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Finance for Europe

Consultation Response

EBA Consultation on Draft Guidelines on the STS criteria for on-balance-sheet securitisations

6 July 2023

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the EBA consultation on its draft Guidelines on the criteria related to simplicity, standardisation and transparency and additional specific criteria for on-balance-sheet securitisations.

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

Responses to the questions of the consultation

Requirements related to simplicity (Article 26b)

Requirements on the originator (Article 26b(1))

Q1. Do you agree that it is not necessary to further specify this criterion? If not, please provide reference to the aspects that require such further specification. For example, should additional interpretations of the term 'no less stringent policies' or 'comparable exposures' be provided and if yes, how are these terms understood in securitisation practice?

Response: AFME members consider that this criterion is clear and does not cause issues in practice. However, there are some uncertainties in the text which may benefit from some clarification.

First, it is not clear what is meant by the requirement that the originator be "authorised or licensed in the Union". AFME members understand that this *does not* mean that the originator needs to be a credit institution, but merely that it must be an EU entity which holds some sort of authorisation or licence in connection with its business, although not necessarily for the specific business of originating the loans which are being securitised. It would be helpful for this to be confirmed in the Guidelines.

Secondly, there is a degree of ambiguity in the ESUR more generally as to who is the "originator" for a given securitisation where there may be multiple entities that fall within the scope of the definition in Article 2(3) of the EUSR. In the context of a synthetic securitisation, the usual approach is for the protection buyer assume responsibility for the obligations imposed on the "originator" for the purpose of the various STS criteria (provided, of course that the protection buyer falls within the scope of the definition in Article 2(3) of the EUSR), and that where the securitised exposures are held by another entity within the same group, to rely on a combination of the reference to being "directly or indirectly" involved in origination in Article 2(3)(a) of the EUSR and the provisions in Article 6(4) of the EUSR to satisfy the risk retention requirements. This is particularly relevant if the protection buyer is an EU entity, but some of the securitised exposures are held by its non-EU subsidiaries. Again, it would be helpful for the Guidelines to confirm therefore, where there are multiple entities in the group that may constitute an originator, the obligations imposed on the originator under the STS criteria may be satisfied either (i) by the protection buyer alone, in reliance on Articles 2(3) and 6(4) of the EUSR, or (ii) on a cumulative basis by each relevant originator, but without any need for each such originator to be a party to the securitisation documentation.

Origination as part of the core business activity of the originator (Article 26b(2))

Q2. Do you agree that it is not necessary to further specify this criterion? If not, please provide reference to the aspects that require such further specification. Please substantiate your reasoning.

Response: AFME members agree that no further guidance is required for this criterion.

Exposures held on the balance sheet (Article 26b(3))

Q3. Do you agree that it is not necessary to further specify this criterion? If not, please provide reference to the aspects that require such further specification. Please substantiate your reasoning.

Response: It is a common practice for the securitised exposures in a synthetic securitisation to have been separately securitised as part of a traditional securitisation, used or pledged in a cover pool for covered bonds issued by the originator, or otherwise used as collateral by the originator for its funding operations. It is generally understood that this does not present an issue so long as those exposures remain on the capital balance sheets of the originator and the originator retains the credit risk in respect of those exposures. It should be noted that the issue here is similar to that which arises in the context of the use by an retainer of the interest retained under Article 6 of the EUSR for funding purposes, which is explicitly permitted by Article 12(2) of Commission Delegated Regulation (EU) No 625/2014, provided that the originator retains the credit risk associated with that retained interest. (This permission is also contained in Article 13(2) of the Final Draft RTS on Risk Retention published on April 2022 (EBA/RTS/2022/04) but which are yet to enter into force).

Nevertheless, this fact pattern does regularly generate comments from competent authorities as part of the assessment process. It would therefore be helpful if the Guidelines could clarify: (i) that the group of entities referred to in this criterion includes securitisation special purpose entities in respect of traditional securitisations where those SSPEs are consolidated with the originator for capital purposes such that the securitised exposures remain on the originator's capital balance sheet and (ii) this criterion does not prevent the use of the securitised exposures as collateral for funding purposes, including covered bonds, repo financing and central bank liquidity schemes, provided that the securitised exposures remain on the capital balance sheet of the originator, even though the legal title to the assets may have been transferred or pledged as part of those funding arrangements. See also our observations in relation to Article 26b(6)(a) below on this issue.

No double hedging (Article 26b(4))

Q4. Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Response: AFME members agree with the statement in paragraphs 117 and 118 of the proposed Guidelines. However, we consider that some further clarification is required in relation to the existence of separate hedges on different parts of the *same* exposures as those which are included in the securitised portfolio. We have two comments in this regard.

First, it is generally understood that the reference to not hedging the credit risk of the underlying exposures should be interpreted as referring to not hedging the credit risk on the portion of the exposures which is protected by the securitisation, but that it does not prevent the originator from hedging the unprotected portion (subject, of course, to compliance with the risk retention rules in Article 6 of the EUSR). For example, if a bank has a loan of EUR 100, and it chooses to purchase protection of EUR 50 against that loan in the securitisation, it should be permitted to enter into another hedge (which may in fact be a second synthetic

securitisation or a single-name hedge) in respect the remaining EUR 50 (or EUR 47.5 if applying vertical risk retention), without that being considered to contravene this criterion. It would be helpful if this could be clarified in the Guidelines.

Secondly, an issue which sometimes arises is where the securitised exposures benefit from member state guarantee arrangements that apply generally to specific types of exposures (as opposed to where the originator has specifically entered into a hedge of individual securitised exposures). Such guarantee schemes often provide only partial protection against losses and so mean the originator is still exposed to the residual credit risk of the securitised exposures. AFME members are of the view that such general guarantee schemes should not be considered to contravene this criterion provided that any recoveries received by the originator under such schemes in respect of the securitised exposures are taken into account in determining the realised loss on those securitised exposures. For example, if there is a loan of EUR 100 and following a credit event the originator receives a payment of EUR 20 under a guarantee scheme, as well as other recoveries of EUR 30 from the underlying borrower, so long as the calculation of the realised loss under the synthetic securitisation would result in a final loss of EUR 50 rather than EUR 70, the existence of the guarantee scheme should not be considered to be a hedge for the purpose of this criterion. We consider that this interpretation is consistent with the underlying purpose of the criterion, which is to avoid the originator double-recovering for the loss, while also avoiding unnecessarily preventing the originator from pursuing prudent credit risk management of exposures merely because of the existence of a government guarantee scheme. It would be helpful if this could be clarified in the Guidelines. In essence this is the same position as arises where an exposure benefits from a parent company guarantee. In such circumstances, the parent company guarantee would not be considered as a separate hedge of the exposure, but rather any payments from the guarantor would be taken into account in determining the realised loss.

Credit risk mitigation rules (Article 26b(5))

Q5. Do you agree that it is not necessary to further specify this criterion? If not, please provide reference to the aspects that require such further specification. Please substantiate your reasoning.

Response: AFME members agree that no further guidance is required for this criterion.

Representations and warranties (Article 26b(6))

Q6. Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Response: We have a number of comments in relation to this criterion:

To the best of the originator's knowledge: Paragraph 15 of the Consultation Paper clarifies that the originator is not required to take all legally possible steps to determine the various matters, and that it is only required to take the steps that it would usually take in connection with its activities in terms of origination, servicing, risk management and use of information from third parties. This clarification should also be included in the Guidelines themselves. We also suggest that the list of information sources set out in paragraph 119 of the draft Guidelines should be treated as examples rather than an exhaustive list, and it should be open to originators to have recourse to other information sources as well. This should include, where the originator has purchased the exposures from a third party (ie. what is commonly referred to as a "limb (b) originator"), information obtained from that third party.

