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French Banking Federation Response to the ECB and BoE Discussion Paper “The case for a better functioning securitisation market in the European Union”

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorized as banks and doing business in France, i.e. more than 390 commercial, cooperative and mutual banks. FBF member banks have more than 38,000 permanent branches in France. They employ 370,000 people in France and around the world, and service 48 million customers.

The FBF welcomes the opportunity to comment on the discussion paper issued by the European Central Bank (ECB) and Bank of England (BoE) regarding the case for a better functioning securitisation market in the European Union (the “Discussion Paper”).

The FBF and its members would like to thank the Central Banks for producing such an exhaustive and well-balanced paper on the role of securitisation within Europe and the impediments for the revival of the EU’s securitisation market. Whilst we support the “high quality securitisation”/ “qualifying securitisation” principle, we welcome the debate on how the definition of “qualifying securitisation” (QS) should be addressed and on the certification process for QS.

I. General comments

The FBF agrees with the objectives stated in the Discussion Paper regarding the development of securitisations markets. It seems indeed useful to develop these markets to help to finance the economy, in a context in which banks are now subject to a strict regulatory framework, which is likely to prevent them increasing their balance sheet volume, constrain the level of own funds they can use to finance loans, limit the transformation they can perform and force them to dedicate increasing amounts to the constitution of a liquidity buffer.

In the opinion of the FBF, **the main issue to be treated to improve the functioning of the securitisation market in Europe is the prudential treatment of securitisation.** Incentives are currently low both for the originators and for the investors to issue or acquire ABS.

- This is especially true concerning the solvency treatment for investors. This treatment remains penalizing in the consultative document published by the Basel Committee in December 2013. A policy option that should be considered is to make the solvency treatment of securitisations more consistent with the one granted to covered bonds, which are products comparable to securitisations since they are also backed by assets originated by the bank. Currently, as a refinancing tool, securitisations suffer a lot from that comparison with covered bonds.
- This is also true concerning the liquidity treatment for investors. The FBF notes that a step is currently being undertaken in the direction of defining “qualifying securitisations” as far as liquidity is concerned, since in the Delegated Act on LCR, securitisation might be better treated than forecasted, with criteria in line with those mentioned in the Discussion Paper. Haircuts applied to ABS remain however very high, with a minimum of 25% up to 35% and a classification in level 2B considerably limiting the amount of securitisations authorized in the liquidity buffer as compared to covered bonds. It would be more consistent to apply haircuts similar to those applied by the Central Banks in the context of their refinancing operations.
- For the originator:
 - o the funding (senior tranches) is expensive due to the regulatory constraints imposed to investors that drives spreads up;
 - o the benefit in terms of leverage ratio and in terms of RWA is currently low when compared to the costs of issuing securitisations eligible to deconsolidation or to the notion of “significant transfer or risks” moreover the regulatory framework is not achieved, which might not provide for enough security to undertake a long and costly operation.

The FBF notes that the Discussion Paper mainly deals with securitisation done with assets originated by the concerned institution. However, there is an important part of ABS and ABCP in Europe which are done with assets directly bought from the clients by the securitisation vehicles. Such kinds of ABS and ABCP also represent an important way to finance the real economy, and therefore need to benefit from a market liquidity, and should not be forgotten when defining the “qualifying securitisations” mentioned by the Central Banks.

Other initiatives regarding the transparency of the information allowing the investors to correctly assess the risks generated by the products sold are welcome. However, the requirements should not be so detailed such that they in fact hinder the issuance of new products. For example, the requirement to publicly disclose some detailed characteristics of the portfolio loan per loan, such as the internal ratings, could cause legal issues. For example ESMA published on 24 June 2014 details of new disclosure regime for structured finance instruments (SFI) in the final draft RTS for CRA3 regulation. In this RTS, issuers are requested to publish detailed information on the underlying pool even for ABCP and private deals, which could imply additional cost for the transactions and may be an issue in terms of confidentiality with the clients.

Instead, public authorities could help the market to develop by disclosing the historical behavior of different kinds of loans, or coordinating the efforts to disclose prices and indexes. In addition, standardization of the documentation is welcome, taking into account however that some differences remain in the national securitisation frameworks.

Initiatives regarding the access to ancillary facilities are welcome, despite the fact initiatives mentioned in the Discussion Paper seem difficult to apply. This issue seems an area to be further explored and developed, as costs generated by the issuance of new securitisations are indeed a barrier to the development of the market. For example, larger EMIR exemptions for securitisation swaps could be considered.

Market liquidity will be developed when other barriers have been lifted. Especially, the current reputational problems of securitisations could be lifted if the regulators themselves recognize that they can benefit from a better prudential treatment, according to the principles to be defined. The process of “certification” will be important in that matter and more clarity would be welcomed concerning the way regulators intend to grant the “qualifying securitisation” label to a structure (granting by the National Central Banks? The supervisor? The rating agencies?).

Qualifying securitisations and policy objectives

First and foremost, we share the view expressed in the Discussion Paper that the *“use of ‘qualifying securitisation’ should not be regarded as a one-size-fits-all approach; additional requirements may be needed depending on the application”*¹. In our view, the contemplated approaches/ definitions for HQS should be aligned with the two quoted potential benefits for ‘qualifying’ securitisations, *“improved secondary market liquidity”* and *“specific capital treatment”*². Also, we agree that *“different objectives may require different market characteristics”*³. Consequently, the approach for defining QS is subject to prior identification of clear policy objectives for HQS.

