EACB Comments

Commission Consultation Document
An EU framework for simple, transparent and standardised securitisation

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EACB AISBL – Secretariat • Rue de l'Industrie 26-38 • B-1040 Brussels
Tel: (+32 2) 230 11 24 • Fax (+32 2) 230 06 49 • Enterprise 0896.081.149 • lobbying register 4172526951-19
www.eacb.coop • e-mail : secretariat@eacb.coop

Contact:

For further information or questions on this paper, please contact:
- Mr. Volker Heegemann, Head of Department (v.heegemann@eacb.coop)
- Mr. Marco Mancino, Adviser, Banking Regulation (m.mancino@eacb.coop)

The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 31 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4.200 locally operating banks and 68.000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 205 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 78 million members and 860.000 employees and have a total average market share of about 20%.

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General comments

The members of the EACB welcome the opportunity to contribute to the discussion launched by the European Commission on the development of criteria for High Quality Securitisation (HQS) in Europe.

We see that In the context of the Capital Markets Union (CMU) there is room for improvements improve in terms of integration, harmonisation and flexibility in order to better channel the diverse flow of savings to the diverse type of investments. This can no doubt help to increase investments (SMEs, infrastructure projects) and hence foster growth and employment.

However, any improvement to the European Capital Markets has to acknowledge the pivotal role of banks (as issuers, investors and intermediaries) in financing the real economy. This clearly assumes a special relevance for retail banks and particularly for cooperative banks, because of their direct relationship with retail investors on the one hand, and with SMEs on the other. Thus, initiatives such as the development of HQS shall complement but do not supplant traditional bank lending.

Securitisation is indeed a very important element, also from our perspective as cooperative banks. Securitisation fills a "middle ground" between direct bank lending and pure capital markets funding. That is, allowing smaller banks (for instance within cooperative networks) to finance their lending to SMEs and individuals through an access to the capital markets that makes it possible to generate high-rated securities backed by such kind of retail lending. It also allows to better diversify risks and unlock capital in order to improve local lenders' ability to continue financing and boosting economic growth in their regions.

However, the current securitisation framework (and the unjustified stigma resulting from the meltdown of the USA' securitisation model which had nothing to do with the European one) has created a very difficult environment for this important funding source to be revived.

The Commission is well aware of the complexity and intricacy of existing EU provisions concerning the subject, as laid out also in Annex 2 to the Consultative Document. For this reason, it is essential to adopt a holistic approach that develops on and harmonises these different sets of requirements. A common framework will help preventing the fragmentation of securitisation markets in terms of criteria for high-quality securitisations, with the possibility to include certain more sensitive elements for each respective sector (banking, insurance, asset management, credit ratings etc.).

Answers to selected questions

Q.1 ***A.*** *Do the identification criteria need further refinements to reflect developments taking place at EU and international levels? If so, what adjustments need to be made?* ***B.*** *What criteria should apply for all qualifying securitisations ('foundation criteria')?*

We generally agree with principles behind the criteria suggested (e.g. on simplicity, no mixed pools of different asset types, derivatives only for hedging, and no re-securitisations). It is true that criteria for HQS need to be designed in a manner providing minimum scope for further interpretations, and in a way that is practicable.

We would like however to point out a number of aspects that require refinement and further development:

- With regard to impairment requirements as a criterion for simple securitisations, a precedent EBA discussion paper proposed an impairment definition that seemed difficult to reconcile with the impairment rules specified in the respective accounting standards. Amongst other things, it was indicated that no underlying assets which have "a credit score indicating significant risk of default", however no further clarification was provided on what is deemed a "significant risk" in this context opening the way for numerous possible interpretations.
- The definition of criteria should maintain the Commission's overarching goal to support the economy. An impairment definition based on the judgement of rating agencies (ECAIs) for assessing impairment requirements seems inadequate in this context. The importance for the European economy of SMEs, which usually do not have a rating issued by a rating agency or another publicly-available score, seems to be not in line with such requirements.
- Another aspect are cross-relationships with other regulatory streams, such as the proposals for a revision of the Standardised Approach for credit risk. Based on the current proposals, the calibration is likely to determine higher risk weights, if the origination of HQS requires that only assets with a certain risk weight are included, this may leave out of scope many SME receivables. Instead, adherence to credit processes should be the leading factor for eligibility in a securitisation, to avoid distorted incentives.
- With regard to simplicity, the criteria shall not discriminate against multi-originator issues. This is due in particular to the fact that for many small local/regional lenders, a single-originator securitisation transaction may simply not be cost-effective as their available asset pools may not be large enough to spread the overhead costs of issuing, or indeed to give investors a sufficiently diversified asset base. Multi-originator pooled issuance may provide a cost-effective route.
- With regard to the requirement for the transfer to the SPV, it shall be sufficiently robust (i.e. a true sale) but should not be extended as far as “perfection of interest”. If this requires full registered legal transfer at the point of original sale, it would be a major and disruptive departure from current practice.

