Comments on

EBA Consultation Paper – Guidelines on Connected Clients under Art. 4(1)(39) Regulation (EU) No. 575/2013 (EBA/CP/2016/09)(the "Draft Guidelines")

Frankfurt am Main, October 2016

"Economic dependency through a main source of funding" (paras. 27 et seq. DRAFT Guidelines):

Executive Summary:

- **In paras. 27 et seq. (in combination with Example E6)**, the Draft Guidelines propose to treat all SPVs which are sponsored by a bank (such as SPVs in an ABCP programme) as economic dependent through a main source of funding and hence as connected clients within the meaning of Art. 4(1) No. 39(b) CRR.

We believe that such proposed treatment:

- **contradicts** fundamental principles for the determination of groups of connected clients as commonly accepted and reaffirmed in the Draft Guidelines itself, because (i) the fact that the bank itself may fall away shall from such bank's own perspective not result in a group of connected customers (the bank itself shall not constitute the link as it may disregard its own insolvency) and (ii) pure liquidity risks which may arise as a result of a closure of the ABCP market are covered in a maximum conservative way by LCR and NSFR rules and not by the large exposure regime;

- **neglects** the actual economic risk inherent in such "limited recourse" structures, because the insolvency of a sponsor bank does not result in an increase of the credit risk associated with the securitisation transactions as the repayment out of collection proceeds is not affected;

- **is inconsistent** with other regulatory objectives and measures because (i) banks are encouraged to sponsor only fully supported conduits as this is a key quality aspect for STS criteria and also a requirement to fulfil the self-retention requirments and (ii) concentration risks within securitisation transactions are managed already in accordance with the CRR by way of the look-through principle,

- is **not** by any other means **justified** but creates a "lex ABCP conduit", arbitrarily discriminating just one individual bank product because ABCP conduits should also just be treated in accordance with general principles of the large exposure regime without the need for discriminating examples.

- We think that, from the **perspective of the sponsoring bank**, SPVs in an CRR-compliant ABCP programme do not constitute a single economic risk. Therefore, the example E6 should be deleted and the related paras. 27 et seq. should be amended as they do not clarify the application of the rules, but try to enforce a specific rule for ABCP conduits and securitisation SPVs in deviation of established CRR principles. The example E6 results in the aggregation of independent risks and hinders an appropriate economic evaluation of loss risks. This may have **unforeseen consequences** but will certainly **hamper the financing of real economy entities through ABCP**.

In particular, we have the following comments:

Similar to the 2009 CEBS Guidelines, EBA proposes to consider a „one-way or two-way dependency on the same funding source" as a factor for an economic dependency within the meaning of Art. 4(1)(39)(b) CRR (see para. 27 Draft Guidelines). However, more pronounced as the 2009 CEBS Guidelines, EBA now proposes that loans granted by the reporting institution itself should be considered as such a common source of funding (see para. 28 Draft Guidelines). In addition (and, again, following the 2009 CEBS Guidelines), EBA lists a number of indicative factors that may lead to the assumption of contagion or idiosyncratic risks (see para. 29 Draft Guidelines). In application of these guidelines, EBA concludes in Example E6 (on p. 17/18) that an institution providing liquidity lines to several SPVs "can constitute the source of risk (the underlying risk factor) as recognized in recital 54 of Regulation (EU) No. 575/2013".

1.

We believe that the approach taken in paras. 28 and 29 Draft Guidelines (and the conclusion drawn in the example E6 based on it) is incorrect and not justified for the following reasons:

First, sectoral concentration risks fall outside the scope of the large exposure regime (see CP, Background and Rationale, para. 7 on p. 7). Therefore, it is beyond doubt that the fact that several clients tap the same banking or capital market segment (e.g. for commercial paper in general or ABCP in particular) for funding purposes does not constitute a dependency which may justify the treatment as a "single risk" within the meaning of Art. 4(1)(39)(b) CRR. However, EBA's proposal does not shed any further light on the crucial distinction between a funding source that constitutes a "market" and, therefore, a sectoral concentration risk (outside the scope of the large exposure regime) and a funding source that constitutes an economic dependency within the meaning of Art. 4(1)(39)(b) CRR.

Second, the large exposure regime aims to prevent "excessive concentration of exposures to a client or a group of connected clients may result in an inacceptable risk of loss" (see recital 53 CRR). Based on that legislative intent, we think that a loan granted by an institution itself is, at least from the perspective of such institution, an intrinsic fact that should not constitute per se a relevant economic dependency between separate clients and a risk of excessive concentration for that institution. In this context, we think that recital 54 CRR is misconstrued. If EBA's reading of recital 54 and Art. 4(1)(39)(b) CRR were correct, it would lead to a circular reasoning, as then, logically, any and all exposures to separate clients of an institution must be seen as connected with each other, which, in turn, would render the entire concept of the large exposure regime non-sense and useless. In our view, this should not be the result of its application. Accordingly, we believe that an institution must rather look to extrinsic facts or circumstances (in terms of funding sources e.g. the credit granting by other entities or the absence thereof) that may or may not connect clients to a single economic risk unit.