One can assume that policy objectives may encompass the following:

- 1. Reviving the EU securitisation market by supporting simple, structural robustness and transparent products,*
- 2. Focusing on the economic sectors approved by policy makers,*
- 3. Reducing reliance on rating agencies within the regulatory capital framework,*
- 4. Increasing transparency for investors,*
- 5. Increasing the secondary market liquidity.*

The French banks support all these policy objectives. We consider that the EU regulatory approach (under CRR, both capital and liquidity frameworks, and Solvency II) and the future international regulatory framework for securitisation should be more risk-sensitive aiming at correctly reflecting the characteristics of each securitisation product (credit and liquidity risks).

¹ Point 20

² Point 20

³ Point 50

Thus, the potential uses for ‘*qualifying securitisation*’/ ‘*high quality securitisation within the qualifying securitisation category*’ need to be clearly assessed and stated. In our opinion, the high quality securitisation can be used for:

a. Capital requirements: Basel risk weight floor

A minimally disruptive change in the Basel capital framework would be to allow a lower floor for regulatory capital, on a fixed-value basis or a risk sensitive basis (which would mainly depend on the risk sensitiveness of the underlying assets). For funding purposes, the key issue is the senior tranche which currently attracts too much capital for high quality pool assets. The same issue concerns the EU ABCP transactions (alternative and important source of funding for EU corporates, decorrelated from their credit risk) which would be highly penalised by the proposed risk floor (i.e. 15% RW).

b. Capital requirements: Lower risk weights

Lower risk weights would be justified by an analysis of the risk but they suppose alternative calibration and significant deviation from Basel framework (the actual framework or the under discussion RWAs’ calibration at the BCBS level). The FBF supports the alternative proposal for calibrating the RWAs, the Conservative Monotone Approach proposed by the AFA Quant Group.⁴

c. Liquidity requirements: LCR Haircuts

Minimally disruptive change into the regulations would be to permit lower haircuts for QS.

d. Liquidity requirements: LCR eligibility

As contemplated by the European Commission, a broader set of asset classes could be granted LCR eligibility. Short dated real economy securitisations like auto loan ABS and ABCP justify this approach.

Qualifying securitisations and definition approach

We welcome the high level principle-based approach proposed by the ECB and BoE. We understand that such a “*designation is not intended to provide an opinion on credit or other risks, but make the assessment of these risks more straightforward. The designation would apply to all tranches of the securitisation.*”⁵ In addition, we welcome that this principle-based approach should serve as a building block or “*platform*” from “*which more detailed criteria could be built as appropriate (e.g. regulatory capital and liquidity treatment, credit rating assessment, etc.)*”⁶. Therefore, the “*designation*” level and the “*regulatory treatment*” level (either capital or liquidity) do not rely on the same amount of information or requirements.

⁴ Please refer to the website www.riskcontrollimited.com

⁵ Point 126

⁶ Point 127

For the regulatory treatment level, specific and additional criteria need to be formalized, and we consider that the regulatory treatment should be appropriately differentiated across the tranches of qualifying securitisation. This appropriated regulatory regime would better reflect the level of risks associated with these positions.

Indeed, regulators could propose:

1. A **more differentiated risk-based approach** (a gradual scale would assess on the regulatory side the level of risk and the regulatory requirements), or
2. A **binary approach** where “*qualifying*” would allow for differentiating a single category of securitisation, with a unique regulatory treatment, or
3. A **combination of both**, where a securitisation transaction could be considered as “*qualifying*”, while the regulatory treatment of each tranche would follow a risk-based approach (i.e. for LCR purposes, only the senior tranche of a qualifying securitisation would be eligible, the same for the risk weight floor under the capital requirements, whilst the risk weights applicable to the non-senior tranches of a qualifying securitisation would also incorporate the seniority/ credit enhancement level).

We support the combination of “*qualifying*” and “*differentiated risk-based approach*” (i.e. the third approach above): we consider that both approaches (a 'qualitative' label and a quantitative approach) will have to be combined to cover all the spectrum of operations.

Qualifying securitisations and consistency

We welcome the official positions on taking a holistic perspective on the securitisation related issues in Europe, including the high quality securitisation debate. Consistency across regulations (Solvency II versus CRR) or within a regulation for different asset classes (securitisation against covered bonds within the CRR) should be properly considered.

II. Detailed comments on some specific points of the Discussion Paper

1. Comments on the principles of a “*qualifying securitization*” (Box3)

The FBF welcomes the principle-based approach regarding the definition of “*qualifying securitisation*”. The FBF would like to stress that similar approaches have already been undertaken both by the industry, with the “*PCS*” label (“*prime collateralized securities*”), and by regulators (EIOPA, the European Central Bank with the criteria for Central Bank eligibility and the EDW data repository).

Detailed comments on the principles evoked in the Discussion Paper are the following:

- Qualifying securitisations should not exclude securitisations with a revolving period that allow financing short term assets. Instead, enough transparency (e.g. on eligibility criteria) should allow investors to correctly assess the potential additional risks generated by such types of securitisation.
- Qualifying securitisations should not prohibit the seller from keeping some degree of management of the assets (including servicing, recovery management, and in some circumstances negotiating some amendments to the credit) provided such rights are clearly explained in the prospectus; especially when the originator is a bank and runs a client relationship with the debtors, such agreements can be beneficial both for the seller and the investors provided the rules are clearly set and understood.
- The qualifying securitisations standard should not require initial designation at closing of back up functions (e.g. on servicer, swap counterparty) ; they should however (i) set a clear framework for the replacement of such roles including the events triggering the replacement and (ii) define the party(ies) in charge of the appointment of new entity(ies) for such roles. This would avoid costs when no back up function is actually used, and allow a potentially better choice at the time a replacement of any servicer or counterparty is actually necessary.
- The qualifying securitisations standard should not prohibit call and remarketing clauses, provided again the framework of the remarketing is clearly set. Such mechanism allows to use securitisations to refinance long term assets at a reasonable funding cost for the seller, and allow at the same time investors to get additional remuneration in relation with the remarketing risk.