*Q.2 **A.** To what extent should criteria identifying simple, transparent, and standardized short-term securitisation instruments be developed? What criteria would be relevant? **B.** Are there any additional considerations that should be taken into account for short-term securitisations?*

As also noted by the Commission, Asset Backed Commercial Paper (ABCP) issued by multi-seller conduits have been neglected in previous proposals for HQS (e.g. in the EBA and the joint BCBS/IOSCO consultations). However, it seems that discussions are still ongoing to include ABCP in the scope of HQS, and we believe that these instruments should in fact be considered in this context.

In the consultation paper it is recognised that ABCP Conduits can play an important role in the financing of businesses. Indeed, multi-seller conduits are platforms that purchase predominantly trade or leasing receivables from corporations or leasing companies, where the purchase is funded by issuing short-term ABCP. The sponsor bank which is running the conduit provides liquidity lines that can be drawn if losses in the pool of securitized receivables occur. In many cases the ABCP are "fully supported". That means that any losses of the investors are borne by the provider of the liquidity facility. The risk is then mitigated by the facts that the pool consists of a diversified portfolio of independent debtors with a high granularity and that the eligibility criteria of the transaction often exclude higher-risk exposures.

Considering the specificities of multi-seller conduits specific tailor-made "high quality" criteria for liquidity lines to multi-seller conduits could be considered. In this context, certain well defined criteria for simple, transparent and standardised securitisations could be specified for the sponsor bank to qualify ABCP as HQS. At the same time other adjustments should be considered for the originator of an ABCP, which is not a regulated financial institution that securitises own loans but an unregulated real economy corporate that uses the conduit to securitise its receivables.

Finally, we believe that synthetic securitisation transactions should not be excluded from HQS by principle. Indeed, especially institutions with a strong focus on SME financing maintain close business relationships with their SME-clients. These relationships would be severely stressed in case of a true-sale, as these clients typically would regard a true-sale of their loans to some third party as breach of trust.

Therefore, many SME-financing institutions prefer synthetic protection to their loan portfolios for capital relief, risk management, and to create room for new loan business with their clients. If synthetic securitisations are generally excluded from HQS, the securitisation market will not be able to substantially support European SME-Financing.

However, it is evident that, as synthetic securitization, these transactions may well be structured to ensure simplicity, transparency and standardization and there are several ways to define and to establish HQ-criteria for synthetic securitisations that comply with the EBA-criteria suggested for true-sale transactions.

We would welcome the opportunity to discuss this topic with EBA and the European Commission.

*Q.5 **A.** What impact would further standardisation in the structuring process have on the development of EU securitisation markets? **B.** Would a harmonised and/or optional EU-wide initiative provide more legal clarity and comparability for investors? What would be the benefits of such an initiative for originators? **C.** If pursued, what aspects should be* *covered by this initiative (e.g. the legal form of securitisation vehicles; the modalities to transfer assets; the rights and subordination rules for noteholders)? **D.** If created, should this structure act as a necessary condition within the eligibility criteria for qualifying securitisations?*

In general, an uniform set of rules and regulations would significantly simplify establishing a securitisation structure, reducing the time and resources needed (e.g. documentation efforts, harmonised documentation standards). However, also other measures - stopping short of a new EU structure established by legal instrument – may well yield quicker benefits.

In any case, best market practices may provide guidance for developing a European securitisation structure and the areas of law affected.

We expect that a European initiative for the harmonisation of securitisation structures shall provide investors with a higher degree of legal certainty and comparability, contributing to restore the attractiveness of the European securitisation market. However, while a standardised securitisation structure may remove legal uncertainty and enhance comparability, a new framework may also lead to legislative fringes – which may in turn lead to uncertainty amongst investors. Thus, involving the institutions and develop on their practical experience would certainly be beneficial.

Finally, an EU securitisation structure should not be a prerequisite for classification as HQS. In particular, it must be considered that legal harmonisation is likely to take quite some time and waiting for legal adjustments may not allow to pursue the Commission's goal to quickly re-start the securitisation markets.