The conclusions related to the example E6 illustrate the conceptional flaw:

From an outsider's perspective, all three SPVs (A, B and C) have at least two different sources of funding: first (and pre-dominantly), a funding via ABCP issuance to investors in the ABCP market and, secondly (and as a fall-back), via drawings under liquidities facilities granted by the sponsor bank.

From the perspective of the sponsor bank, it is the funding via the ABCP market that matters. The funding via ABCP is, however, an extrinsic risk factor that is, at the same time, a sectoral concentration risk that cannot constitute by itself an economic dependency within the meaning of Art. 4(1)(39)(b) CRR. As said before, the other source of funding, i.e. the liquidity facility granted by the sponsor bank is, from the perspective of such institution, not relevant.

Hence there is, in the absence of other connecting factors, no room for a grouping of the SPVs as connected clients from the reporting (sponsor) institution's perspective.

We think that this result is warranted and there is no regulatory gap that needs to be closed. It is simply a matter of economic perspective.

From the perspective of a third institution investing in any CP issued by A, B and/or C and relying on the sponsor support (rather than the quality of the underlying assets acquired by the SPV), the facility of the sponsor bank may matter and the analysis may therefore be different: the investor institution may come to the conclusion to treat all SPVs as group of connected clients because of the common liquidity support by the sponsor bank.

Third, the situations (or factors) listed in para. 29 Draft Guidelines (which were taken, by and large, from the 2009 CEBS Guidelines) are not selective and hence not suitable to provide a meaningful distinction to sectoral concentration risks and to appropriately assess "contagion or idiosyncratic risks". They seem to be arbitrarily designed to catch certain ABCP or SIV structures which went into trouble during the financial crisis, but they are extremely broad and ambiguous and therefore go too far:

- It is unclear what is meant with the addendum in brackets "(the same bank or conduit that cannot be easily replaced)" after "use of one funding entity"? What means easily in this context?

- Why should the "use of the same investment advisor" by itself lead to contagion risks? Would that factor then catch all SPV, funds and trusts structures advised and managed by the same investment management company?

- What means "use of similar structures"? What means similar? Similar to what? What is the connecting element here?

- Why should the "use of similar underlying assets" by itself lead to contagion risks and has this fact anything to do with a common source of funding?

In addition, the draft EBA Guidelines omit to clarify that these criteria bear only the character of an example. If these criteria are to be applied literally (and mechanically), we are afraid that institutions would be required to connect and group totally unrelated and segregated SPV and fund structures to one economic risk, which makes apparently no sense. Hence we believe that the use of ambiguous and non-selective factors will not provide any further clarity and certainty but do the entire opposite.

Fourth, as stated above, the large exposure regime aims to avoid the accumulation of losses due to concentrations (see recital 53 CRR). The sectoral dependence of the SPVs A, B and C on refinancing (i) via the ABCP market and/or (ii) credit facilities provided by the bank has no effect on the loss risk from the perspective of the Bank providing the credit facilities. Whether the ABCP market is functional or not, does not increase the loss risk in the case of a drawing. It increases the probability of a utilization of the credit facility but it has no effect on the probability of the repayment of the credit facilities. Liquidity aspects are, however already covered to the highest extent possible in the LCR provisions for securitization liquidity facilities. Therefore the sectoral dependence on the capability of ABCP is not relevant as it has no impact on the loss risk.

Fifth, we understand that in negation to all general principles, the example E6 constitues a group of connected customers through common funding via the bank itself. However, the SPV does not encounter any danger as the refinancing provided by the sponsor bank is 100% congruent. Even if a sponsor bank would fall away, no loss risk arises out of this scenario, as the SPV would cease to purchase new assets and would repay outstanding drawings out of the proceeds. The worst case scenario would be the wind-down, but not the insolvency or loss, of a SPV. In difference to an operating company which depends un-terminated credit lines to continue its business, a SPV requires this only to do new business as all existing business is fully and congruently refinanced. On this basis, especially example E6 cannot constitute a single risk as, regardless of a potential refinancing by a third bank (which also would be possible), as the insolvency of the bank would not endanger the repayment of drawings.

Sixth, unlike the 2009 CEBS Guidelines, the EBA proposal omits to include other selective criteria to determine an economic dependency through a main source of funding.

2.

In sum, we believe that such approach may lead to unwarranted (and probably unintended) consequences:

First, taken literally, the proposal would lead, in general, to any SPVs as clients (especially in securitisation or specialized lending structures sponsored by an institution) becoming now a group of connected clients despite the fact that the relevant risks may be appropriately segregated (legally and economically) and hence in fact no excessive single concentration risk exists. We think that such regulation or any application by a competent authority conflicts with the principle of proportionality which the provisions of the CCR aim to preserve (recital 46 CRR).