Concerning the transparency issue:

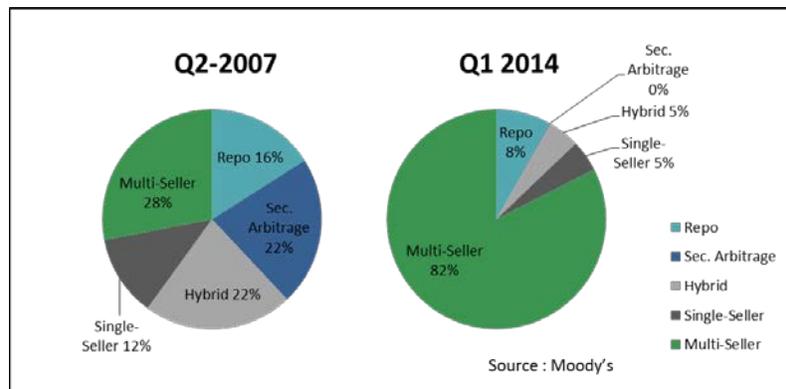
- Concerning the supplying of loan per loan information, the European Data Warehouse (EDW) should remain the reference for the euro zone for qualifying securitisations. Adding another data repository would be burdensome and redundant, since EDW is already very detailed and is used for the vast majority of the recent ECB eligible transactions. Cash flows models can however be published separately through specialized market data providers, and is a useful additional information for investors.
- The disclosure of the historical behavior of the portfolio should allow some imperfections. A gradual approach for qualifying securitisations might be implemented if all the historical data are not available (i.e. giving more benefit when historical data set are considered as more complete). This is currently the approach used by rating agencies.

2. Why ABCP conduit transactions and CPs issued by the conduit should be identified as 'qualifying securitisation'?

No loss for Multi-seller ABCP conduits during the crisis

In the discussion paper, ABCP conduits and trade receivables transactions are not mentioned as assets that could be defined as 'qualifying securitisation'. The few references to ABCP conduits in the document are in Box 4, where is explained what happened during the financial crisis of 2007. Indeed some ABCP investors suffered from losses during the crisis, however it was not on multi-seller ABCP conduits, but on other types of conduits such as SIVs and securities arbitrage conduits.

Today, the ABCP market comprises mainly of plain vanilla, traditional multi-seller conduits. Gone are the days when the market included more-sophisticated structures such as SIVs or securities arbitrage conduits. Although there are some securities arbitrage programs still outstanding, most of them are in the process of winding down as they let their securities run off. These are securities such as RMBS, CMBS, and CDOs, which most sponsors/investors would rather not continue to fund. Indeed, based on data published by Moody's, the global outstanding of ABCP conduits in Europe is around 77 Bn USD, 82% of the ABCP market as per Q1 2014 comprises multi-seller conduits sponsored by banks or independent companies versus 28% as per Q2 2007 — a reflection of investors' preference for this type of structure.



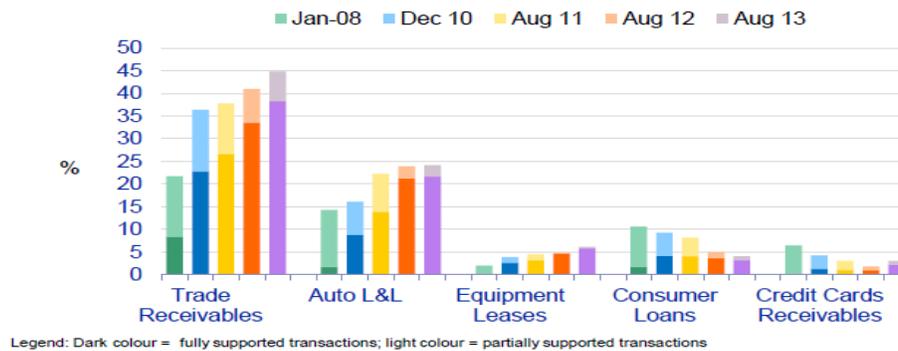
Contrary to SIVs, multi-seller ABCP conduits have weathered the crisis very well, first because they were differently structured (with bank liquidity lines covering 100% of the outstanding CPs), and second because they were (and are) financing real economy assets with direct access to the sellers, which enables asset performance transparency and favors dialogue for potential restructuring when necessary. During the subprime and the Lehman crises, multi-seller ABCP conduits did not exhibit the same illiquidity as SIVs and arbitrage programs. And at the time of the Euro sovereign debts crisis in 2011, multi-seller ABCP conduits evidenced stronger resilience. An important reason for this is that these products have had sound underwriting practices.

Conduit show a low-risk profile based on the robust structure of the securitisation financing whereby the conduits only purchase a senior tranche in each portfolio, protected by significant overcollateralization: the originators of the portfolios always retain the first-loss tranche, which is typically dynamically adjusted to the performance of the portfolio, tight cash controls, and appropriate portfolio performance covenants which allow for early wind down of the financing if the portfolio deteriorates.

Multi-seller ABCP conduits finance real economy

Multi-seller ABCP Conduits provide European corporates, and then the real economy, with a sustainable and resilient funding alternative to borrowing directly from banks. The assets funded in ABCP conduits are simple assets of good quality and short term pretty much like those we can find in factoring activity. The main part of the underlying assets, funded in multi-seller ABCP conduit in EMEA, is trade and auto receivables (72% as of Q1-2014), this share increasing continuously since 2008 compared to longer term assets (eg. CLO, consumer loans and residential mortgages) as described in the graph below.

