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Dear Mr. Guersent,

Re: New European Securitisation Framework

After entry into force of the two Regulations (EU) 2017/2401\(^1\) and (EU) 2017/2402\(^2\) on 1 January 2019 and in the light of the experience in the interpretation and application of the new European securitisation framework, the members of the European Financial Market Lawyers Group (EFMLG)\(^3\) would like to take the opportunity to discuss some critical issues. The focus will be (i) on the scope of application and the potential cross-border effect of the new framework and (ii) on how the new framework contributes to the real economy\(^4\) and the stability of the financial

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3. The European Financial Markets Lawyers Group is a group of senior legal experts from the EU banking sector dedicated to undertaking analyses and initiatives intended to foster the harmonization of laws and market practices and facilitate the integration of financial markets in Europe. The Group is hosted by the European Central Bank. More information about the EFMLG and its activities is available on its website at www.efmlg.org.
4. See The Next CMU High-Level Group’s Report to Ministers and presented to the Finnish Presidency on “Savings and Sustainable Investment Union”, dated 9 October 2019, page 9: “A deep and well-functioning securitisation market that can recover strongly from the lows of 2013/14 is an essential element of a dynamic capital market and for euro area lending, including for SMEs.”
sector, especially in the area of the securitisation of non-performing loans (NPLs)⁵. The EFMLG would also like to address some technical issues which may affect the smooth implementation of the two Regulations.

The EFMLG is writing to kindly ask you to consider these concerns. Some of them may be addresses by the Q&A published by the Commission or the European Supervisory Authorities (ESAs), some of them would need a modification of the two Regulations, which, however, could follow the comprehensive review required under Article 46 of Regulation (EU) 2017/2402.

SECURITISATION REGULATION ("Reg 2017/2402")

Scope of Application (Article 1(2) Reg 2017/2402)

The Securitisation Regulation applies to institutional investors, originators, sponsors, original lenders and securitisation special purpose entities (Article 1(2) Reg 2017/2402).

Territorial Scope

The territorial scope of the Securitisation Regulation is unclear. Unlike other regulations, e.g., the Regulation (EU) No 575/2013 (CRR)⁶ or the Regulation (EU) No 648/2012 (EMIR)⁷, the Securitisation Regulation does not restrict its scope of application to European entities or entities that pursue activities in Europe. Contrary, the term "sponsor" defined in point (5) of Article 2 Reg 2017/2402 implies a broader coverage of all sponsors "whether located in the Union or not".

On the other hand, the new Article 14(1) CRR, which extends the scope of the due-diligence requirements set out in Article 5 Reg 2017/2402 to third country subsidiaries that form part of the same regulatory consolidation, clearly indicates the legislator's understanding that the scope of application should, in principle, be limited to entities that are supervised in Europe. Further, points (b) and (d) of Article 5(1) Reg 2017/2402 modify the due-diligence requirements for securitisations where the originator, sponsor or original lender is located in a third country, obviously because the risk retention and credit granting requirements set out in Articles 6, 7 and 9 Reg 2017/2402 are not applicable to them.

We consider a narrow territorial scope limited to European entities reasonable, because it avoids considerable overlaps in regulatory compliance, which otherwise could only be resolved through a complex equivalence mechanism. We therefore would propose the following changes:

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⁶ See Article 1 CRR: "institutions [...] supervised under Directive 2013/36/EU".
⁷ See Article 2 point (8) and (9) EMIR: "authorised in accordance with Directive 2013/36/EU" and "undertaking established in the Union".
Article 1(2) of Article 2 Reg 2017/2402 should read as follows: “This Regulation applies to institutional investors. It applies to originators, sponsors, original lenders and securitisation special purpose entities established in the Union.”

The definition of “institutional investor” should be modified in point (12)(a), (b) and (d) to (g) of Article 2 Reg 2017/2402 by replacing the words “as defined in point […] of Directive” wherever they appear with the words “authorised in accordance with Directive”. This change would follow the approach taken in point (8) of Regulation (EU) No 648/2012.

