taken by the EBA is too prescriptive and can lead in some cases to an increase of discrepancies between banks, and even in some cases to irreconcilable constrains. We understand that the definition of a mezzanine tranche will depend on the prudential treatment adopted by the bank, and that the SRT will be based on the percentage of mezzanine tranche that will be sold. This approach bares the two aforementioned critics, and we ask for a strong simplification: the aim of defining a SRT is to make sure that the bank holds a residual part of risk such that its interests are aligned with investors in order to reduce moral hazard. This goal can be achieved with a definition based on a minimal vertical percentage of risk retained (i.e. 5%) and by a minimal percentage of retention of capital requirement. We suggest to stick to those two metrics in order to avoid an unexpected closure of the securitization market due to irreconcilable constrains. This will be also a strongly welcomed simplification compared to the proposal.

We also do not think that the future profitability of transactions or the use of excess spread should be penalized in the assessment of a transaction. It is an essential risk management tool to use future margin to cover future credit losses, as well as a protection for investor that lead to a decrease of protection costs. This should not lead to a deduction.

The usage of call can also be normalized, but only to avoid options that are not linked to a sound management of the securitization. For example, clean-out calls are useful in order to reduce excessive cost at the end of transactions.

In particular, with regard to amortisation, it is important to provide enough flexibility to use other alternative amortisation structures than pro-rata amortization such as a hybrid that features sequential amortisation until the protected tranche reaches a certain percentage threshold, after the amortisation switches to pro-rata amortisation.

Question 8: Do you agree with the proposed safeguards related to the use of pro-rata amortisation?

The BSG recommends to provide some flexibility to adapt and/or omit some of these triggers where they are not applicable to the particular asset type or transaction.

The contractual triggers that switch from a pro-rata amortisation to a sequential amortisation will significantly increase the costs of the securitisations.

As banks often enter into these transactions for regulatory capital relief, an interesting idea would be to link the trigger to variable which are used to assess the SRT.

Question 9: Do you agree with the proposed safeguards related to the use of time calls? Do you agree with the different approach to time calls in traditional vs. synthetic transactions?

The theoretical framework that justifies the proposed constraints regarding time calls is somehow flawed.

First of all, there is no clear argument about the reasons why the first call date should be so far out in the life of the transaction.

Finally the BSG strongly opposes the prohibition of time calls in traditional securitisations. There is no clear justification for the statement that banks will be more tempted to use time calls in a traditional SRT securitisation than in a synthetic. By no means, SRT should be automatically discarded when time calls are associated to traditional securitisations.

Question 10: Do you agree with the proposed safeguards on the use of excess spread in traditional securitisation?

We agree with the proposal regarding excess spread for traditional securitizations (i.e. it should represent the actual excess spread generated by the portfolio). We understand that the 1250% risk weight or capital deduction is limited to synthetic securitization and that it does not concern traditional securitization for which excess spread is just sound risk management.

Question 11: Do you agree with the proposed safeguards constraining the use of excess spread in synthetic securitisation? In particular, do you agree with:

a. The proposal of only allowing a contractually fixed (pre-determined) excess spread commitment in synthetic transactions?

b. The proposal to only allow a 'trap' excess spread allocation mechanism in synthetic transactions?

It is unclear why the 'trapping mechanism' is preferred to the 'use-it-or-lose-it mechanism', while the 'trapping mechanism' achieves less risk transfer than the latter.

Treating the trapped excess spread as a securitization position subject to 1250% risk weight or deduction leads to a doubling of capital requirement and is not fair. Once again, excess spread should be considered as sound risk management and should not be taken into account neither in the risk transfer self-analysis.

Question 12: Do you agree with the proposed way to treat the excess spread commitment in synthetic securitisation transactions for the purposes of the quantitative assessment of SRT and commensurate risk transfer?

We support the proposal to deduct from the capital, 1 year of excess spread for synthetic securitizations.

Question 13: In relation to the further considerations for stakeholders' consultation on the own funds treatment of excess spread:

a) Do you agree that the unrealised/unfunded component of the excess spread commitment should become subject to Pillar I own funds requirements?

b) What would be the impact on SRT transactions if Pillar I own funds requirements were recognised as suggested in Section 3.2?

No, see comments on question 11 & 12.