Outstanding balance of purchased assets by selected asset types
(as % of aggregate balance of purchased assets)



This type of funding arrangement has proven to be compelling both for clients and for banks. Client benefits – low cost source of working capital, diversification of funding sources, allows for the warehousing of assets prior to ABS issuance, lowers company’s overall cost of capital, anonymous access to the liquid short term market. For the bank it is a way of arranging market funding to major clients on the basis of well-diversified pools of receivables such that the credit profile is higher than that of the seller of the assets. It is a very efficient way of increasing the availability of funding and avoid tapping the limited market or bank appetite for the borrower’s general corporate risk.

Main regulatory initiatives that are penalizing ABCP conduits

As well explained in the discussion paper, the current regulatory environment has a negative impact on the whole securitisation market because of its uncertainty, but also because it is perceived as unduly conservative. If we do a focus on ABCP conduits, the main impacting regulations are:

- 1- **The Liquidity Coverage Ratio (LCR)** defined in Basel III: ABCP conduits are strongly impacted by this rule since it is a short term refinancing tool and then have a good share of the outflows under 30 days. This rule has a direct impact on the price of the funding for the client, because to reduce the LCR impact at the bank level, the conduits have to fund the assets issuing longer term paper (over 1 month) which is more expensive.
- 2- **The new capital framework for securitisation** proposed by the Basel Committee: this rule may have an impact on regulated ABCP investors but the main impact is on the banks sponsoring ABCP conduits. In fact banks attract capital because of the liquidity lines provided to the conduits to protect the ABCP investors from underlying assets losses. The new proposal will immediately increase the price for the clients and in some cases, capital applied to ABCP conduits transactions could be higher than if the bank was lending on an unsecured basis to the same corporate. In those circumstances, it is obvious that a structure transaction would no longer make sense, and the client would borrow unsecured, increasing the final risk for the banks sector.
- 3- **The Money Market Fund (MMF) Reform in Europe:** securitisation positions were in the first proposal excluded from the scope of eligible assets a MMF in Europe could invest in, which was a big issue for ABCP conduits in Europe since around 70% of ABCP investors are European MMF. Thanks to explanation efforts from the banking industry, but also from some corporate clients (i.e. Auto companies), the proposal has been amended to include ABCP backed by corporate debt assets, including trade receivables but not auto and consumer loans. Further lobbying effort is currently done to increase the scope of eligible asset classes...
- 4-

If the MMF reform is too restrictive, the risk is to see the ABCP conduits looking for funding mainly in US because the rules are less penalizing regarding US MMF. But do we want to finance European companies in US, when we know what happened during the sovereign debt crisis of 2011?

- 5- The RTS published by ESMA on **CRA3** Disclosure obligations: among other requirements, private securitisation deals and ABCP issuer will have to publish all information (loan-level data, transaction structure, legal documents...) which may be an issue in terms of huge database work that this rule means (resources, costs...), but also a problem of confidentiality for banks clients. It is important to keep in mind that confidentiality is the main driver for clients to choose this kind of funding, in order not to disturb their activity (i.e. client relationship).

'Qualifying securitisation' principles are in line with multi-seller ABCP conduits

- Trade receivables should be included in the list of underlying assets that comply with 'qualifying securitisation' principles

Regarding Auto loans and leases, there is a consensus to say that this is an underlying asset class that may comply with the 'qualifying securitisation' principles, but trade receivables are never included in the list of 'good' asset classes, contrary to SME loans. On our point of view SME loans and trade receivables should benefit from the same treatment. In fact a corporate has two ways to obtain some funding: (i) by obtaining a loan from a bank (SME loans) or (ii) by financing trade receivables.

Moreover trade receivables transactions have additional features that make them less risky for an investor, such as short term maturity, revolving structure, assets eligibility criteria and dynamic credit enhancement.

Based on the good quality of assets underlying an ABCP conduit programme, it is important not to penalize the sponsor bank providing the liquidity line to the conduit, and then make the bank benefit from the advantages given to 'qualifying securitisations' when calculating RWA for the liquidity line supporting a transaction.

Thanks to a less penalizing treatment this useful way of financing banks clients will remain competitive for banks compared to unsecured loans.

- ABCPs should be 'qualifying securitisations'

In an ABCP conduit transaction, the issued commercial papers enable the client to get some funding from the capital market at a very attractive price, that's why ABCP should be liquid. If ABCP are outside the scope of 'qualifying securitisation', this means that ABCPs will not be attractive for investors and then banks will have to fund these transactions on their balance-sheet, increasing at the end the cost of fund for the clients.

Moreover an ABCP can be assimilated to a short term covered bond, that's why we think that the regulatory treatment of ABCP should be made more consistent with the one granted to covered bonds. Indeed when comparing a covered bond with an ABCP both are products with double recourse on the bank (issuer for covered bonds and sponsor for ABCP) and on the underlying assets.

- Eligibility to ‘qualifying securitisations’ creates a virtuous circle

Including the securitisation transactions financed in ABCP conduits in the scope of ‘qualifying securitisations’ will reduce the level of capital for the sponsor bank, and then enable ABCP conduit financing to stay profitable for the bank compared to an unsecured loan. Then if the commercial papers are also ‘qualifying securitisations’, which means eligible as liquid asset for the purpose of LCR calculation, but also eligible to ECB repo, this will give to ABCP more attractiveness for investors, and then decrease the level of spread, which means at the end a reduction of the funding cost for the client. As we know ABCP conduit is a good real economy funding tool, this is important to be sure that this kind of structure will not be jeopardized because of new regulations.

3. Synthetic securitisation

The FBF welcomes the paragraph 5 and agrees that credit risk transfer away from the banking sector can be beneficial.