An entity of the group to which the originator belongs and included in the scope of supervision on a consolidated basis: Please see response in relation to Article 26b(3), above, which also applies here. The

relationship between sub-paragraphs (a) and (b) of this criterion is unclear. Sub-paragraph (a) refers to the "group of entities to which the originator belongs", while sub-paragraph (b) refers to "an entity which is included in the scope of supervision on a consolidated basis". We do not actually think that there is any meaningful distinction to be drawn here, and that both expressions should be considered to have the same meaning, which is also the same as the "group" being referred to in Article 26b(3). We think that this is also consistent with the substance of the proposed guidance on these points in paragraphs 120 and 121 of the draft Guidelines. However, addressing these two expressions separately in the Guidelines, without acknowledging the overlap is confusing and we would suggest instead replacing paragraphs 120 and 121 of the proposed Guidelines with a single paragraph confirming that both expressions should be interpreted in the same was as for Article 26b(3).

Time for making representations: The text of Article 26b(6) is inconsistent in terms of specifying the time at which the various representations are to be made. The introductory wording clearly refers to the past tense (ie, the "that the following requirements *have been met*"), but does not specify when in the past the requirements were met. While a time is specified in sub-paragraphs (c), (f) and (h), that is not the case for the other sub-paragraphs. AFME members consider that this is an oversight in the drafting, and that it would be helpful to clarify that all these representations are being made in respect of each securitised exposure at the time it is included in the securitised portfolio.

This leads to the question of what is meant by at the time an exposure is included in the securitised portfolio. In most cases, the originator does not have access to up-to-the-minute live information about the status of the securitised exposures, and thus cannot make the representations in sub-paragraphs (c), (d), (f) or (h) as at the actual date on which the exposure is included in the portfolio. Rather, the market practice is to make such representations by reference to a "portfolio cut-off date" for the initial portfolio (which would usually be set shortly before the closing date), or for exposures added to the portfolio post-closing, by reference to the most recent date for which the originator has up-to-date information about the exposures. It would be helpful if the guidance could clarify that "the date [an exposure] is included in the securitised portfolio" permits the representations to be made "as of" an earlier date specified for such purpose in the transaction documentation where such earlier date represents the [latest] date for which the relevant information is or can be made available in respect of the relevant securitised exposures.

Article 26b(6)(a): This criterion has the potential to cause what we consider to be unintended consequences. On its face, the reference to the originator or group member holding the "full legal and valid title" would prevent the securitisation of exposures which have been used as collateral for funding purposes on a title transfer basis (eg., as is the case for some central bank liquidity schemes), though presumably not where such collateral has been provided by way of security, or where the exposures have been securitised through a traditional securitisation (see above response on Article 26b(3)). This distinction arises from the use of the odd expression "full legal and valid title". While the concept of "legal title" is widely understood the concept of "valid title" does not really refer to a form of right in rem, but rather that a right in rem is *actually* held by the person who claims to hold it. The more common expression would have been "legal and beneficial" title, and it is not clear if that is what was actually meant, but in any case that would still lead to the same issue. We do not think that the intention behind this representation was actually to require that the legal title must be held by the relevant group entity, but rather that the entity has all of the economic interest and credit risk in the exposure. Given that in a synthetic securitisation the investors are not relying on the actual payments on the securitised exposures for payments of interest and principal on the securitisation notes, it makes no difference in practice whether the originator has legal title to the exposure, or merely has the economic exposure. Provided that the servicing principles are being complied with (which is separately dealt with in Articles 26c(8) and 27e(7)(c)-(d)), the exposures are held on the capital balance sheet of the originator (which is dealt with in Article 23b(3)) and the originator retains the credit risk (which is dealt with in Article 26b(6)(b)), it makes no difference to the investor whether the originator is the legal owner of the exposure

or not. The potential credit loss will be the same in both cases. Further, taking into account the comment above on the time for making representations, the representation in sub-paragraph (a) is actually only a statement about what *has been* the case at the time the exposure was included in the securitised portfolio. It does not prevent the originator from subsequently transferring the legal title. If that is the case, then the criterion serves little real purpose as it would be open to the originator to enter into the title transfer arrangement after the exposure has been included. Finally, from a policy perspective, it makes no sense to distinguish between the ability to use the securitised exposures as collateral on a title transfer basis compared with a security basis. For these reasons, it would be helpful for the Guidance to clarify that this criterion does not prevent the originator or other relevant group entity from using the securitised exposures as collateral for funding operations provided that the entity retains all of the credit risk exposure to the securitised exposures. Again, the position is similar to that which arises in the context of the use of the retained interest for funding purposes discussed in our response to Article 26b(3), above.

Eligibility criteria, active portfolio management (Article 26b(7))

Q7. Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Response: AFME members broadly agree with the proposed guidance in paragraphs 122 and 123 of the draft Guidelines, although it should be clarified that it should not be necessary to show that the tests set out in those paragraphs are satisfied in the case of the specific examples already specified in limbs (a) to (d) of Article 26b(7) of the EUSR. It should also be clarified that the originator is not engaging in active portfolio management by merely selecting specific exposures which satisfy the relevant eligibility criteria and portfolio criteria out of the total pool of available exposures which satisfy those criteria at the relevant time. On a more detailed level, the reference to "'ramp up' period" in paragraph 123 of the proposed Guidelines should also refer to a "replenishment period".

It is not clear what the EBA is trying to achieve with the proposed guidance in paragraph 124 of the Guidelines and we encourage the EBA to reconsider whether this statement is really necessary as we are concerned that it actually creates more confusion rather than providing clarity in its present form. We broadly agree with the proposed guidance in paragraphs 125 and 126 of the Guidelines, although we question whether paragraph 125 is really necessary as it really just seems to be repeating what is already said in the level 1 text but equating the word "stringent" with the word "strict", which we consider to be self-evident.

We also wish to make the following requests for additional clarification.

<u>Removal of securitised exposures:</u> The text of sub-paragraph (c) of this criterion is unclear. The text reads as follows:

> *An underlying exposure may be removed from the transaction where that underlying exposure: ... (c) is subject to an amendment that is not credit driven, such as refinancing or restructuring of debt, and which occurs during the ordinary course of servicing of that underlying exposure;*

From a grammatical perspective, it is not clear whether the "such as refinancing or restructuring of debt" is intended to be an example of an amendment that would or would not be credit driven. Given the placement of the sub-clause, and the reference to "restructuring of debt", however, the better view is that these are intended to be examples of credit driven amendments, and thus amendments that may *not* be the basis for the removal of the relevant exposure. While this is not controversial in the context of restructurings, that is not the case for refinancings, which are often treated as being not credit driven in the sense that the bank agrees to the refinancing precisely because it does *not* have credit concerns about the relevant borrower.

However, as the terms of the refinancing may mean that the exposure no longer satisfies the eligibility criteria, or will change the amortisation profile and therefore weighted average life of the securitisation, it is not uncommon for transactions to include a provision requiring refinanced exposures to be removed where they do not occur at a time of financial distress and do not otherwise constitute a restructuring credit event. Given that "refinancing or restructuring of debt" is considered together in this sub-paragraph, there is some uncertainty as to whether it is permitted to remove such exposures. We therefore request that the Guidelines clarify that a refinancing or restructuring which occurs at a time when the borrower is not in financial difficulty, should not be considered to be a "credit driven" for the purposes of this criterion.