Personal Scope

The personal scope of application as defined in Article 1(2) Reg 2017/2402 also means that some provisions of the Securitisation Regulation remain less effective. An example is Article 3 Reg 2017/2402, which governs the sale of securitisation positions to retail clients. The provision applies only to sellers that qualify as institutional investor, originator, sponsor, original lender or securitisation special purpose entity. The same applies to Article 4 Reg 2017/2402: In order to be subject to the prohibition set out in Article 4 Reg 2017/2402, the securitisation special purpose entity must be established by the originator, sponsor or an institutional investor.

Definitions (Article 2 Reg 2017/2402)

Securitisation (point (1)(c) of Article 2 Reg 2017/2402)

The revised definition of securitisation incorporates the clarification previously contained in recital (50) of the CRR: that the transaction should not create exposures which possess all of the characteristics listed in Article 147(8) CRR, i.e., specialised lending exposures. The barriers between securitisations and specialised lending transactions are not always clear. This may be illustrated by the following example:

A credit institution holds a portfolio of non-performing residential mortgage loans. The majority of the non-performing loans has been worked-out and the credit institution acquired the properties through judicial or non-judicial foreclosure. The credit institution sells the foreclosed properties to a third party who wants to securitise them. The properties are transferred to a special purpose entity (SPE), which issues debt instruments in multiple classes. The third party pursues one or all of the following strategies: (i) selling the properties, (ii) operate the properties by renting them to tenants, (iii) leasing the properties long-term to a housing company who operates the properties.

As far as Article 147(8) CR and strategy (i) is concerned, the SPE was created specifically to finance the properties, i.e., the physical assets. However, the question is whether the sale proceeds are considered “income” in the meaning of Article 147(8)(c) CRR. If the proceeds are not income, the transaction would not qualify as specialised lending. The subsequent question

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8 Recital (50) of the CRR reads: “An exposure that creates a direct payment obligation for a transaction or scheme used to finance or operate physical assets should not be considered an exposure to a securitisation, even if the transaction or scheme has payment obligations of different seniority.”
would be whether a transaction where the transferred exposure are exclusively tangible assets or non credit-obligations in the meaning of Articles 134, 156 CRR could qualify as securitisation. We believe that tangible assets represent credit risk and that they are eligible for being treated under the securitisation framework\(^9\); however this is not free from doubt.

As far as strategy (ii) is concerned, the renting of properties creates income and the pledge of the rental agreements and the related cash flows, if any, may constitute the substantial degree of control that is required under Article 147(8) CRR. However, considering the volatility of the rental agreements, which may be terminated any time, the responsible credit risk manager may take the view that they are not sufficiently reliable and unable to serve as primary source of repayment. If Article 147(8) CRR is not met, would the qualification as securitisation be easier, because the securitised exposure would include at least some payment obligations of tenants that could default? Or are the rental payments too much dependent on the servicer ability to keep the proportions under rental agreements, which may be viewed as business risk?\(^10\)

In strategy (iii) the long-term lease may be the primary source of repayment and it may be the only collateral that the responsible credit risk manager would consider, especially if the housing company is creditworthy and has a good rating. One could argue that the lease payments are not income generated by the properties, because it is not the SPE (or its servicer) that operates the property but the housing company. The lease payments are sourced under the lease contract and they are to be paid independently of whether the properties are actually rented or not. Strategy (iii) should therefore support the qualification as securitisation.

To complicate it further, assumed the credit institution sells the non-performing residential mortgage loans prior to work-out and the foreclosure is performed by the servicer of the SPE who finally ends-up with the properties only. One could argue that at inception the transaction qualified as securitisation because it was the pool of non-performing loans (and not the properties) that represented the transferred credit risk. Could the work-out of a securitised exposure result in a re-classification of the transactions into a specialised lending exposure? If yes, what would be the relevant point in time: the foreclosure of the last non-performing residential mortgage loan?

