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EBF response to EBA consultation on Draft Guidelines on the STS criteria for non-ABCP securitisation (EBA/CP/2018/05)

The EBF welcomes the opportunity to comment on the EBA consultation paper on Draft Guidelines on the STS criteria for non-ABCP securitisation (EBA/CP/2018/05).

The EBF appreciates the efforts of EBA that aim at an harmonised interpretation and application of the criteria on simplicity, transparency and standardisation ('STS') applicable to non-ABCP securitisation, as set out in Articles 20, 21 and 22 of Regulation (EU) 2017/2402. Indeed, the EBF encompasses the main objective of the guidelines that consists in providing a single point of consistent interpretation of the STS criteria by the originators, sponsors, SSPEs, investors and competent authorities throughout the Union.

It is noteworthy that this paper focuses on the main concerns of the industry and does not aim at providing an exhaustive view of the industry on the draft guidelines. In principle, the EBF comments related to the EBA interpretation of the criteria for ABCP securitisations are aligned with the following comments on the consultation related to non-ABCP securitisations.

The EBF welcomes and supports many of the elements of the interpretation proposed by EBA. For instance, regarding the EBA proposal for **interpretation of the criteria related to environmental performance of assets** (Article 22(4)), we believe that EBA is right when defining that such requirement will only apply in case the information on the energy performance certificates for the assets financed by the underlying exposures is available to the originator, sponsor or the SSPE and captured in its internal database or IT systems. When the information is not available, the requirement should not apply.

Notwithstanding this, the EBF would like to share its views on the following elements of the consultation that raise concerns.

European Banking Federation aisbl

Brussels / Avenue des Arts 56, 1000 Brussels, Belgium / +32 2 508 3711 / info@ebf.eu
Frankfurt / Weißfrauenstraße 12-16, 60311 Frankfurt, Germany
EU Transparency Register / ID number: 4722660838-23

www.ebf.eu

1. **True sale, assignment or transfer with the same legal effect** (Article 20(1), 20(2), 20(3), 20(4) and 20(5)) – See proposed changes below

Para 13 states that the contents of the legal opinion should be accessible to third parties. **The term "third parties" should be specified in more detail**. Where ABCP transactions are concerned, we believe third parties should refer only to competent authorities and parties which are directly exposed to the risk associated with the pool of underlying exposures. By contrast, commercial paper investors and potential investors are protected by the "fully supported" liquidity facilities and do not, therefore, require any additional information about the true sale.

The transformation of the requirement for a true sale into a requirement for a legal opinion raises some concerns. It is important to recognise that other reasonable mechanisms are used to validate a "true sale". At this respect, recital (23) refers to the Securitisation Regulation that states that *"[a] legal opinion provided by a qualified legal counsel could confirm the true sale or assignment or transfer with the same legal effect…".* Most non-securitisation sales are not generally accompanied with a true sale legal opinion. True sale opinions mainly aim at ensuring that a transaction that is expected to be a sale will not be recharacterised as a secured loan. This risk is considered to be insignificant for most non-securitisation sales.

The legal opinion should cover only the legally effective transfer of assets. It should only address risks which could impair the transfer. These are essentially clawback risks and re-characterisation risks. Commingling risks and set-off risks, on the other hand, are risks which have no direct link with the transfer of the assets, but which may exist independently of the transfer. These risks are not normally the subject of a true sale opinion, nor are they addressed by Article 20(1) or 24(1) of the STS Regulation ("…transfer of the title…"). The phrase "commingling risks and set-off risks" should therefore be dropped from para 10b.

In addition, when the intermediate steps took place many years before the securitisation and any legal opinion do not include a true sale legal opinion because a securitisation was not expected at that time, the EBA requirements may raise concerns. Indeed, the requirement of paragraph 13 to confirm that a legal opinion approved the true sale for the seller remains impractical in many cases since this does not exist. The representations and warranties required under Article 20(6) are a good alternative to provide enough comfort about the true sale without imposing inadequate requirements.

The specific wording in Article 20(6) (Regulation 2017/2402) states that "the seller shall provide representations and warrants that, to the best of its knowledge, the underlying exposures included in the securitization are not encumbered or otherwise in a condition that can be foreseen to adversely affect the enforceability of the true sale or assignment or transfer with the same legal effect." which indicates that the guidelines introduction of the necessity to provide a legal opinion is in excess of what is required under the STS Regulation. This requirement also appears to go beyond the "concise explanations" requirement set out in ESMA's "comments regarding the expected content of the STS notification" included in the ESMA consultation on Draft technical standards on content and format of the STS notification under the

Securitisation Regulation(ESMA33-128-33). Given the scope of the "concise explanations" due to be included in the proposed STS notification we would welcome a reduction in the emphasis on legal opinions.

2. EBA proposal for interpretation of the criteria on underwriting standards (article 20.10)

According to the Securitisation Regulation, the underlying exposures shall be originated in the ordinary course of the originator's or original lender's business pursuant to **underwriting standards** that are **no less stringent** than those that the originator or original lender applied at the time of origination to **similar exposures that are not securitised**. The underwriting standards pursuant to which the underlying exposures are originated and **any material changes** from prior underwriting standards shall be **fully disclosed** to potential investors without undue delay.