Other permitted removals: AFME members understanding is that sub-paragraphs (a) to (d) of this criterion is intended as a non-exhaustive list of examples of circumstances where exposures may be removed from a securitisation without being considered to constitute active portfolio management. We request that it be clarified in the Guidelines that the following additional circumstances also do not constitute active portfolio management:

- Removal of exposures where the originator has changed the basis on which it would calculate the RWA for those exposures (and thus the basis on which it would calculate the K_{SA} or K_{IRB} for those exposures). For example, where an exposure is moved from the Standardised Approach to the IRB Approach, or where there has been a change to the internal model applicable for that exposure.
- Reduction in the protected amount for exposures where there has been a reduction in the exposure value for the purposes of the CRR but without there being a corresponding repayment (for example, in the case of securitisation of unfunded commitments as discussed in EBA Q&A 2018/4025 where there is a reduction in the conversion factor or cancellation of an undrawn commitment).
- Removal of exposures that is not related to the creditworthiness of the exposure but where for operational reasons it is no longer possible for the originator to comply with the servicing principles or Article 7 reporting obligations in respect of that exposure.
- Removal of exposures which have become subject to other hedging arrangements (other than where those other hedging arrangements were entered into specifically for the purpose of enabling such removal) such the originator would no longer be able to comply with the risk retention requirements or the requirements of Article 26b(4).

In all of these cases, the removal is not being done for either of the purposes specified in paragraph 122 of the draft Guidelines and thus we would not expect any of these scenarios to be problematic from a policy perspective.

In most synthetic securitisations, eligibility is tested only when the exposure is included in the portfolio. However, there are some transactions in the market (primarily involving EIF) where the originator may be required to remove exposures from the portfolio for other reasons, such as failure to comply with the servicing principles, the exposure becoming subject to sanctions, or certain other changes to the nature of the exposures outside the control of the originator. It would be helpful if the Guidelines could clarify whether or not such removal is permitted.

Homogeneity, obligations of the underlying exposures, periodic payment streams, no transferable securities (Article 26b(8))

Q8. Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Response: AFME members do not consider the proposed guidance in paragraph 127 of the Guidelines to be necessary, or that it really adds anything to a clear meaning of the level 1 text. We agree with the proposed guidance in paragraph 128 of the Guidelines (although note our observations in relation to Article 26b(12) below). However, we would request adding clarification that this can also include credit facilities or credit lines in respect of which commitment fees are payable while the facility is undrawn but which would provide for interest when drawn.

Although not included in the actual proposed Guidelines, we also note the observation in paragraph 27 of the Consultation Paper, which suggests that it is expected that a portfolio combining specialised lending exposures with other corporate exposures would not meet the homogeneity requirements under Article 26b(8). We do not think this statement is correct or appropriate. The requirements for securitised exposures to be considered homogenous are set out in the relevant RTS, the final draft for which is clear and does not require any further elaboration by way of guidelines, particularly given that the proposed guidance is not consistent with the EBA's own observation on whether a separate asset class was needed for project finance on page 26 of the EBA's Final Report on the draft RTS on Homogeneity (EBA/RTS/2023/01).

No resecuritsation (Article 26b(9))

Q9. Do you agree that it is not necessary to further specify this criterion? If not, please provide reference to the aspects that require such further specification. Please substantiate your reasoning.

Response: AFME members agree that no further guidance is required for this criterion.

Underwriting standards, originator's expertise (Article 26b(10))

Q10. Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Response: We have a number comments in relation to this criterion.

Similar exposures: In relation to the proposed guidance in paragraph 129(b) of the draft Guidelines, we note that the Homogeneity RTS being referred to here do not require that all the securitised exposures are made to the same types of obligor where they are instead all made to borrowers resident in the same jurisdiction or the exposures are secured by immovable properly located in the same jurisdiction. We therefore assume that the purpose of referring to Article 2(3)(a) of the Homogeneity RTS in this paragraph simply means that if the securitised exposures comprise both exposures to *both* SME/micro enterprises and other types of enterprises, then the originator or original lender will need to have expertise in securitising exposures to both types of obligors. However, this begs the question whether this clarification is required in the first place as we would consider it to be self-evident that if the portfolio contains different types of exposures then the originator or original lender would need to have expertise originating all of those exposure types in order to satisfy this criterion. To avoid confusion, therefore, we request that this point be clarified.

No less stringent underwriting standards: The intention behind paragraphs 130 and 131 of the draft Guidelines is not clear. On the one hand, paragraph 130 implies that the originator must also be originating comparable but non-securitised exposures of the same type as the securitised exposures. However, paragraph 131 appears to contradict paragraph 130 by stating that there is no requirement for the originator or original lender to hold any similar exposures or to have actually originated such similar exposures. This also runs counter to the requirement in Article 26b(11)(c) (as to which, please see our comments below), which implies that such other comparable exposures must be held by the originator at the time of the securitisation. In light of this, we consider that paragraphs 130 and 131 should be deleted.

Changes to underwriting standards: We agree with the proposed guidance in paragraphs 132 and 133 of the draft Guidelines. However we query whether an explanation of the purpose of changes to the underwriting standards is necessary as suggested in paragraph 134 of the draft Guidelines. No such explanation would ordinarily be expected to be provided for each provision in the original underwriting disclosed to comply with this criterion, so it is not clear why changes to those criteria should require such an explanation. In addition, it should be clarified that it is only necessary to disclose changes to underwriting standards during the replenishment or revolving period, as any changes after that time will not have any impact on the securitisation.

Residential loans: We agree with the proposed guidance in paragraphs 136 to 139 of the draft Guidelines.

Equivalent requirements in third countries: We agree with the proposed guidance in paragraph 140 of the draft Guidelines.

Criteria for determining the expertise of the originator or original lender: We agree with the proposed guidance in paragraphs 141 to 143 of the draft Guidelines.

No exposures in default and to credit-impaired debtors/guarantors (Article 26b(11))

Q11. Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Response: We have a number of comments in relation to this criterion.

Exposures to a credit-impaired debtor or guarantor: Paragraph 146 of the draft Guidelines refers to the circumstances specified in sub-paragraphs (a) to (c) of this criterion as definitions of credit-impairedness. While this is the case for sub-paragraphs (a) and (b), that is not the case for sub-paragraph (c). This reference should be updated. We agree, however, with the proposed guidance in paragraphs 147, 149 and 150 of the draft Guidelines.

To the best of the originator's knowledge: Please see our observations in relation to this same point in relation to Article 26b(6), above, regarding the nature of the non-exhaustive list of information sources. In this regard, we note that the explanation set out in paragraph 39(c) of the Consultation Paper should also be reflected in the Guidelines themselves.

Risk of contractually agreed payments not being made being significantly higher than for comparable exposures: The application of sub-paragraph (c) of Article 26b(11) is one of the most unclear provisions in the STS criteria, and we have a number of concerns with the proposed guidance in paragraphs 151 and 152 of the draft Guidelines. Paragraph 151 appears to be attempting to define both what constitutes a comparable exposure and then, at a macro level, whether the performance of the actual securitised exposures can be expected to be significantly different from those of the comparable exposures. What is not said here, though is presumably implied, is that the securitisation will fail this criterion if the expected performance of the securitised exposures will be significantly *worse* than the performance of the comparable exposures.

Before turning to our concerns with this, it is helpful to consider the level 1 text for this criterion. Article 26b(11) provides as follows:

> *Underlying exposures shall not include, at the time of selection, exposures in default within the meaning of Article 178(1) of Regulation (EU) No 575/2013, or exposures to a credit-impaired debtor or guarantor who to the best of the originator's or original lender's knowledge:*

(a) *has been declared insolvent or had a court grant his creditors a final non-appealable right of enforcement or material damages as a result of a missed payment within three years prior to the date of the origination or has undergone a debt-restructuring process with regard to his non-performing exposures within three years prior to the date of the selection of the underlying exposures, except where: [...]*

(b) *was at the time of origination of the underlying exposure, where applicable, on a public credit registry of persons with adverse credit history or, where there is no such public credit registry, another credit registry that is available to the originator or the original lender; or*

(c) *has a credit assessment or a credit score indicating that the risk of contractually agreed payments not being made is significantly higher than for comparable exposures held by the originator which are not securitised. (emphasis added)*

Although the criterion is partly expressed in the plural, as indicated by the underlined text above, it is clear that it is a test that is intended to be applied to each individual underlying exposure. That is, each underlying exposure may not have a credit assessment or a credit score indicating that the risk of contractually agreed payments not being made is significantly higher than for comparable exposures held by the originator which are not securitised. The problem, of course, is that in practice it is not possible to apply this test to each individual underlying exposure, because that means that unless all exposures are to the highest-rated obligors, at least some of them would fail the test.