The barriers between securitisations and specialised lending should be based on clear criteria which can be applied by all parties involved in a transaction irrespective of the level of information that they have. The criteria could be based on point (1)(b) of Article 2 Reg 2017/2402 which requires a "distribution of losses during the ongoing life of the transaction". Such “running waterfall” is typical for securitisations whereas specialised lending transactions very often use “liquidation waterfalls”, which provide for a distribution of losses upon an event of default only. Distinguishing between running waterfalls and liquidation waterfalls would also

\(^9\) The calculation of KIRB in accordance with Article 255(1) to (5) CRR should be possible. The risk-weighted exposure amount has to be calculated in accordance with the formula set out in Article 156 CRR (Article 255(2) CRR). The expected loss associated with tangible assets is zero (Article 158(3) CRR), i.e., not to be included. Dilution risk is not relevant for tangible assets.

\(^10\) The fact that the repayment of the securitisation position is dependent on business risk does as such not preclude a transaction from qualifying as securitisation. This is confirmed by Article 258(2)(c) CRR who just questions the application of the SEC-IRBA and only if the repayment is highly dependent on non-credit risk drivers, i.e. factors not reflected in KIRB.
justify the different capital requirements, i.e., the reflection of the subordination of a specialised
loans in the loss given default (LGD). The detailed description of the waterfall is part of the
information that originators, sponsors and SPEs have to provide under the second sub-
paragraph of Article 7(1)(b) Reg 2017/2402, hence the required transparency should be given.

**Originator (point (3) of Article 2 Reg 2017/2402)**

The term originator distinguishes between (a) the entity that was involved – itself or through
related entities, directly or indirectly - in the original agreement which created the obligations
(the "first limb originator") and (b) the entity that purchases third party's exposure on its own
account and then securitises them (the "second limb originator").

**First Limb Originator**

The first limb originator is similar to the term "original lender", who is defined in point (20) of
Article 2 Reg 2017/2402 meaning the entity which concluded – itself or through related entities,
directly or indirectly - the original agreement which created the obligations. The first limb
originator seems to be broader because it is not just the conclusion that qualifies as originator:
any involvement in the creation of the original agreement suffices\(^{11}\). We would propose to align
the definitions and to distinguish between first limb originators and original lenders\(^{12}\) by
introducing the criteria of forming the intention to securitise the exposure. Point (3)(a) of Article
2 Reg 2017/2402 should read as follows:

“(a) itself or through related entities, directly or indirectly, concluded the original
agreement which created the obligations or potential obligations of the debtor or potential
debtor giving rise to the exposures being securitised and then securitises them.”

**Second Limb Originator**

The second limb originator is the entity that purchases third party's exposures in order to
securitise them. The wording "purchases a third party's exposures on its own account" is
unclear. As it is with the first limb originator, it should be possible for the second limb originator
that it purchases the third party's exposures itself or through related entities, i.e., directly or
indirectly. We would propose the following wording:

“(b) selects and purchases itself or through related entities, directly or indirectly, a third
party's exposures on its own account and then securitises them.”

**Sponsor (point (5) of Article 2 Reg 2017/2402)**

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\(^{11}\) This would even qualify an external law firm which was entrusted by the original lender with the
documentation of the contract and the negotiation of individual clauses, which, however, should not
suffice.

\(^{12}\) The distinguishability of originator and original lender is necessary for the "fall back" in the second
sentence of Article 6(1) Reg 2017/2402: Where the originator, sponsor or original lender have not agreed
between them who will retain the material net economic interest, the originator shall retain the material
net economic interest.
We appreciate the broadening of the definition of sponsor, which now includes third country credit institutions and entities that pursue any of the activities and services listed in Annex I of Directive 2014/65/EU (MiFID II).