Most credit risk transfer transactions are done under a synthetic format since Synthetic Risk Transfer is easier to implement than “true sale” structure: the assets are not transferred into an SPV and stay in the balance sheet of the bank with the following benefits:

- No transfer price issue and no cancelation of funding in place ;
- No need to notify the Borrowers or get their consent ;

Synthetic securitisation applies to a wide range of assets: large corporates, SME loans, Trade finance, shipping loans, etc.

Risk sharing transactions are an efficient de-risking tool for the originating bank. It transfers risk outside the banking system without dissemination of systemic risk outside the regulated space:

- The assets remain funded by the originating bank, and some leverage is implicitly provided to the investor by the bank ;
- The counterparty risk mentioned in paragraph 45 generally does not exist as the full nominal of the protection is often fully cash collateralised from inception ;
- Investor is himself term funded considering the nature of the risk and lack of liquidity on his investment ;
- No additional leverage should be provided by bank funding.

Risk sharing transactions are an efficient RWA/Capital management tool subject to adequate calibration of the regulatory formula used to compute RWA exposure on the retained tranches:

- It should be risk sensitive to give the right incentive to the bank ;
- Conservative multiplication factor (1+p) and RW floor could be justified by risk model, among which a possible underestimation of internal risk parameters of the pool (PD, LGD Asset correlation factor). They are less relevant and could be lower when the pool of assets is already on the balance sheet before securitisation

The cost of a transaction is commensurate to the risk transferred and depends on market conditions. For the bank, the decision to enter into a given transaction may depend on:

- Ability to free up line on concentration exposures ;
- Cost of saved RWA/Capital compared to alternative source of capital ;
- Return on capital on the opportunities for the redeployment of the saved RWA/capital ;

The “high cost protection” criteria should therefore be assessed in view of the risk transferred rather than historical remuneration conditions on the securitised assets. In addition, there is no waterfall mechanism in synthetic securitisation as the investor does not have access to the cash flows on the assets.

As a summary, “high quality” synthetic credit risk transfer securitisations should have the following characteristics:

- Simple and transparent structure ;
- Efficient risk transfer mechanism (no support to the investor, comprehensive SRT analysis) ;
- Strong alignment of interest between originator and investor (risk retention, loss sharing alignment) ;
- Cost assessment should be based on the risks of the pool not on the revenues it generates (this is a major difference with cash securitisation where the pools cash flows pay interest and principal on the various tranches) ;
- Investor should be term funded and should not leverage its investment with bank funding.

III. Answers to certain questions raised in the Discussion Paper

Do respondents agree with the benefits of a well-functioning securitisation market as outlined in Section 2?

The document is not mentioning ABCP or the assets that are funded by ABCP being mainly trade receivables. Despite the fact that ABCP can be classified as ‘liquidity products’ under the bucket typology provided by ECB and BOE page 9, nor ABCP nor their underlying assets benefit from any regulatory advantages (LCR eligibility or Capital Charge under Basel Capital Framework - existing or December 2013 consultation) whereas their structure is very close from covered bonds – ABCP being protected by liquidity lines covering at least 100% of the ABCP issued, they should then receive equivalent regulatory treatments as covered bonds. Also, reference is made to SME Loans in § 43 and § 44 which are to be encouraged but nothing on trade receivables ABCP securitisation which is funding the working capital of companies and which has also to be encouraged. Since trade receivables are short term assets, it is normal to fund them by short term liabilities i.e. ABCP and not ABS. Size of ABCP market in Europe amounts to 57 Bios EUR equivalents in EMEA out of which 72% of asset funded are trade receivables, auto loans or auto leases (source Moody’s: EMEA ABCP Market Summary: Q1 2014). The liquidity of ABCP depends on regulatory treatments that they receive from regulators under LCR and capital charge.

Do respondents agree with the impediments to and economic concerns of investors that have been identified? Do respondents think that there are any additional impediments to investors, and if so, what are they?

As mentioned by ECB in its opinion on the EU proposal for a Regulation on the Money Market Funds dated May 22 2014, restrictions to invest in ABCP by Money Market Funds (MMF) need to be reevaluated:

6.3 Further, MMFs play an important role as one of the main investors in the market for short-term Securitisation assets, such as Asset Backed Commercial Papers (ABCPs). The ABCP market is important for the intermediation of short-term credit to the real economy, e.g. trade credit. The proposed regulation sets forth requirements for eligibility of securitisation assets for investment by MMFs, including requirements for the underlying pool of assets regarding type, credit and liquidity risk and maturity limit. While the ECB acknowledges that these requirements will increase the transparency of MMF investment portfolios and improve credit and liquidity risk management, it suggests evaluating the benefits of the contemplated restrictions to investment in ABCPs against their impact on the functioning and depth of the securitisation markets.

Due to the fact that SEC has not proposed such strict measures on ABCP in its draft proposal on US MMF, the position taken by European Commission on this proposed regulation, if adopted, will lead to the funding of European assets in ABCP conduits located in the US.

Given the liquidity crisis that happened in summer 2011 leading to run off of US investors from European names, this is a poor perspective for European economy.

Reference to draft EU MMF reform as potential impact on securitisation / ABCP in Box 2 – table 1 is missing.

Do respondents agree with the impediments to and economic concerns of issuers that have been identified? Do respondents agree that the infrastructure concerns raised above affect the economics of securitisation? Do respondents think that there are any additional impediments to issuers, and if so, what are they?

Leverage ratio: securitized pools will be treated on balance sheet most of the time except if all the tranches are placed, which is quite rare, and even in such case, a balance guaranteed swap bearing no credit risk might still call the securitised assets back on balance sheet. Therefore the leverage ratio of the bank very often will not be reduced despite the non-recourse funding created by the ABS issuance, unless the IAS39 derecognition standard is clarified.