We therefore assume that the EBA has taken the view that, unlike sub-paragraphs (a) and (b), sub-paragraph (c) can only be interpreted as a portfolio-level test. We agree with this conclusion. However, we disagree that for this purpose the broad definition of comparable exposures set out in paragraph 151(a) of the draft Guidelines is correct. If that broad definition applies, then if the average performance of the securitised portfolio is expected to be significantly worse than that of the overall book of comparable exposures, the securitisation will fail this criterion. The effect of this is that it would not be possible for the securitised portfolio to have an average credit quality that is significantly worse than that of the overall book. This also leads to the question of what constitutes a significant difference between the credit quality of the securitised portfolio and the credit quality of the wider book, a point on which the EBA has not proposed any guidance.

Against this backdrop, paragraph 152(a) of the draft Guidelines appears to provide a helpful solution, by saying that the criterion will be deemed to have been met where the underlying exposures do not include exposures that are classified as "doubtful, impaired, non-performing [or equivalent] under the relevant accounting principles". In many cases, this requirement would be satisfied, as the eligibility criteria for the securitisation will exclude any such exposures.

However, in circumstances where the deeming provision in paragraph 152(a) of the draft Guidelines does not apply, the original issue remains.

We do not think that that the intention of this criterion was that an originator would be restricted to securitising a portfolio which has an average credit quality that is not significantly worse than that of the overall book of comparable exposures, particularly if what constitutes comparable exposures for this purpose is defined as widely as is the case in paragraph 151(a) of the draft Guidelines. Rather, the correct definition of comparable exposures for this purpose should be other exposures which satisfy the eligibility criteria set out in the transaction documentation other than those criteria which specifically relate to the creditworthiness of the securitised exposures. If the comparable exposures are defined in this way, the tests proposed in paragraphs 151(b) and 152(b) of the draft Guidelines would work if they are adjusted so that they refer to the credit quality of *some* comparable exposures held by the originator. It should also be clarified that the

securitisation would only fail the criterion where the expected performance of the underlying exposures would be significantly *worse* (not different) from that of those comparable exposures.

At least one payment made (Article 26b(12))

Q12. Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Response: We disagree with the proposed guidance in paragraph 154 of the draft Guidelines, which will be difficult for banks to comply with in practice. In the case of corporate exposures which form the largest assets classes for synthetic securitisations, banks do not necessarily have data available to demonstrate that a borrower has made a payment in respect of any individual exposure (as opposed to having data available at the borrower level. Even if such data is available, the requirement to treat each exposure separately for this purpose potentially adds a minimum delay of at least three months between the origination of an exposure and when it can be added to a synthetic securitisation. There is nothing in the text of this criterion which requires that the one payment requirement needs to apply at the level of each exposure. On the contrary, the criterion simply states that "Debtors shall … have made at least one payment, except where …". Given that the original rationale for this criterion was as an anti-fraud device, where the bank has an existing relationship with the borrower, and can show that the borrower has made payments when due in the past, it is therefore perfectly reasonable to interpret this criterion as requiring only that borrower has made at least one payment in the past, not that that payment relates to the specific exposure being securitised. This is consistent with the approach which has been taken by STS verification agents in relation to the equivalent criterion for traditional securitisation in Article 20(12) of the EUSR. In particular, for a traditional STS securitisation, the third-party verifiers have accepted as a first payment the initial test payment made by the borrower at origination of the loan to ensure that the borrower's card, direct debit or payment details are correct and working effectively.

We have two further observations in relation to this criterion. First, it should be clarified that the types of payments being referred to in this criterion includes commitment or facility fees in respect of undrawn or revolving credit facilities, where no interest or principal payments would otherwise be due until a drawing is made. Revolving credit facilities or credit lines are a very important asset class for synthetic securitisation, and it has always been understood in the market that payment of commitment fees can satisfy this one payment requirement so it would be helpful to have that clarified in the Guidelines. More generally, we consider that the types of payments which can satisfy this criterion should be clarified and broadened in order to include facility fees for instance, as raised above, in respect of all types of credit facilities. Other examples include (i) a down-payment on an auto loan or other similar type of facility or (ii) loans where the initial payment is made by a third party on behalf of the legal borrower (such as in the case of a salary loan, where the payments may be made by the borrower's employer).

Secondly, in our view, the requirement in sub-paragraph (a) of this criterion that the exemption from the one payment requirement for exposures payable in a single instalment only applies to a revolving securitisation is an error. This generally does not present a problem, as most securitisations of single-instalment exposures will include revolving period. However, one situation where that may not be the case is in the context of certain types of exposures which are originated under a framework agreement between the originator and the borrower but which legally take the form of separate obligations. Examples of this could include commercial paper (assuming it falls within the exemption from the prohibition on transferable securities in Article 26b(8)) issued under a commercial paper issuance facility, or dealer floorplan loans made under a framework agreement. In this context, our view is that each exposure generated pursuant to that facility agreement should not be considered a separate exposure for the purposes of paragraph 154 of the draft Guidelines, and we ask that the draft Guidelines be updated accordingly.

Requirements related to standardisation (Article 26c)

Compliance with risk retention requirements (Article 26c(1))

Q13: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Response: AFME members do not have any comments on the proposed guidance for this criterion.

Appropriate mitigation of interest and currency risks (Article 26c(2))

Q14: Do you agree with the interpretation provided? Should additional aspects be clarified? More specifically, is there a need to further clarify the term 'appropriate mitigation' of interest-rate and currency risks and further specify any mitigation measures? Please elaborate.

Response: AFME members suggest that where there is no interest rate or currency risk in a securitisation (for example, because the notes pay a coupon equal to EURIBOR plus a spread, and the collateral held by the SSPE is earning interest on the basis of EURIBOR, possibly minus a spread), or where all the payments in the securitisation are denominated in the same currency, there is no need for any disclosure of that fact. This would make it simpler for the STS verification agents to sign-off on compliance with this criterion.

Referenced interest payments (Article 26c(3))

Q15: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Q16: On reference rates: Is the interpretation on this term deemed helpful for the interpretation of this requirement? Please provide more information on the referenced interest payments used in relation to the transaction in your entity's practice.

Q17: On complex formulae or derivatives: Is the guidance provided sufficient to clarify the requirement or should the guidance be extended? In case of the latter, please provide suggestions on how to define complex formulae and derivatives.

Response: Since the Guidelines on traditional STS securitisation were published in 2018, there has been a significant shift away from interbank rates outside the Eurozone. We therefore think it would be useful to include an explicit reference to risk free rates (i.e., €STR, SOFR, SONIA, etc., although not as an exhaustive list) alongside the other types of rates referred to in paragraph 159 of the draft Guidelines. In other respects AFME members agree with the proposed guidance for this criterion.

Requirements after enforcement notice (Article 26c(4))

Q18: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Response: The reference to "an enforcement event in respect of the originator" in this criterion conflicts to some extent with the circumstances in which the securitisation may be terminated by investors prior to its

scheduled maturity (Article 26e(6)). Given that Article 26e(6) is more explicit about the circumstances in which investors can terminate the transaction, our view is that the reference to "an enforcement event in respect of the originator" in Article 26c(4) should be interpreted as referring to a circumstance where the investor is permitted to terminate the securitisation pursuant to Article 26e(6). It should also be clarified that other default by a SSPE or other transaction party (other than the originator) does not constitute an enforcement event that permits the investors to take enforcement action, as that would otherwise conflict with Article 26e(6).