However, we would like to raise the following points: The clarification "whether located in the Union or not" should be moved so that it applies to both credit institutions and investment firms. Further, it should be clarified that a sponsor could also be an investment management company as defined in Directive 2009/65/EC (UCITSD) or Directive 2011/61/EU (AIFMD), especially those that are authorized to manage portfolios on a client-by-client basis (Article 6(3)(a) UCITSD and Article 6(4)(a) AIFMD). We acknowledge that Individual portfolio management is a service listed in point (4) of Section A of Annex I of Directive 2014/65/EU. However, considering that entities that pursue individual portfolio management can only carry one license, i.e., they are either authorised as an investment firm or as an investment management company (and not as both), a clarification would be desirable. The clarification would be relevant for securitisations in the form of collateralized loan obligations (CLOs), especially those where the securitize exposures consist of bonds or other financial instruments.

"'sponsor' means, whether located in the Union or not, a credit institution as defined in point (1) of Article 4(1) of Regulation (EU) No 575/2013, an investment firm as defined in point (1) of Article 4(1) of Directive 2014/65/EU, an AIFM as defined in point (b) of Article 4(1) of Directive 2011/61/EU or a management company as defined in point (b) of Article 2(1) of Directive 2009/65/EC other than an originator, that..."

Retail Clients (Article 3 Reg 2017/2402)

Article 3 Reg 2017/2402 prohibits the seller of a securitisation position to sell such position to a retail client, unless the seller performed a suitability test in accordance with Article 25(2) of Directive 2014/65/EU (MiFID II). If the size of the retail client’s financial instrument portfolio does not exceed EUR 500,000, the seller must also ensure that the securitisation position purchased by the retail client exceeds EUR 10,000 and that the sum of all securitisation positions acquired by such retail client does not exceed 10% of its financial instrument portfolio. The EUR 500 000-threshold resembles the second identification criteria for clients who may be treated as professionals on request as specified in part II.1 of Annex II of Directive 2014/65/EU.

Scope of Application

As mentioned above, the scope of application of Article 3 Reg 2017/2402 is considerably narrow: It applies only to sellers that qualify as originator, sponsor, original lender or securitisation special purpose entity (Article 1(2) Reg 2017/2402). Any other seller, e.g., an investment firm that is not an investment firm as defined in point (2) of Article 4(1) CRR (a so-called “CRR investment firm”) or that is not investing in the relevant securitisation, is free to sell securitisation positions to retail clients provided it complies with the obligations imposed by Articles 24, 25, 27 and 28 Directive 2014/65/EU (MiFID II) and the implementing national laws.

Further, Article 3 Reg 2017/2402 applies to sales only, i.e., activities as described in the definitions of "dealing on own account" or "market making" (points (6) and (7) of Article 4(1)
Directive 2014/65/EU). Whether it includes individual portfolio management (point (8) of Article 4(1) Directive 2014/65/EU) is doubtful. What is not prohibited is the provision of investment advice or the execution of orders on behalf of retail clients (points (4) and (5) of Article 4(1) Directive 2014/65/EU).

Definitions

Article 3 Reg 2017/2402 uses definitions that are not defined in the Securitisation Regulation nor in the Directive 2014/65/EU.

It is, e.g., unclear whether the “financial instrument portfolio” must consists of financial instruments as defined in Section C of Annex I of Directive 2014/65/EU or whether it may include cash deposits or securitisation positions in the form of loans.

Further, it is not clear how the thresholds are to be determined: Is it the notional amount or the market value that is the basis for the determination? How are “interest only strips” (as defined in point (2) of Article 242 CRR), which have no notional amount treated?

Securitisation Special Purpose Entities (Article 4 Reg 2017/2402)

Article 4 Reg 2017/2402 provides that securitisation special purpose entities (SSPEs) shall not be established in a third country which (i) has been listed by the Financial Action Task Force (FATF) as a high-risk and non-cooperative jurisdiction\(^{13}\) or (ii) has not signed a tax treaty or multilateral tax agreement with one of the Member States that complies with the standard outlined in Article 26 of the Organisation for Economic Co-operation and Development (OECD)’s Model Tax Convention on Income and Capital.