The EBA clarification requires that all material changes to the underwriting standards applied over a period of 5 years before the issuance of securitisation will have to be disclosed. **The EBF believes that this requirement is inappropriate and will not provide investors with any added value** since these latter ones are more interested in the data on underlying exposures that would allow them to assess credit quality. The requirement to disclose material changes in underwriting standards should remain forward-looking from the closing date of the deal.

3. EBA proposal for interpretation of the criteria requiring no predominant dependence on the sale of assets (Article 20(13))

In its interpretation of the concept of **predominant dependence**, EBA requires that the residual values on which the transaction relies are sufficiently low on a relative basis: the value of assets at the time of transfer of the exposures **should not exceed 30 %** of the total initial exposure value of all securitisation positions held in this securitisation. **This percentage limit is too low** and is not aligned with the sense of the level 1 text. This would prevent many market-standard and high-quality auto and equipment leasing transactions from getting STS treatment. Indeed, we understand that predominant dependence should be interpreted as the main source of payments. **We would suggest increasing the threshold to at least 50%, or alternatively set a threshold per asset class.**

The EBA interpretation of the concept of predominant dependence also requires that the **granularity** of the pool of underlying exposures is sufficiently high i.e. the pool contains **at least 500 exposures** which is excessive. In certain small pools of assets that include only 10 assets, granularity can be considered as achieved. However, we would accept an interpretation of granularity that requires **100 obligors** which would be consistent with the threshold for applying the large exposure limits in securitisation.

4. EBA proposal for interpretation of the criteria requiring appropriate mitigation of interest-rate and currency risks (Article 21(6))

The EBA interpretation of the criteria requiring appropriate mitigation of interest-rate and currency risks sets **very strict requirements that go well beyond market practices**.

- Paragraph 57e: The requirement for a "**concise sensitivity analysis that illustrates the effectiveness of the hedge under extreme but plausible scenarios**" is excessive and represents a significant element of additional work to be done presumably in the offering document and the ongoing reporting.

- Paragraph 58: The requirement that **non-derivative forms of mitigation should meet at least one of the criteria** explained in points a or b is too restrictive.

Non-derivative forms of mitigation should be accepted if they are deemed to be sufficiently robust to cover the relevant risks and it remain clearly disclosed to investors.

In particular, the requirement that sets that **interest rate and currency risks must be mitigated by dedicated and funded reserves is inappropri**ate. Other mechanisms should be allowed to cover those risks such as subordination or minimum margin maintenance or overcollaterization. And hedging multiple risks with one measure could even be beneficial to investors as long as the sum of all risks is properly covered by the measure, since it allows to use underutilized cover for one risk to be used as additional cover for another risk.

- Paragraph 59: The requirement that imposes to **continuously disclose the measures, as well as the reasoning supporting the appropriateness of the mitigation of the interest rate and currency** is extremely costly and does not seem justified by the interpretation of level 1 text.

5. EBA proposal for interpretation of the criteria related to the expertise of the servicer (Article 21(8))

The requirement for well-documented and adequate policies, procedures and management controls is extremely burdensome. It is worth noting that not all the entities subject to EU supervision have been assessed such as required.

Furthermore, we wonder why paragraph 75 introduces a 5-year experience requirement with similar exposures. This creates very one-sided teams, where it would be better to have teams consisting of people with different backgrounds and experience with different kind of exposures.

6. EBA proposal for interpretation of the criteria on homogeneity, periodic payment streams, no transferable securities (Art. 24.15)

The EBF would like to reinforce the messages contained in the prior EBF response to the EBA Consultation on draft RTS on homogeneity of the underlying exposures in securitisation. The EBA proposal on homogeneity may be too constrictive and will lead to a fragmentation of the securitisation market and severely restrict securitisation as a useful funding tool. This may lead to the deprivation of this valuable financing tool for those originators with more diversified exposures but smaller market share in each segment, thus damaging the free competition in the market.

In order to avoid these negative effects, it is important to ensure that well established securitisations considered as high-quality under current market practices are preserved and considered as simple, transparent and standardised under the new securitisation framework. EBA itself recognises in its paper that the aim of the new proposal on homogeneity is not to alter current market practices.

In principle, the EBF comments related to the EBA interpretation of the criteria for ABCP securitisations are aligned with the previously comments detailed for non-ABCP securitisations.

About EBF

The European Banking Federation is the voice of the European banking sector, uniting 32 national banking associations in Europe that together represent some 4,500 banks - large and small, wholesale and retail, local and international - employing about 2.1 million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that securely handle more than 300 million payment transactions per day. Launched in 1960, the EBF is committed to creating a single market for financial services in the European Union and to supporting policies that foster economic growth.

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For more information contact:

Saïf Chaïbi
Policy Adviser
s.chaibi@ebf.com
+32 2 508 37 23