We do not think that the proposed guidance in paragraph 161 of the draft Guidelines is necessary, or technically correct. The amount of cash that will remain in the SSPE during any extension period will be as specified in the criterion itself, but that will not be subject to any agreement with the trustee or representative of the investors. It will simply be determined by the calculation agent or cash manager in accordance with the terms of the transaction documents. This is also important to ensure compliance with Article 26e(3). Further, it is not clear what is the purpose of paragraph 162 of the draft Guidelines. Any cash or other collateral that remains held by the SSPE will be held in the same way as it was held prior to the termination. However, it may be helpful to clarify that the reference to "defaulted underlying exposures" in Article 24c(4) can include exposures which have experienced a potential credit event prior to the termination of the securitisation, which then crystallises into an actual credit event after such termination.

Allocation of losses and amortisation of tranches (Article 26c(5))

Q19: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Response: Paragraph 165 of the draft Guidelines defines the "last part of the maturity of the transaction" as "the period close to the maturity of the credit protection". It also refers to the maturity date being determined as the earliest date the protection may terminate in accordance with Article 238 of the CRR. Given that Article 238 defines the maturity without reference to a time call, this would be the scheduled maturity date of the securitisation, by which point the portfolio would have amortised to zero (or very close to zero). It is not clear what the "period close to the maturity of the credit protection" is referring to, but if that is the last calculation (ie, quarterly) period before the scheduled maturity date of the securitisation then this will clearly not work given that paragraph 164 of the draft Guidelines defines "significant losses" as being two thirds of the absolute amount of losses expected to occur during the expected maturity of the transaction. We do not think this can be the intention, and propose that this guidance be revised so that the "last part of the maturity of the transaction" is defined as the final third of the expected maturity of the transaction (ie, taking any time calls into account). If that is not considered to be consistent with the level 2 text of the relevant Final Draft RTS, then the definition of "significant losses" needs to be reconsidered as it is not realistic to proceed on the assumption that two thirds of the entire losses would be incurred in the very last calculation period for the securitisation.

A further point relates to the final paragraph of Article 26c(5). There is an error in the level 1 text that means that it cannot be applied literally in the case of a mezzanine securitisation. To illustrate the point, assume the following fact pattern:

- Remaining junior tranche notional amount (unexecuted; retained by originator): EUR 10
- Remaining mezzanine tranche notional amount (placed with investors): EUR 100
- Aggregate outstanding defaulted amounts: EUR 30
- Aggregate initial loss amounts: EUR 15

In this case, the final paragraph of Article 26c(5) would require an amount equal to EUR 30 – EUR 15 to be retained pending completion of the work-out. However, if the remaining junior tranche is taken into account, the maximum loss which could be allocated to the mezzanine tranche is only EUR 5 (ie, EUR 15 – EUR 10). It therefore does not make sense to require an amount of EUR 15 of the mezzanine tranche to be retained. Further, the issue would not arise if the junior tranche had been issued and purchased by the originator, as then it would count towards the remaining credit protection for the purposes of Article 26c(5). Therefore, the Guidelines should clarify that for the purpose of determining the amount of credit protection which remaining payment date, the calculation should take into account the amount of any unexecuted retained tranches which rank junior to the tranches covered by the credit protection.

Early amortisation provisions/triggers for termination of revolving period (Article 26c(6))

Q20: Do you agree that it is not necessary to further specify this criterion? If not, please provide reference to the aspects that require such further specification. Please substantiate your reasoning.

Response: One issue which would benefit from some further clarification is the distinction between replenishment (or a revolving period) and substitution of ineligible exposures. It is not uncommon for transactions to have a defined revolving period during which the originator may replenish the securitised portfolio in response to amortisation, disposal or recoveries in respect of the securitised exposures. During that revolving period, the originator can also add additional exposures to replace any exposures which have been removed due to them having been found not to have complied with the eligibility criteria. However, there are also transactions where substitution of ineligible exposures is permitted after the end of the revolving period. Some transactions also go further and permit substitution of exposures which have prepaid early after the end of the revolving period. It is unclear whether this should be permitted given the apparent policy intention behind Article 26c(5) of specifying circumstances where the transaction should move to an amortisation phase. This type of substitution mechanic also raises questions about how to calculate the earliest date at which a time call may be exercised given the requirement from in paragraph 201 of the draft Guidelines that it be set at a period equal to the WAL plus the length of the revolving period (though please also see our comments on this in relation to Article 26e(5)). It would be helpful for this to be clarified in the Guidelines.

Transaction documentation (Article 26c(7))

Q21: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Response: AFME members do not have any comments on the proposed guidance for this criterion.

Servicer's expertise and servicing requirements (Article 26c(8))

Q22: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Response: AFME members do not have any comments on the proposed guidance for this criterion other than those set out in relation to the concept of "similar exposures" in our observations on Article 26b(10).

Reference register (Article 26c(9))

Q23: Do you agree that it is not necessary to further specify this criterion? If not, please provide reference to the aspects that require such further specification. Please substantiate your reasoning.

Response: AFME members agree that no further guidance is required for this criterion.

Timely resolution of conflicts between investors (Article 26c(10))

Q24: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Response: AFME members agree that no further guidance is required for this criterion.

Requirements relating to transparency (Article 26d)

Data on historical default and loss performance (Article 26d(1))

Q25: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Response: AFME members only comment on this point is that there should be no requirement to use third party or proxy market data where the originator already has sufficient information about the exposures to make the disclosures required by this criterion. However, where the originator does not have such information, it should be permitted to use proxy data. The proposed guidance in paragraph 180 of the draft Guidelines should be amended to clarify this.

Verification of a sample of the underlying exposures (Article 26d(2))

Q26: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Q27: In particular, do you agree with the interpretation of the scope of the verification, in particular with the specification on how the size of the representative sample should be determined? Should additional aspects/parameters for determining the sample be clarified? Please substantiate your reasoning.

Response: We have a number of comments in relation to this criterion.

First, however, it is important to note that there is an important distinction between the requirement in Article 26d(2) for synthetic securitisations, and that which appears in Article 22(d) of the EUSR for traditional securitisations.

Article 22(d) of the EUSR provides as follows:

> *A sample of the underlying exposures shall be subject to external verification prior to issuance of the securities resulting from the securitisation by an appropriate and independent party, including <u>verification that the data disclosed in respect of the underlying exposures is accurate</u>.* (emphasis added)

In contrast, Article 26d(2) of the EUSR provides as follows:

A sample of the underlying exposures shall be subject to external verification prior to the closing of the transaction by an appropriate and independent party, including verification that the underlying exposures are eligible for credit protection under the credit protection agreement. (emphasis added)

As can be seen, whereas for a traditional securitisation, the requirement is to verify that the data disclosed is accurate, the requirement for a synthetic securitisation is instead to verify that the underlying exposures are eligible for credit protection.

In paragraph 80 of the EBA Guidelines on STS Criteria for Non-ABCP Securitisation (EBA/GL/2018/09), the EBA effectively requires two separate processes to take place: (i) verification that the provisional portfolio complies with the eligibility criteria and (ii) verification that the information disclosed in any formal offering document is accurate. This is logical, on the basis that the starting point in Article 22(d) of the EUSR is to verify that the information disclosed is *accurate*, which goes beyond merely verifying that the eligibility criteria are complied with. However, there is no requirement to ensure that the information disclosed is accurate in the case of a synthetic securitisation under Article 26d(2) of the EUSR. Rather, the level 1 text refers only to the eligibility of the underlying exposures. We therefore agree with the EBA's proposal in paragraph 185 of the proposed Guidelines, which sets out a single process, to verify compliance with the eligibility criteria. There is no need for a separate "pool audit" to verify the accuracy of the information disclosed. Our further comments below should be read against this backdrop.