Scope of Application

As mentioned above, it is unclear who is supposed to comply with Article 4 Reg 2017/2402. The Securitisation Regulation applies to originators, sponsors, original lenders and institutional investors only. Typically, but not necessarily, it is the originator or sponsor who establishes the SSPE. One can take from the due-diligence requirements set out in Article 5(1) and (2) Reg 2017/2402 that institutional investors are under no obligation to verify the location of the SSPE and to ensure that it is not established in a jurisdiction that is banned by Article 4 Reg 2017/2402. The location of the SSPE may be of relevance for the risk assessment performed under Article 5(3)(b) Reg 2017/2402, which should cover all structural features of the securitisation. However, nothing would prevent an institutional investor to hold a securitisation position issued by an SSPE located in banned jurisdiction.

In some securitisations there exist no SSPE. One example would be a credit institution that securitises its loan portfolio through a synthetic securitisation that uses embedded credit derivatives or financial guarantees (point (10) of Article 2 Reg 2017/2402). What happens if the

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\(^{13}\) Currently, the FATF lists the following 14 jurisdictions: Bahamas, Botswana, Cambodia, North Korea, Ethiopia, Ghana, Iran, Pakistan, Serbia, Sri Lanka, Syria, Trinidad & Tobago, Tunisia, Yemen.
credit institution was incorporated in one of the high-risk and non-cooperative jurisdictions identified by the FATF?

In some traditional securitisations SSPEs are used, but there was no act of establishment as such: A proprietary trader may have originated loans or leveraged loans to corporates through a special purpose entity (SPE) that he funded through equity and debt instruments issued. At a later point in time the proprietary trader decides to reduce his funding by inviting institutional investors to acquire senior debt instruments issued by the SPE. The SPE transforms into an SSPE.

Further, some SSPE may hold its securitised exposures indirectly through an SPE. An example are real estate only (REO) companies that acquire the real estate properties upon the judicial or non-judicial foreclosure of the defaulted mortgage loans. REO companies are, by definition, not subject to Article 4 Reg 2017/2402.

**Tax Treaties**

The second criteria that qualifies a banned jurisdictions, the absence of a qualified tax treaty or multilateral tax agreement is difficult to verify and may result in a fragmented regulatory practice. We would propose to require the ESAs to publish a list of those third countries that do not comply with the requirement set out in point (b) of Article 4 Reg 2017/2402.

**Due-diligence (Article 5 Reg 2017/2402)**

*Meaning of “Verification”*

In the context of the due-diligence requirement set out in Article 9(3) Reg 2017/2402, the European Banking Authority (EBA) clarified that the obligation to verify should be interpreted consistently with the purpose of Article 9 Reg 2017/2402 and appropriate to the class of assets being securitised and the nature and type of the securitisation. In particular, verification should mean to ascertain through appropriate means that the requirements referred to in Article 9(1) Reg 2017/2402 are met. To that end, the originator should use adequate resources and make all reasonable efforts to obtain as much information as is available and appropriate for such verification in accordance with sound market standards of due diligence for the class of assets and the nature and type of securitisation.

We agree with the EBA's interpretation of the term "verify", but believe that it should apply to the institutional investors’ obligation under Article 5 Reg 2017/2402 as well. We would propose the following new definition:

"verify means the use of adequate resources and reasonable efforts to obtain as much information as available and appropriate for such verification in accordance with sound

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14 Article 9(3) Reg 2017/2402 requires the second limb originator to verify that the entity which was, directly or indirectly, involved in the original agreement which created the obligations or potential obligations to be securitised fulfills the requirements referred to in Article 9(1) Reg 2017/2402.

market standards of due diligence for the relevant class of securitised exposures and the nature and type of securitisation.”

Extraterritorial Effect

The scope of the due-diligence requirement set out in point (e) of Article 5(1) Reg 2017/2402 is unclear. Point (e) requires an institutional investor to verify that the originator, sponsor or SSPE has, where applicable, complies with the transparency requirement set out in Article 7 Reg 2017/2402 in accordance with the frequency and modalities provided for in that Article. Unlike points (a) to (d) of Article 5(1) Reg 2017/2402, point (e) does not distinguish between originators, sponsors or SSPEs established in the Union and those established in third countries.