Performance history: while issuers certainly understand the importance of providing loan loss performance over time spans as long as possible, one has to be careful in the field of RMBS, which is the bedrock of the market, not to draft into the definition of QS/HQS unrealistic requirements such as performance data over the entire life cycle of the assets.

Do respondents agree that market liquidity may be a barrier to a well-functioning securitisation market?

Market liquidity is important for a well-functioning securitization market. The main entities which could provide market liquidity on this market are the banks (notably thanks to their secondary trading desks), that is why the capital and liquidity regulations on this asset class for the banks are so important for the improvement of the market. Therefore, for example, ABS and ABCP should be recognized into liquidity buffers under LCR.

The view of the Bank of England and the ECB is that a ‘qualifying securitisation’ should be defined as a security where risk and pay-offs can be consistently and predictably understood. Do respondents agree with this definition? What characteristics of a ‘qualifying securitisation’ not already included in the principles in Box 3 should warrant such treatments? Do respondents have any comments on the principles in Box 3?

Defining a “qualifying securitisation” as being a “security where risk and pay-offs can be consistently and predictably understood” could be contemplated. However, for the sake of clarity we would prefer the following definition: “a quality/ qualifying securitisation (QS) is a **sustainable, simple and transparent** transaction that **tranches a portfolio of sustainable low-risk underlying assets**”. In addition, a high quality/ qualifying securitisation (HQS) is a tranche of a Qualifying Securitisation that is **sufficiently senior** to be **robust**.

The regulatory regimes should mirror the policy objectives presented above; a Qualifying Securitisation should be assessed in a way that is compatible with policy objectives. At a minimum, the regulatory regime should not discourage QS/HQS, or better, the regulatory regime encourages QS/HQS (originators are encouraged to **issue** Quality Securitisations and investors to **invest** in High Quality Securitisations).

The high level principles included in Box 3 encompass principles related to *simplicity, structural robustness and transparency* of the qualifying securitisations (in accordance with point 126 of the DP). Our proposal consists in six principles for judging criteria for defining qualifying securitisations:

- Supporting the *simplicity* and *transparency* principles,
- Enhancing the structural robustness principle into *safe securitisation* principle, and
- Consider three additional principles: *regulatory governance principle, sustainability principle, and objective statistical basis principle*.

We propose a principle-based approach for defining a “qualifying” securitisation and support the use of the Conservative Monotone Approach (CMA) for assessing the target attachment point that a tranche should at least have to be ‘sufficiently senior’. This proposal is consistent with the combination of “qualifying” and “differentiated risk based approach” presented above.

Six principles for judging criteria for defining qualifying securitisations

1. Regulatory Governance Principle

In our opinion this principle is extremely important for certifying the soundness of the qualifying securitisation and the proper application of other five principles. Thus, *the control parameters should permit regulators to achieve their objectives and exercise judgment in assigning the QS/ HQS label across types of exposure*.

There are multiple topics which should be under regulatory scrutiny, as the following:

1. Regulation of the origination of the underlying assets by regulators using/ defining QS/HQS for setting responsible lending rules ;
2. Regulatory control for risk measures used to define HQS ;
3. Regulatory control for the numerical parameters of any risk formula used in assessing HQS ;
4. Regulatory control of the certification process for QS/ HQS by regulating the **Independent gatekeepers** for the HQS label ;
5. Static (at inception) HQS label or dynamic control (with a frequent assessment of the validity of the HQS label) to be set forth by regulators.

A level of regulatory control is required for receiving capital/ liquidity recognition for QS/HQS. One could also contemplate that investors which apply IRB approaches perform the QS/HQS analysis and assessment. In the meantime, regulations should encompass all adequate provisions with regard to due diligences requirements for investors. The QS/HQS process should not create incentives or leeway for weaker due diligences requirements for investors.

This concept is similar to using external auditors to validate the accounts prepared by the company accountants.). Private labels like PCS, Rating Agencies, Central Banks, Competent External Auditors or Law Firms could be such gatekeepers.

- Rating agencies could provide an HQS label in addition to an external rating, as long as they are regulated by ESMA. However, this will lead them to admit there are different qualities of AAA (which is an obvious statement for all but for rating agencies) ;
- Private label as PCS or TSI could be used (need to be regulated) ;
- National central banks could approve post-closing an HQS label (such as approval process for ECB Eligibility – however the process would be driven by the jurisdiction of the underlying assets, not by the jurisdiction of issuance) ;
- Competent External Auditors or Law Firms could also be authorised to determine an HQS label.

2. Sustainability Principle

By developing a sustainability principle, we seek to formalise the notion that asset classes that are subject to **instabilities associated with market price effects should not form part of the QS category**. Moreover, both *the underlying assets* should be sustainable and *the securitisation market for such underlying assets* should be sustainable.

By definition, sustainable assets are real assets (no synthetic underlyings).

For a securitisation transaction done for funding purpose, according to definition above underlying assets that are sustainable are for example: residential loans⁷ for an owner-occupier, with-recourse residential loans for a buy-to-let property, credit card, auto loan or an auto lease to purchase or lease an automobile, corporate trade receivable, infrastructure loan, aircraft or shipping loan or export finance, corporate loan whose purpose is to finance an investment.

The sustainability principle, coupled with history of low credit risk through time requirement for underlying assets (according to the safe securitisation principle) and “Responsible Lending Rules” or equivalent requirement would allow to provide a framework for identifying what types of underlying assets fit within QS/HQS framework in a consistent manner across asset classes, over time and across regulations or private initiatives such as EIOPA definitions of HQS, PCS or Central banks’ eligibility criteria (which uses different lists of eligible assets and where asset classes are eliminated in a variety of ways).