Time for verification: This criterion requires the verification to occur prior to the "closing of the transaction". In most transactions this is uncontroversial, as this would be generally understood to be the date on which the notes are issued. However, for transactions which do not involve note issuance (eg., bilateral guarantees), there may be a difference between the execution date of the guarantee (the "signing date") and the effective date of the protection. This will usually be due to the requirement for various conditions precedent to be satisfied on the part of the originator, and is almost always the case for transactions involving the EIF as protection provider. In this context, it is generally understood that the closing date is the effective date – ie, once all the necessary conditions precedent have been satisfied, and it follows that it is therefore possible for the verification to occur during the period between the signing date and the effective date. It would helpful if this understanding could be confirmed in the Guidelines.

Scope of the verification: There is an inconsistency between the paragraph 181 of the draft Guidelines, which refers to verification of a sample of the "provisional portfolio from which the securitised pool is extracted" and paragraph 183 of the draft Guidelines which refers to a "random sample of underling exposures extracted from all the underlying exposures in the securitisation", and which therefore suggests that the verification must be undertaken in respect of the actual portfolio, not the provisional portfolio. As a practical matter, the position in paragraph 181 is more feasible, as it is common for there to be last minute adjustments to the securitised portfolio during negotiations with investors, although paragraph 181 would only seem to permit *removal* of exposures from that provision portfolio, not inclusion of other exposures that did not form part of that provision portfolio. Nevertheless, this discrepancy should be corrected one way or the other. We also assume that there is no concern if the originator chooses to verify every exposures in the portfolio.

Partly following from the preceding comment, it is also unclear what is meant by the reference to "without replacement" in paragraph 183 of the draft Guidelines. This wording appears to be redundant, as either the verification is undertaken on the provisional portfolio (in which case subsequent replacement would not affect the audit) or on the final portfolio (in which case there would be no replacement anyway). We would suggest this wording be deleted.

It is also unclear what is meant in paragraph 185 of the draft Guidelines by verification of those eligibility criteria "that are able to be tested prior to the closing of the transaction". Given that the originator is required

to represent under Article 26b(6)(c) that the exposures comply with all of the eligibility criteria, this would appear to imply that *all* eligibility criteria must be verified. At the same time, paragraph 185 indicates that the verification should take the form of a check of the originator's database or IT systems against the transaction documentation. Depending on the nature of the eligibility criteria, they may not all be in a form that allows for checking by reference to the originator's IT systems. We therefore propose that the scope of the verification should encompass those eligibility criteria which are capable of being verified by reference to the information stored in the originator's IT systems and that it be clarified that there is no requirement for a physical check of the underlying legal documentation for the securitised exposures.

It should also be clarified that the reference in paragraph 185 of the draft Guidelines to the "transaction documentation" is a reference to the securitisation transaction documentation, and not to the documentation for the underlying exposures. Finally, the reference to "confirm[ing] that the occurrence of a credit event would trigger a credit protection payment …" should be deleted as it is not strictly correct. For example, in the case of a mezzanine securitisation, credit events will only lead to credit protection payments once the first loss tranche has been exhausted. It should be sufficient to state that the purpose of the verification is to confirm that the exposures satisfy the relevant eligibility criteria as referred to in the previous paragraph.

Liability cashflow model (Article 26d(3))

Q28: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Response: AFME members' only comment here is that it should be clarified that while the model needs to be made available to investors on an ongoing basis, there is no obligation on the originator continually to update the model over the life of the transaction, unless there have been amendments to the securitisation documentation which result in the model no longer accurately reflecting the securitisation cashflows.

Environmental performance and sustainability disclosures of the assets (Article 26d(4))

Q29: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Response: We generally agree with the proposed guidance on this criterion. However, we suggest that a degree of proportionality should also apply, such that this disclosure is only required in respect of newly-originated loans (after the Guidelines come into force), and only where data is available for at least a minimum proportion of the securitised portfolio as otherwise it is actually misleading to publish data on a small proportion of the securitised exposures if that is all that is available. We also note that it is important for these Guidelines to be consistent with the RTS to be adopted pursuant to Article 26d(6) when they are available.

Compliance with disclosure requirements under Article 7 (Article 26d(5))

Q30: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Response: AFME members do not have any comments on the proposed guidance for this criterion.

Criteria specific for on-balance-sheet securitisation (Article 26e)

Credit events covered under the credit protection agreement (Article 26e(1))

Q31: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Response: AFME members do not have any comments on the proposed guidance for this criterion.

Credit protection payments (Article 26e(2))

Q32: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Q33: Do you agree with the interpretation of the determination of interim credit protection payments? Do you agree with the interpretation of the criterion with respect to the 'higher of' condition? Should the interpretation be amended, further clarified or additional aspects be covered? Please substantiate your reasoning.

Response: AFME members do not have any comments on the proposed guidance for this criterion.

Debt workout and credit protection premiums (Article 26e(3))

Q34: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Response: We suggest three minor clarifications in relation to this criterion. First, in relation to paragraph 196 of the draft Guidelines, the reference to the "outstanding nominal amount" should be replaced with a reference to the "outstanding nominal amount or commitment amount". This is to cater for the common scenario where undrawn commitments are securitised and the protected amount may be greater than the drawn amount in a pre-default scenario.

Secondly, the criterion is unclear as to whether the protection fees are to be calculated by reference to the outstanding nominal amount of the performing securitised exposures or the outstanding balance of the protected tranche(s) (the drafting of the level 1 text appears to have it both ways by referring to "the outstanding nominal amount of the performing securitised exposures at the time of the payment and reflect the risk of the protected tranche"). The correct answer should be that the protection fees are calculated by reference to the outstanding balance of the protected tranche(s) and this should be clarified in the Guidelines. Technically this actually makes the current proposed guidance in paragraph 196 of the draft Guidelines redundant in its present form, so it should also be revised to clarify that the outstanding balance of the tranches should be reduced to reflect interim and final losses determined in respect of the securitised exposures. This is the correct way if capturing the point otherwise being made in that paragraph as well as the level 1 text. For completeness, it would also be useful to clarify that this does not prevent adjustment payments being made upon calculation of the final loss to reflect the difference in the protection fees that were actually calculated and the protection fees that would have been calculated if the final loss had been known at the time of the initial loss calculation (whether positive or negative, and commonly referred to in the market as "make-up interest amounts").

Finally, the references to the balance "at the time of the payment" is not technically correct, as in almost all cases the protection payment will be sized based on either the balance of the tranche at the beginning of the

relevant calculation period or some type of average balance calculated over the that calculation period. It will never be calculated by reference to the closing balance which prevails at the time of the payment. Therefore, it should be clarified that the reference to "at the time of the payment" should be interpreted as referring to the balance of the protected tranche(s) at the beginning of the relevant calculation period for the payment date.

Third-party verification agent (Article 26e(4))

Q35: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Response: Paragraph 198 of the draft Guidelines is incorrect, in that it is referring verification prior to the issuance. This is addressed in Article 26d(2). Article 26e(4) is dealing with verification following the occurrence of a credit event. This paragraph should therefore be deleted.

One further point that would benefit from further clarification is the basis on which verification may occur on a sampling basis. In the case of mezzanine transactions, to avoid unnecessary cost of the originator, it is common (including in many transactions with EIF acts as the protection provider) for verification only to be required once the cumulative losses exceed a certain percentage of the retained junior tranche. It would be helpful for the Guidelines to clarify that this is a permitted approach to sample verification.

Early termination events by originator (Article 26e(5))

Q36: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Q37: Do you consider necessary to provide interpretation of the term 'breach by the investor of any material obligation'? Please provide information on such material breaches applied in securitisation practice.