One could argue that the legislator’s actually did distinguish between European and third country entities and that this intention is reflected by the words “where applicable”, which refer to the narrow application of the Article 7 Reg 2017/2402, which - as pointed out above – should cover European entities only. However, one could also argue the opposite and construe the words “where applicable” as referring to the originator, sponsor or SSPE and the obligation set forth in the first sub-paragraph of Article 7(2) Reg 2017/2402, which requires the originator, sponsor and SSPE to designate amongst themselves the entity that fulfils the transparency requirement set out in Article 7 Reg 2017/2402.

The unclear wording of Article 5(1)(e) Reg 2017/2402 has received great attention from originators and sponsors in third countries who sell securitisation positions to European institutional investors. The concern has grown after the ESMA has published its regulatory and technical standards which will specify the information that originators, sponsors and SSPEs should make available to investors (especially through a recognised securitisation repository) as well as the format of the information (the so-called “Disclosure Templates”).

The issue has been raised during the consultation of the Disclosure Templates. ESMA has noted the uncertainty and indicated that they have passed them on to the responsible legislative bodies.

Risk Retention (Article 6 Reg 2017/2402)

Nominal Value (Article 6(3)(b) to (e) Reg 2017/2402)

Article 6(1) Reg 2017/2402 requires the originator, sponsor or original lender of a securitisation to retain on an ongoing basis a material net economic interest in the securitisation of not less than 5%. Article 6(3) Reg 2017/2402 specifies the five options that qualify as a retention of a material net economic interest. Three options have in common that they require a calculation of the level of retention based on the nominal values of the securitised exposure (points (b) to (e).

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of Article 6(3) Reg 2017/2402): this includes the retention of a 5% first loss tranche in accordance with point (d) of Article 6(3) Reg 2017/2402.

For securitisations collateralised by exposure, which have been acquired with a material purchase price discount (e.g., a nominal value of EU 100 was acquired for EUR 40), the reference to nominal values is inappropriate\(^\text{18}\). The originator did not fund the discount (e.g., EUR 60). The discount represents a pure economic upside and there is no risk of loss that could incentivise the originator to apply sound and well-defined criteria for credit-granting when selecting the purchased exposure.

However, in line with the unambiguous wording of Article 6(1) Reg 2017/2402, Article 10(1)(b) of EBA’s final draft regulatory technical standards on risk retention (“EBA RTS”)\(^\text{19}\) confirms that the calculation of the level of retention shall be based on nominal values and that the acquisition price of the securitised assets shall not be taken into account. The EBA acknowledges that for retention options based on the nominal values of the securitised exposures is substantially higher for securitisations that use exposures sold at material discounts to the nominal value\(^\text{20}\).

As a potential solution, EBA refers to point (a) of Article 6(3) Reg 2017/2402 and the retention option based on the nominal value of the tranches sold to investors (the “vertical slice”). However, this retention option is typically not used in securitisations of non-performing loans (NPL). We would propose to introduce in of Article 6(1) Reg 2017/2402 the following new subparagraph:

"By derogation from subparagraph 1, where an originator purchases a third party’s exposures with a [material] discount and then securitises them, the level of retention shall be based on the acquisition price of the securitised exposures instead of its nominal values."

Further, as a technical note, we would propose to insert in point (e) of Article 6(3) Reg 2017/2402 after the words “not less than 5%” the words “of the nominal value”.

**Retention on Group Level (Article 6(4) Reg 2017/2402)**

As already under the old Article 405(2) CRR, where a parent institution, financial holding company or mixed financial holding company or one of its subsidiaries securitises exposures from one or more credit institutions, investment firms or other financial institutions which are included in the scope of supervision on a consolidated basis, the retention requirements may be satisfied on the basis of the consolidated situation of the related parent or holding company (Article 6(4) Reg 2017/2402). Considering the nature of the risk retention requirement set out in

\(^\text{18}\) See EBA-Op-2019-13, page 8 (nos. 25/26): “The EBA considers that there are certain provisions in the Securitisation Regulation that do not take duly into account the specific features of NPE securitisations and lead to compliance issues for participants in this market. As pointed out above, these relate to the requirements on risk retention, insofar as the risk retention amount for some methods is calculated on the nominal value of the NPEs, rather than on the discounted value after applying the NRPPD, and overstates the amount to be retained as a result.”