*Q.6 **A.** For qualifying securitisations, what is the right balance between investors receiving the optimal amount and quality of information (in terms of comparability, reliability, and timeliness), and streamlining disclosure obligations for issuers/originators? **B.** What areas would benefit from further standardisation and transparency, and how can the existing disclosure obligations be improved? **C.** To what extent should disclosure requirements be adjusted – especially for loan-level data – to reflect differences and specificities across asset classes, while still preserving adequate transparency for investors to be able to make their own credit assessments?*

At present, the player involved in a securitization requires a set of information organized according to each assessment methodology. It would instead be advisable to establish a standardized approach (kind of requested data, form, etc.) of the information that "Originators/Issuers" should represent both during the structuring phase of the operation and in the "on-going" one. A single set of information should be provided to players and investors, to rating agencies and to the ECB. The information package would therefore appear on a single venue, with a view to simplifying the related requests and its usability. The excessive demand for data with diverse features, especially for multi-originator securitizations, makes it extremely burdensome for originators/servicers to manage the operation, to the detriment of the use of such form of funding.

Currently, the implementation by the ECB of the "data quality checker" on "loan level" for RMBS and SME, allows for a clear identification of the two underlying types, outlining the differences and the respective specificities. It would be advisable to avoid burdening the originators via further disclosure obligations. On the contrary, the "loan level" approach should be implemented also for other underlying types.

*Q.7 **A.** What alternatives to credit ratings could be used, in order to mitigate the impact of the country ceilings employed in rating methodologies and to allow investors to make their own assessments of creditworthiness? **B.** Would the publication by credit rating agencies of uncapped ratings (for securitisation instruments subject to sovereign ceilings) improve clarity for investors?*

Rating agencies, in their ABS risk evaluation, take into account the sovereign rating of each Member States. The application of "country ceilings" implies the issuance of a rating on ABS which, as stated above, does not take into account only the quality of the underlying portfolio. In order to mitigate such effect and to allow an assessment referred solely to portfolio risk, a double rating should be made public by CRAs: one referred only to the quality of the assets underlying the relevant ABS; another one referred to country risk. Such approach would consent a correct comparison amongst the underlying assets within the number of securitizations structured among different Member States.

*Q.8 **A.** For qualifying securitisations, is there a need to further develop market infrastructure? **B.** What should be done to support ancillary services? Should the swaps collateralisation requirements be adjusted for securitisation vehicles issuing qualifying securitisation instruments? **C.** What else could be done to support the functioning of the secondary market?*

With a view to improving the ABS market and to securing liquidity therein, ECB, in addition to the already launched program of ABS purchase, could consider facilitating the development of a electronic secondary market, through the introduction of "Specialists", registered with ECB itself.

Q.10 If changes to EU bank capital requirements were made, do you think that the recent BCBS recommendations on the review of the securitisation framework constitute a good baseline? What would be the potential impacts on EU securitisation markets?

This is not necessarily the case, as some of the proposals went in the wrong direction. Two examples were widely canvassed at the time. First, holdings of high quality (e.g. AA) senior notes appear to be treated less favourably than direct holdings of various kinds of individual loans – potentially ignoring both collateral and any credit enhancement. Second, the capital required for some securitisation tranches may end up higher than for the entire pool of underlying assets.

The recommendations of the Basel Committee for review of the securitisation framework provide for significant changes to capital requirements for securitisation exposures, with higher risk weights for senior tranches in particular. This would presumably result in additional burdens for European securitisation markets, and would likely exclude any support or revitalisation.

The biggest problem of the revised Basel Framework for securitisations is the fact that banks acting as originators would no longer achieve any economic relief for their RWAs through the securitisation of assets. As a consequence, securitisation would no longer be attractive as a risk management tool for banks, since the purpose of securitisation would then no longer be achievable. For this reason, we are opposed to incorporating the calibration of the Basel Framework. Nonetheless, we are open to those aspects of the Basel Framework dealing with the hierarchy of approaches for the calculation of capital requirements.

Q.12 Given the particular circumstances of the EU markets, could there be merit in advancing work at the EU level alongside international work?

Given the Commission’s focus on jobs and growth, the European work-stream could provide a positive influence on the international debate and ensure that they move in a consistent manner.

This will contribute to achieve harmonised results for the creation of a sustainable, solid and meaningful securitisation market.