Response: Paragraph 200 of the draft Guidelines states that for the purpose of determining the earliest date on which a time call may be exercised, the period should be the sum of the replenishment (revolving) period at closing and the remaining WAL at the end of the replenishment period. The market practice is for this date to be set by adding the scheduled replenishment period to the WAL of the securitised portfolio at closing so as to be able to specify a fixed date in the transaction documentation. The proposal in paragraph 200 however means that the actual call date could not be known in advance, as it would depend on the actual WAL at the end of the replenishment period. Further, if the actual replenishment period ends up being shorter than was scheduled at closing (eg., due to a trigger of the kind referred to Article 26c(6)), the WAL at that time would be added to the original scheduled replenishment period, producing a date that would fall after the remaining WAL at that time, which does not make sense. Having this uncertainty as to when the time call may be exercised is problematic for both originators and investors because it makes it more difficult for them to model the transaction, and is inconsistent with the goals of simplicity and transparency underpinning the STS framework. We therefore propose that paragraph 201 be amended so that it specifies that the earliest scheduled time call should be a fixed date specified in the transaction documentation which is not earlier than the scheduled replenishment period plus the WAL of the securitised portfolio at closing. While we acknowledge that this is not consistent with the EBA's proposals for time calls in its SRT Report from November 2020 (see Recommendation 3, para (c)), the reality is that virtually all transactions executed since that date which include a time call have a fixed date for the earliest exercise of the time call specified in the transaction documentation, without that having attracted adverse comment from competent authorities as part of the SRT assessment process.

Sub-paragraph (b) of Article 26e(5) permits the originator to terminate the transaction due to a failure by the investor to pay protection payments or a breach by the investor of its other material obligations. In the case of a securitisation involving a SSPE, this would not technically be correct, as the investor will be holding notes issued by the SSPE, under which it would have no obligations. Instead, the reference to the investor in that context should be read as a reference to the SSPE. It should therefore be clarified in the Guidelines that the reference to the investor in this sub-paragraph should be interpreted as including a reference to any protection provider which has entered into the credit protection agreement with the originator.

We do not consider that there is merit in attempting to define what constitutes a "material obligation" for the purposes of sub-paragraph (b) of Article 26e(5). Any attempt to do would still involve some degree of judgment being required by the parties which will likely create as many new issues as it will resolve. We therefore consider this should be left up to the parties to interpret the level 1 text as it applies in the context of each transaction.

As a more minor point, it would be helpful to clarify that the originator may terminate the securitisation on the grounds of illegality, as it is clearly not viable for it to be obliged to continue in a transaction where to do so would be illegal.

Early termination events by investor (Article 26e(6))

Q38: Do you agree that it is not necessary to further specify this criterion? If not, please provide reference to the aspects that require such further specification. For example, do you consider it necessary to provide interpretation of the term 'material breach' of contractual obligations by the originator? Please substantiate your reasoning.

Response: For the same reason as set out in final observation in relation to Article 26e(5), we do not think there is any merit in seeking to define what constitutes a "material breach" of contractual obligations by the originator, although we do note that the two criteria are not entirely symmetrical in that Article 26e(5) refers to a breach by the investor of a "material obligation", whereas in respect of the originator the reference is to a "material breach" of a contractual obligation. In practice, however, think this difference is relatively minor as it is unlikely that either an originator or investor would seek to terminate unless there was actually both a material breach and the obligation which has been breached is material.

We do, however, propose one minor clarification in respect of this criterion. The reference to a material breach by the originator of its contractual obligations should be understood as encompassing a material breach by the originator of its contractual obligations in any capacity under the securitisation documentation. For example, where the originator acts as an account bank, a material breach of its obligations as account bank, unless a replacement account bank is put in place, that should also permit investors to terminate the securitisation.

As with Article 26e(5), we also consider that it would be helpful to clarify that the investor may terminate the securitisation on the grounds of illegality, as it is clearly not viable for it to be obliged to continue in a transaction where to do so would be illegal.

Synthetic excess spread (Article 26e(7))

Q39: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Response: We note that the use of synthetic excess spread in synthetic STS securitisations will also be governed by the regulatory technical standards to be adopted by the European Commission pursuant to Article 248(4) of the CRR. However, we wish to make a number of observations about the criteria in Article 26e(7) as well.

Accrual of SES: Sub-paragraph (a) of Article 26e(7) contemplates that SES should be calculated in respect of each payment period. This is inconsistent with the specification in sub-paragraphs (c) and (d) that the amount of SES that can be committed per year cannot be higher than the one-year expected losses. Sub-paragraph (b) then goes on to prescribe that any SES that is not used to cover losses that materialise during each payment period shall be returned to the originator. The effect of these provisions is that, notwithstanding that the criterion clearly contemplates that SES be capped on an annual basis, if the payment periods are shorter than one year, then the SES must be treated as use-it-or-lose (UIOLI) it in those shorter payment periods.

This is inconsistent with both market practice and the Draft RTS on SES. In the case of market practice, it is common for SES either to accrue on an annual basis (regardless of the length of the payment periods), or to accrue on a quarterly basis but be available to absorb losses on a rolling 12-month basis. In the case of the Draft RTS on SES, while they do not permit either the derogation in Article 6(2) of the Draft RTS or the Scalar of 0.6 to apply if the SES accrues on the basis of each payment period but remains available on a rolling 12-month basis, they do permit the SES accrual periods to be different from the payment periods, and thus it would be possible to accrue the SES on an annual basis and still apply either the derogation or the reduced Scalar.

In our view, the discrepancy between sub-paragraphs (a) and (c)-(d) of Article 26e(7) was an oversight in the drafting of the level 1 text, and we request that it be clarified in the Guidelines that the reference to "payment period" in sub-paragraph (a) should be read as referring to the SES accrual period specified in the transaction documentation, consistent with the definition of "SES period" set out in Article 1(4) of the Draft RTS on SES. This is, however, subject to the final outcome in the Draft RTS. If they are modified or interpreted to allow for UIOLI SES calculated in respect of periods shorter than one year to be available for a 12-month period, then the Guidelines should permit the same for the purposes of Article 26e(7).

Rate of SES: Sub-paragraph (a) of Article 26e(7) states that the amount of SES should be expressed as a fixed percentage of the outstanding portfolio balance at the start of the relevant period. It is not clear from this whether it is permissible for that rate of SES to be different for different accrual periods. In our view there is no reason why that could not be the case, provided that the specified rate for each period was set out at closing in the transaction documentation, and that the specified rate for any year does not exceed the 1-year expected losses, and we request that this be clarified in the Guidelines. This may be particularly helpful for originators operating under the Standardised Approach, where the IFRS 9 provisions are often small on closing compared with lifetime historical losses.

At the same time, however, it is important that the actual rate of SES for any given period is determined at closing, capped at the prevailing 1-year expected losses at that time. The Draft RTS on SES are currently ambiguous on this point (see Article 6(2)(a) of the Draft RTS which refers to the 1-year expected loss amounts "for that year", along with Article 5(1) of the Draft RTS which appears to indicate that the relevant parameters are treated as constant over a time horizon of one year only. It is obviously important that both Article 26e(7) and the Draft RTS are interpreted in a consistent manner in this regard, but we would urge the EBA to clarify that for both purposes the 1-year expected losses used to cap the amount of SES that can be committed in any given year should be determined by reference to the 1-year expected losses on the securitised portfolio at closing and should not change over the life of the securitisation.

Calculation of 1-year expected losses: Sub-paragraph (d) of Article 26e(7), as well as paragraph 203 of the draft Guidelines provide that the calculation of the 1-year expected losses under the Standardised Approach should be "clearly set out in the transaction documentation". It remains unclear what that actually requires, and how much detail is required to be set out. The calculation of expected losses is complicated and commercially sensitive, and it does not really benefit investors to see the precise calculations by which it is derived. We also note that there is no corresponding requirement to disclose the detailed calculations of the regulatory expected loss amounts under the IRB Approach for sub-paragraph (c) of Article 26e(7). In light of this, we submit that sub-paragraph should be interpreted as only requiring disclosure of which accounting framework that governs the calculation of expected losses, but without any requirement to disclose the actual calculations.