For the securitisation market to be sustainable, the underlying assets should be illiquid and not marketable individually on the capital markets. The securitisation will provide the ‘primary’ funding source on the capital markets.

If an individual bond or ABS or tradable loan is individually marketable on the capital markets, those instruments can already get their primary funding from capital markets investors. A securitisation of such underlying instruments becomes often ‘an arbitrage transaction’ whose main aim is to extract margins, not to provide funding for the underlying assets. The funding provided to the underlying assets is a side effect of the transaction; it is on a ‘secondary’ basis. The securitisation market will stop completely the moment the margin extraction cannot occur at a profit:

- According to the sustainability principle, the securitisation market for ‘CDOs of ABS’ is not sustainable, as the underlying ABS are already liquid and tradable on the capital markets ;
- Balance-sheet Corporate Securitisations are sustainable, as both the underlying assets and the securitisation market are sustainable. A typical example would be SME loans.

3. Safe Securitisation Principle

According to this third principle, the *underlying assets* should be assets which have a history of low unexpected losses through time, *the structure* should be of low legal risk. In addition for HQS, *the tranche* must be sufficiently safe.

⁷ I.e. mortgages and loans secured by a guarantee, cf. EBA report on EU covered bonds framework and capital treatment.

For *the underlying assets*, the regulators should exercise judgement and decide on the cut-off point in terms of low risk weight (on a pool basis) based on policy initiatives (the Standardised Risk weight values could be used). In addition, the underlying assets have to display a strong and predictable performance (this would exclude high volatility assets), and also minimal losses deviation through a period of severe financial stress (this would exclude new types of assets until they have a proven credit history).

Regarding *the structure* that should be of low legal risk, with structural safeguards which mitigate the legal risk (the collateral should be enforceable: proper legal true sale, no severe clawback or setoff risks), the counterparty risk (no close links) and address its structural robustness (meaning that there should be no market-based triggers, no waterfall where principal proceeds are used to pay interest would be allowed, and no trading activity in the underlying pool).

The senior QS should be sufficiently safe: the credit enhancement should cover the 10 largest exposures. This aspect will be developed further on the attachment point part.

4. Transparency Principle

According to this fourth principle, the underlying assets and the structure should be disclosed in a transparent manner to facilitate the risk assessment and comparisons. The 'substance over form' principle is a form of application of the transparency principle. We agree that transparency requirements reduce information asymmetries between originators and investors. This could be accomplished by loan-level data requirements and more standardised investor reports, by the information disclosed in Prospectuses or Offering Memorandum or equivalent, or by look-through to calculate risk parameters.

5. Simplicity Principle

According to this fifth principle, the nature of repayment risks for the underlying assets should be simple, and the structure should be designed in a simple manner.

First, with regard to the structure; we consider simplicity means that tranching is *Plain-Vanilla*. Also simplicity is not an issue of number of tranches but is an issue of non-complexity. The non-complexity means the priority of payment of the tranches is sequential or pro-rata, that is not incorporating provisions for principal proceeds diversion to pay interest if it leads to a credit enhancement erosion, etc.

Secondly, with regard to the underlying assets, only homogeneous pool should be considered (consisting of one type of asset), with no direct market risk, in the underlying assets (no LTV-based default triggers, etc...) or in the pool (no buckets valued at market).

6. Objective Statistical Basis Principle

According to this sixth principle, any risk measure used in an HQS definition (e.g. a rating or a formula-based risk measure) should be based on a clear, objective statistical measure of risk.

This principle implies that the choice of the risk measure needs to be aligned with the regulatory objectives. The external ratings (based either on Probability of Default (PD) or on Expected Loss (EL) of the tranche), which are not regulatory parameters, are poor-proxy for a HQS label. In addition, they are not stable risk measures. The Unexpected Loss (UL) is a regulatory measure, expressed as a risk weight and provides a stable risk measure for securitisation tranches (the Conservative Monotone Approach is UL-based). Therefore, regulators will be entitled to define the values of the regulatory parameters to use (eg. $CSSF_M, \rho^*_M$) to enable users to assess if an HQS tranche is sufficiently senior (this point is detailed hereunder).

Using the Conservative Monotone Approach for HQS

As indicated above, we propose a complementary approach for the principle-based approach for defining a “qualifying” securitisation the use of the Conservative Monotone Approach (CMA) for assessing the target attachment point that a tranche should at least have to be ‘sufficiently senior’. The CMA and the principle-based approach for definition defining a “qualifying” securitisation are complementary in supplying a substitute for agency ratings in some regulatory applications. Agencies ratings embody both quantitative analysis of the degree of conservatism in the tranching of the deal given the nature of risks in the underlying securities and qualitative analysis of the deal. Correspondingly, the CMA and the HQS principle-based approach would cover, respectively, quantitative and qualitative aspects of HQS evaluation. In addition, the CMA provides a measure of (UL+EL) rather than EL which is what ratings aim to identify (at least Moody’s style ratings, S&P/Fitch ratings focus on PD).

Based on the CMA, the formula below gives the target attachment point A_{Target} that a tranche should at least have to be ‘sufficiently senior’

$$A_{Target} = W \times K_W + LGD \times N \left(\frac{N^{-1} \left(\frac{K_P}{LGD} \times CSSF_M \right) - N^{-1} (K_{Target}) \times \sqrt{\rho^*_M}}{\sqrt{1 - \rho^*_M}} \right)$$

The formula does not rely on ratings. It requires regulatory control, with the parameter $CSSF_M$ (capital surcharge scaling factor) and ρ^*_M (conditional pool correlation). In Europe, regulatory control could be exercised in the different jurisdictions by the national central banks who are best equipped to assess the risks of their national assets (eg. Banque de France for French mortgages, Banco de España for Spanish SMEs...). A central supervisory process (European Central Bank or European Banking Authority) would then validate the proposed numerical values $CSSF_M$ and ρ^*_M .