Question 14: Are there any other safeguards or alternative regulatory treatments to address risks retained through excess spread in traditional and synthetic securitisation transactions?

It is not justified to require to recognise excess spread as a securitisation position. The amount of excess spread which is used to absorb losses before touching the tranches should be recognised as a cost of the transaction.

Question 15: Should there be a specific treatment in those transactions featuring excess spread in which the originator, instead of achieving SRT in accordance with one of the SRT tests specified in the CRR, chooses to deduct all retained securitisation positions from CET 1 or apply a risk weight of 1250% to all of such securitisation positions ('full deduction option'), in order to be allowed to exclude the securitised exposures from the calculation of risk-weighted exposure amounts?

In coherence with question 14, the excess spread should not be recognised in this situation, since the originator has already effectively reserved sufficient capital to cover even a 100% loss scenario.

Question 16: What are your views on the use of originator's bankruptcy as an early termination clause? How does this clause interact with the resolution regime (i.e. the BRRD framework)? Should this clause be banned?

We do not think it is necessary to include this clause in the prudential regulation. Insolvency clause are a market standard and are already included in ISDA Master Agreements used for credit derivatives. However, it is not necessary to have them in securitizations, and, under resolution, it would more probably be less disruptive to transfer securitization to another bank.

Question 17: Do you agree with the proposed originator's self-assessment of risk transfer? Should such assessment be formulated differently?

The BSG agrees in general with this proposal, although it would be helpful to provide additional guidance and specification. The proposal of originator's self-assessment of risk transfer seems, however, too heavy and not justified for all transactions.

Question 18: Are you aware of circumstances where institutions have entered into a structured risk transfer transaction which is not captured by Articles 243 or 244 CRR? For example, where the accounting treatment has meant a transaction is not considered for SRT assessment, or where transactions economically similar to SRT transactions do not fall into the definition of a 'traditional securitisation' or 'synthetic securitisation'.

BSG Members are not aware of any such transactions.

Question 19: Do you agree with the proposed specification of the minimum first loss tranche thickness for the purpose of the first loss test?

BSG Members agree that a test for minimum thickness of protection tranches is appropriate.

The current mechanistic tests show an anomaly that EBA must correct in order to avoid unjustifiably discarding the achievement of SRT for viable securitization transactions.

However, we have the following comments on the test proposed:

- It should be applied before the closing of the transaction since it would be more difficult (or impossible) to adjust the equity layer during the life of the transaction.
- The constrain on the mezzanine tranche once again will come on top of the requirement on the first loss tranche, which may lead to the impossibility to structure a transaction.

Question 20: Do you agree with the proposed specification of the minimum first loss thickness for the transactions assessed under the mezzanine test (i.e. transactions including mezzanine securitisation positions)? Do you consider this requirement relevant for all the approaches for calculation of securitisation own funds requirements (including e.g. SEC-ERBA)?

We agree with the substance of the test, which we understand is trying to prevent abuses of the test observed by the EBA. However, the test should be restated or clarified to take into account transactions in which a sufficiently large portion of mezzanine risk is sold to cover UL, and where the attachment point of the sold mezzanine tranches encompasses the portion of EL not covered by a thin first loss tranche.

Question 21: Is a specification needed of the minimum thickness of tranches constituting mezzanine securitisation positions for the purpose of the mezzanine test?

No specification needed.

Question 22: What impact do you expect the new CRR securitisation framework to have on tranches' minimum thickness?

With respect to the new CRR securitization framework, senior risk weights tend to increase dramatically, whereas mezzanine risk weights tend to be rather stable, and first loss tranches remain to be deducted/with 1250% risk weight. EL and provisioning of the underlying portfolio remain unchanged.

From the originator's perspective, the focus is to achieve economically efficient SRT. Senior tranche sizes will shrink and mezzanine as well, as first loss tranche sizes (incl. Excess Spread) being increased.

But a more likely effect in most cases may be that banks will cease to do SRT deals because it is likely that the incremental cost of selling additional tranches makes the transaction uneconomic compared to the bank's cost of capital, and the sale of such additional tranches might cause the bank to fail the high cost of credit protection rules as proposed by the EBA.

Question 23: Do you have any comments on the test of commensurate risk transfer proposed under Option 1?