Types of credit protection agreements (Article 26e(8))

Q40: Do you agree that it is not necessary to further specify this criterion? If not, please provide reference to the aspects that require such further specification. Please substantiate your reasoning.

Response: AFME members agree that no further guidance is required for this criterion.

Specific type of credit protection agreement (Article 26e(9))

Q41: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Response: Paragraph 205 of the draft Guidelines provides that the legal opinion should opine that the credit protection "complies with the law" in all the relevant jurisdictions. This is an unusual requirement and goes beyond the usual standard of legal opinion required under for credit protection arrangements and synthetic securitisations under Articles 194(1) and 245(4)(g) of the CRR, and which is also reflected in the level 1 text of this criterion. This is also not an opinion which is customary in market. As no explanation has been provided for why it is necessary to extend the scope of the opinion, we request that this requirement be deleted. In addition, we do not think that paragraph 206 of the draft Guidelines adds anything that is not already covered by the level 1 text and should also be deleted.

Requirements for recourse to high-quality collateral (Article 26e(10))

Q42: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Response: We agree with the proposed guidance in relation to this criterion. However we also wish to make the following observations.

Charge-back collateral structures: This criterion requires that both the originator and the investor should have recourse to high quality collateral of one of the prescribed types. However, it does not specify how that recourse should be achieved. We therefore think it should be clarified that this may take the form of a "chargeback" structure, where the protection provider (whether the investor directly or a SSPE) places a cash deposit with the originator (regardless of its rating), with the originator placing opening a cash or securities account with a third party bank or custodian that meets the requirements of sub-paragraphs (a)(iii) or (b) of Article 26e(10), and grants security over that account in favour of the protection provider to secure repayment of the cash deposit. Such a structure would give the investor recourse to the high quality collateral posted by the originator in the event that the originator fails to repay the cash deposit, while of course the originator remains the owner of that high quality collateral and thus also has recourse to it by being entitled

to have the collateral released from the security as protection payments are due under the securitisation. In our view such structures clearly fall within the scope of Article 26e(10), but it would be helpful to state that explicitly in the Guidelines.

Applicable credit rating: The derogation in Article 26e(10) which permits cash collateral to be held in the form of cash on deposit "with the originator, or one of its affiliates, if the originator or one of its affiliates" has a CQS 2 rating (which may be lowered to CQS 3 by the competent authorities in certain circumstances). The provisions go on to state that where "the originator or one of its affiliates no longer qualifies for the minimum credit quality step", the cash needs to be moved to a bank which does have the required rating. The drafting of the level 1 text is not as clear as it could be, but on its correct construction the requirement is not that the originator itself has the required rating, but merely that the originator or one of its affiliates has the required rating, which may include an affiliate in a different jurisdiction. It would be helpful if this point could be confirmed in the Guidelines.

Finally, the provisions allowing a competent authority to lower the required credit rating for cash collateral to be held with the originator or one of its affiliates from CQS 2 to CQS 3 is not clear as to whether such a decision needs to be made by the competent authority for its entire market, or whether it can be made on a case-by-case basis for a given originator. In our view, even though the reasons for making such a decision clearly require consideration of the broader market conditions in the relevant member state, there is nothing in the language to suggest that it cannot be made on a case-by-case basis, and we request that this be confirmed in the Guidelines.

STS criteria not specified above (i.e. early termination event by investor (Article 26e(6)) etc.)

Q43: Do you agree that no other requirements are necessary to be specified further? If not, please provide reference to the relevant provisions of the STS requirements and their aspects that require such further specification. Please substantiate your reasoning.

Response: There are two further points which we wish to make.

Amendment of STS securitisations: There is no guidance in the EUSR as to the circumstances in which a STS securitisation can be amended without that amendment causing the securitisation to lose its STS status, or to have that STS status re-assessed, which will usually not be possible as there will have been some portfolio migration and defaults since the original closing date which would mean it is no longer to satisfy Article 26b(11). AFME members' view is that an amendment should only trigger a re-assessment of the STS status where it involves any of the following:

- Extension of the maturity of or a change in the amortisation structure of the securitisation.
- A change to the date on which a time call may be exercised.
- A change to the length of any revolving period, or the triggers for the early end of that revolving period.
- An increase in the maximum portfolio size of the transaction.
- A change to the thickness of any of previously-issued tranches of the securitisation.
- A change in the use of synthetic excess spread.
- A change in the coupon or protection fees payable by the originator.
- A material change to the eligibility criteria or any portfolio criteria.
- Any other amendment which would result in the securitisation no longer satisfying all the STS criteria.

The execution/placement of a previously unissued tranche of the securitisation should not constitute an amendment which would lead to a reassessment of the STS status of the securitisation, provided that such new tranche is carved out of the positions previously retained by the originator.

Similarly, other more minor amendments to the securitisation should not trigger a re-assessment of the STS status. This is regardless of the form which the amendments take.

Grandfathering: Since the STS framework for on-balance sheet securitisation was introduced in April 2021, a large number of transactions have been executed. As is evident from the number of comments made in relation to each of the criteria above, in many cases it has been necessary for the parties to those transactions to take a view on the specific requirements of many of the criteria. Where they have done so in good faith, it would be manifestly inappropriate for the STS status of those securitisations to be lost solely on the basis that EBA may now produce Guidelines that are inconsistent with some of the positions that parties have taken in various transactions. While in theory the Guidelines are supposedly merely setting out what the correct interpretation has always been, the reality is that that is not how it works in practice. It is therefore important to include a confirmation that the Guidelines only apply to securitisations executed after the publication of the Guidelines.

Amending guidelines

Q44: Do you agree with the proposed amendments to the Guidelines EBA/GL/2018/09? Should additional aspects be clarified? Please substantiate your reasoning.

Response: Please see our response in relation to Article 26b(12) above, which applies equally to the proposed amendments to Guidelines EBA/GL/2018/09. In addition, we note that in the context of traditional STS securitisations, while an initial payment will be made, as noted above, as this criterion has historically been understood as an anti-fraud measure, that initial payment may be of a minimal amount and thus it is questionable whether it would be considered to meet the requirement that it relates to the "economic substance" of the exposure. We therefore suggest that this reference in the draft Guidelines be deleted.

In relation to the Article 22(2), it is unclear what is meant by the reference to "without replacement" in the proposed amendment to paragraph 80 of the existing Guidelines. As reflected in paragraph 78 of the existing Guidelines, common market practice is for the audit to be undertaken on the provisional portfolio (in which case subsequent replacement would not affect the audit) or on the final portfolio (in which case there would be no replacement anyway). The proposed replacement wording for paragraph 80 of the existing Guidelines appears to be inconsistent with this. In a similar vein to our response to the proposed guidance on Article 26d(2), above, this inconsistency needs to be tied up.

In addition, for the purposes of Article 22(2), we draw your attention to the proposed new paragraph 80b of the proposed Guidelines, which incorrectly refers to the "credit protection agreement". This reference is not relevant in a traditional securitisation to which this paragraph relates, so it should be deleted (see the mark-up below).

> "*80b. The verification should include the verification of the compliance of the underlying exposures in the provisional portfolio with the eligibility criteria ~~under the credit protection agreement~~ that are able to be tested prior to the closing of the transaction.*"

Q45: Do you agree with the proposed amendments to the Guidelines EBA/GL/2018/08? Should additional aspects be clarified? Please substantiate your reasoning.

Response: Please see our response to Question 44 above, which applies equally (except for the comments relating to the proposed amendments to the guidance on Article 22(2) of the existing Guidelines) to the proposed amendments to Guidelines EBA/GL/2018/08.

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