Second, although the European ABCP market and the related structures changed dramatically over the last years since its lapse during the 2007 financial crisis, EBA's proposal would in particular catch still existing ABCP programmes in Europe which now try to comply to the fullest extent with the new regulatory framework applicable to securitisations in Europe and used to almost exclusively finance the acquisition of real economy assets. The crucial element combining all such programmes is the fact that the investors in the ABCP basically rely on just one bank as sponsor to provide the full liquidity and credit support (instead of several liquidity banks, so called "fully supported ABCP conduits"), which is per se a result of the application of the self-retention requirements (Art. 405 (1) sub-para. 2, sentence 2) and related own funds and liquidity requirements in the CRR. We think that the large exposure regime (as now proposed and interpreted by EBA) is not appropriately harmonised with the self-retention, own funds and liquidity requirements contained in CRR and hence inconsistent with those regulations.

Third, the treatment proposed by EBA may significantly limit the ability of European sponsor banks to promote real economy financing above their individual large exposure limit without justification. It is inconsistent with the aim of other EU bodies (Commission, the Council of the EU and the EU Parliament) to promote real economy financing in Europe, in particular through high quality securitisation (including ABCP). We therefore think that this specific guideline does not serve its own purpose and also contradicts other legislative initiatives (like the CMU).

3.

We therefore suggest to delete para. 28 and 29 Draft Guidelines entirely and to include, instead, selective criteria to assess an "economic dependency through a main source of funding" (following up on the criteria contained in no. 45 of the 2009 CEBS Guidelines):

A dependency is supposed to exist when (i) the underlying assets are not appropriately segregated and (ii) there is just one single source (entity) of funding which must be replaced but is not replaceable within an adequate timeframe and (iii) the respective clients are not able to overcome their dependence on such source even by taking on practical inconvenience or higher costs. In this respect, we suggest further to clarify that, from the perspective of a reporting institution, only the dependency on external funding sources (as an extrinsic factor) should be taken into consideration and assessed.

4.

Rebuttal of groups of connected clients pursuant to Article 4 (1) (39) (a) CRR is required without restrictions in case of SPVs that are included in the commercial consolidation pursuant to IFRS 10.

Auditors require with reference to IFRS 10 in many cases the inclusion of SPV's from securitisation transactions in the consolidated financial statements. Often it is sufficient that the originator has sold its loan or lease receivables to an SPV involved in a securitisation transaction, render the servicing and holds a securitisation position. For instance, such securitisation position may exist only to fulfil the risk retention requirements pursuant to Article 405 CRR or may stem from overcollateralization. Through the inclusion of the SPV in the originator's consolidated financial statements, a case of control is assumed based on IFRS 10 in conjunction with Article 4(1) (37) CRR. However, no single idiosyncratic risk exists in many of such cases. This, in particular, applies to SPV's involved in the securitisation with an insolvency-remote set up and further features of high quality securitisations warranting that there is no channel of contagion between the SPV and the originator constituting a single idiosyncratic risk. If the possibility to rebut the group of connected clients pursuant to Article 4 (1) (39) (a) CRR is not given due to the missing single idiosyncratic risk, a group of connected clients between the originator and the SPV involved in the securitisation would have to be constituted. This would have severe consequences for the funding opportunities of the real economy. All securitisation transactions and all other exposures to a certain industry group – for example a car manufacturer – had to be consolidated by the financing bank. The consequence of such a regulation would be that the large loan exposure limits of financing banks soon would be reached. Thereby the funding opportunities of the real economy would be considerably hampered.

TSI – What we do

Securitisation in Germany and TSI – the two belong together. True Sale International GmbH (TSI) was set up in 2004 as an initiative of the German securitisation industry with the aim of promoting the German securitisation market.

Nowadays TSI Partners come from all areas of the German securitisation market – banks, consulting firms and service providers, law firms, rating agencies and business associations. They all have substantial expertise and experience in connection with the securitisation market and share a common interest in developing this market further. TSI Partners derive particular benefit from TSI's lobbying work and its PR activities.

Furthermore TSI's concern has always been to establish a brand for German securitization which is founded on clearly defined rules for transparency, disclosure, lending and loan processing. Detailed guidelines and samples for investor reporting ensure high transparency for investors and the Originator guarantees, by means of a declaration of undertaking, the application of clear rules for lending and loan processing as well as for sales and back office incentive systems. The offering circular, the declaration of undertaking and all investor reports are publicly available on the TSI website, thus ensuring free access to relevant information.

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Another objective has always been to give banks an opportunity to securitise loans under German law on the basis of a standardised procedure agreed with all market participants.

And finally the goal is to create a platform for the German securitization industry and its concerns and to bridge the gap to politics and industry.

Events and Congress of TSI

Events of TSI provide opportunities for specialists in the fields of economics and politics to discuss current topics relating to the credit and securitisation markets. The TSI Congress in Berlin is the annual meeting place for securitisation experts and specialists from the credit and loan portfolio management, risk management, law, trade and treasury departments at banks, experts from law firms, auditing companies, rating agencies, service providers, consulting companies and investors from Germany and other countries. Many representatives of German business and politics and academics working in this field take advantage of the TSI Congress to exchange professional views and experience. As a venue, Berlin is at the pulse of German politics and encourages an exchange between the financial market and the world of politics.