Other:

References to trade receivables is missing in § 134

References to revolving securitisation is missing in Box 3

Do respondents think that a liquid market for ‘qualifying’ securitisations used for funding would result from a ‘qualifying certification’?

Yes.

These principles may then provide a framework to aid various authorities and market participants to set their own eligibility criteria. How might such a framework be developed? What role could the appropriate authorities play in the process of certifying that a transaction is a ‘qualifying securitisation’? What are the associated risks?

A positive regulatory qualification of securitisation issues placed in the market could give strong support to the re-emergence of a healthy European market. The principles listed in Box 3 are generally sound in our view for securitisations placed with investors. The qualification would complement investors’ own analysis of structures that they did not arrange and with which they are necessarily less familiar than the arranger. This sort of qualification would probably be most useful in all regulatory uses designed to apply mainly to assets purchased in the market: solvency rules for insurers or other investors, High Quality Liquid Asset rules for banks, etc...

We also fully agree with the statement in paragraph 102 that a “one-size-fits-all” approach for qualification rules would not be appropriate. Each regulation should appropriately calibrate the rules applying to “qualified securitisations”. As far as solvency rules for banks are concerned, we would like to underline that a strict reading of Box 3 principles would not necessarily always make sense.

For example, the self-liquidating principle for securitisations placed in the market should not prevent banks from funding clients’ portfolios of receivables or loans through ABCP issued by multi-seller securitisation conduits. The liquidity risks generated by these vehicles are addressed by other prudential regulations applying to banks.

Banks may also use “derivatives-based” or “synthetic” structures to transfer a significant portion of their credit risk on certain portfolios to third-party investors. The residual “securitisation positions” kept by banks should not be excluded from the qualification simply because of the use of these techniques, which are often more flexible and less costly.

In both cases, it would still be possible to perform a qualification analysis of the securitisation position held by the banks (quality of the credit risk transferred to the conduit or of the residual senior position kept by the bank).

More generally, we feel that securitisation positions held by the arrangers themselves do not require the same protections that are necessary for third-party investors, as their risk can be also addressed by more detailed regulatory formulas based on a detailed analysis of the portfolios.

The authorities could look what is done for the covered bonds market and do the same for ABS and ABCP.

[Do respondents think that harmonisation and further conversion software could bring benefits to securitisation markets? If so, which asset classes should be targeted? How can accessibility to the existing loan level data be improved, so that it provides most value to investors?]

We have no comments.

Do respondents think that initiatives currently undertaken by authorities in the area of standardisation of prospectuses and investor reports and trade transparency are sufficient or is there scope for further improvements? Would the availability of prospectuses and standardised investor reports in a single location be helpful to securitisation markets?

We have no comments.

Do respondents agree that facilitating investors' access to credit data in an appropriate manner could support the emergence of securitisation markets? Would credit registers be helpful in this respect? If so, which asset classes should be targeted? In what form could access be granted to ensure that borrowers' confidentiality is preserved?

We have no comments.

In order to aid performance measurement and to provide investors with industry-level data, would it be helpful if certain macro-economic data were disclosed or if banks/ non-banks published certain aggregated standardised data? What are the challenges of providing potential investors with sufficient borrower and loan-level data to enable them to model credit risk, and how can these be overcome? What other elements would in your view help to improve secondary market functioning for high-quality securitisation?

In the context of ABCP specifically, conduits prepare detailed monthly reports on the performance of each of their portfolios with information received from each client/seller and they are made available to all their CP investors. CP Investors are on record saying that they are satisfied with the types of reports they are currently receiving. It is important to understand that such information is aggregated by portfolio, and not provided on a loan level basis.

In addition to privacy laws, bank sponsors are bound by most originators and sellers of the securitized assets purchased by its conduits not to disclose confidential information about the originators' assets or customers or even the originators' name or the fact that they entered into the transaction. Such information would be commercially sensitive for these originators and the application of public disclosure requirements would likely result in the removal of this efficient source of funding for many of these originators.

Lastly, on a more practical level, the number of obligors in portfolios purchased by a conduit can reach millions. Also, trade receivables' portfolios, which are core asset classes in Europe, rotate quite quickly (days rather than months or years), with the names of the obligors and amounts owed by each rapidly changing. Providing detailed or loan-level information would be extremely cumbersome, or even impossible (not only from a practical manner but also because this information is often not available from sellers), and mostly useless.

Do respondents think that authorities should consider encouraging the industry to develop such benchmark indices? What risks might these give rise to? What indices would be useful and which could be easily produced?

We have no comments.

Do respondents agree that additional information in the form of a matrix showing implied ratings if the sovereign and ancillary facilities rating caps were to be set at higher levels would be helpful in supporting the investment process and contribute to increased transparency and liquidity?

We have no comments.

How important do respondents see the impediment related to the availability of ancillary facilities? Would the benefits of facilitating SPV bank accounts that fall outside the originator's insolvency estate outweigh the costs of such an initiative? Are there other initiatives in this area that would be beneficial?

We have no comments.

With regard to the policy options mentioned, are there any other considerations authorities should be mindful of?

We have no comments.

Do respondents think there are other policy options authorities should consider to support the emergence of simple, transparent and robust securitisation markets?

We have no comments.

Beyond securitisation, might there be other ways of achieving (some of) the benefits of securitisation as outlined in Section 2? What might be the associated risks of such options?

We have no comments.

Do the principles set out in Box 3 seem broadly sensible given the objective of encouraging a set of securitisations that are more amenable to risk assessment? Are there any obvious unintended consequences?

In addition to the section 2.1, it needs to be clearly stated that revolving transactions are eligible.