The rationale of the test is not fully clear.

In analyzing the impact of these tests on banks existing SRT positions, we note the following problems:

1. In many cases the new definition of mezzanine, excluding mezzanine tranches which are risk weighted 1250% causes the deal to fail the mezzanine test, even in deals which have transferred tranches equal to EL+2/3UL. The likelihood of mezzanine tranches being risk weighted 1250% is much greater under the new CRR approaches.
2. As per our responses to questions 19, 20 and 21 above, the minimum first loss tranche thickness test inadvertently causes several of our transactions to fail, even though we have transferred a total amount of tranches exceeding EL+2/3UL.

Question 24: Do you have any comments on the test of SRT and commensurate risk transfer proposed under Option 2? In particular, is the 50% threshold for SRT therein needed and appropriate?

See comments in question 23 above.
In principle, it should not matter whether the originator sells 20% of the risk or 100% of the risk, since the RWA reduction achieved will be commensurate with the risk transferred.

The effect of the new calibrations is to require an originator to sell a much larger portion of first loss and/or mezzanine tranches in order to reduce the risk weighting of the senior retained tranches below the threshold required by the test. In analyzing the impact of this test on banks existing SRT positions, we note that, in many cases, the increased capital on senior retained tranches required by the new capital calibrations under the revised CRR causes our SRT transactions to fail, even though the positions sold to investors exceed EL+2/3UL, which is the minimum suggested by the EBA.

Question 25: Should the SRT test be different depending on asset classes? Should it differ across STS and non-STS transactions?

No differentiation based on asset class is necessary per se, however there should be a differentiation in the test according to the capital approach an originator is required/chooses to use.

Question 26: Could you provide, on the basis of SRT transactions that are part of your securitisation business, an assessment of the impact in terms of SRT achievement of the proposed requirements under both Option 1 and Option 2, taking into account the new EU

securitisation framework (Securitisation Regulation package)?

3. The regulatory treatment of NPL securitisation

Question 27: Do you agree with the assessment of the market practice of NPL transfer? Are there material aspects that are not covered in this representation?

In general terms, we do.

We would like to point out the following issues:

- The key issue regarding NPL transfer is that the NPL are no more registered at the balance sheet of the originator (hence a decrease of the NPL rate).
- The SRT and regulatory capital relief are not key drivers in our sense for the NPL transfers.
- Consequently, the question of who will be in charge of the servicing, the originator or an independent third party manager, is key for the structuring of NPL securitizations. As a matter of fact, when the originator of the assets remains the manager/servicer after the assets have been "transferred" to the SSPE, the assets can usually not be derecognized or the SSPE be deconsolidated in application of the IFRS accounting rules.
- Another point of attention is the different views that the originator and the investors can have on the expected cash flows.

Question 28: What conditions/initiatives would, in your view, facilitate the well-functioning of the NPL securitisation market?

The NPL secondary market could be further developed if certain obstacles like Barriers to entry for NPL investors are removed.

Question 29: Which, in your view, are the core structural features that should be assessed within the SRT assessment of NPL securitisation transactions? Are the proposals on selected structural features of securitisation transactions proposed in this document (see section 3.2.2) equally valid for NPL securitisation transactions?

The proposed structural features are appropriate.

Question 30: Do you agree with the proposed way of implementing the SEC-IRBA and SEC-SA approaches for the calculation of securitisation tranche capital in the presence of a non-refundable purchase price discount? Do you envisage other ways to implement the mentioned approaches in the presence of a refundable purchase price discount?

We agree with the way of implementing the SEC-IRBA.

Question 31: Do the SRT quantitative tests provided for in the CRR currently in force (Articles 243 and 244 of the CRR) work properly for NPL securitisation transactions? If not, please

provide an explanation to your answer.

We think that clarification of the EBA is required on how the non-refundable purchase discount would be taken into account for SRT quantitative test purposes.

Question 32: How should the alternative commensurate risk transfer proposed in this report be modified to address the specificities of NPL securitisation transactions?

There are no special features of the NPL market in this respect, so no modifications are necessary.

Question 33: How should the quantitative test proposed under Option 2 in this report (see section 3.3.2) be modified to address the specificities of NPL securitisation transactions?

There are no special features of the NPL market in this respect, so no modifications are necessary.