\(^\text{19}\) EBA’s final draft regulatory technical standards specifying the requirements for originators, sponsors and original lenders relating to risk retention pursuant to Article 6(7) of Regulation (EU) 2017/2402 dated 31 July 2018 (EBA/RTS/2018/01) (“EBA RTS”).

\(^\text{20}\) Page 55 of the EBA RTS.
Article 6 Reg 2017/2402, which is no longer an instrument of prudential supervision but rather of products and markets, we would propose the following changes:

"Where a parent undertaking or one of its subsidiaries, as an originator or sponsor, securitises exposures from one or more entities, which are part of the same group and included in the same consolidation on a full basis, the requirements referred to in paragraph 1 may be satisfied on the basis of the consolidated situation of the related parent undertaking.

The first subparagraph shall apply only where the entity which created the securitised exposures complies with the requirements set out in Article 9 of this Regulation and delivers the information needed to satisfy the requirements provided for in Article 5 of this Regulation, in a timely manner, to the originator or sponsor and to the parent undertaking."

In Article 2 the following new definition should be included:

"'parent undertaking' means a parent undertaking as defined in point (21) of Regulation (EU) No 648/2012;
'subsidiary' means a subsidiary as defined in point (22) of Regulation (EU) No 648/2012;
'included in the same consolidation' has the meaning as described in Article 3(3) of Regulation (EU) No 648/2012."

Exemptions (Article 6(5) and (6) Reg 2017/2402)

The risk retention requirement does not apply to securitisations (i) where the underlying exposures are owed or guaranteed by central government, regional government, local authorities, public sector entities, central banks, multilateral development banks, institutions with a standardises approach risk weight of 50% or less, or (ii) which are based on a clear, transparent and accessible index where the underlying reference entities are "widely traded" (e.g., the iTraxx). The list of exceptions is much less extensive than that of other regulatory regimes, namely the credit risk retention rules of the U.S.

The U.S. credit risk retention rules were adopted in December 2014\textsuperscript{21} to implement the credit risk retention requirements of section 15G of the Securities Exchange Act of 1934, as added by Section 941(b) of the Dodd-Frank Act Wall Street Reform and Consumer Protection Act of 2010. Section 15G includes a variety of exemptions from these requirements, including an exemption for asset-backed securities (ABS) that are exclusively collateralized by "qualified residential mortgages (QRM)\textsuperscript{22} or by certain qualifying assets like commercial loans, commercial real estate loans and automobile loans that meet the underwriting standards set


\textsuperscript{22} § 13(a): Qualified residential mortgage means a "qualified mortgage" as defined in section 129C of the Truth in Lending Act (15 U.S.C. 1639c) and regulations issued thereunder, as amended from time to time.
forth in the credit risk retention rules\textsuperscript{23}. As a general exemption, the risk retention requirement does also not apply to certain ABS\textsuperscript{24} that are issued or guaranteed as to payment of principal and interest by the U.S. or an agency of the U.S.

In order to avoid the application of conflicting retention rules and to ease compliance of European institutional investors who intend to acquire positions in foreign securitisations, Article 6(5) Reg 2017/2402 should be modified as follows:

"5. Paragraph 1 shall not apply to securitisations where the securitised exposures or the securities issued under the securitisations are exposures to or securities issued by or exposures or securities fully, unconditionally and irrevocably guaranteed by:

(a) central governments or central banks;

(b) regional governments, local authorities and public sector entities within the meaning of point (b) of Article 4(1) of Regulation (EU) No 575/2013 of Member States;

(c) institutions to which a 50 % risk weight or less is assigned under Part Three, Title II, Chapter 2 of Regulation (EU) No 575/2013;

(d) national promotional banks or institutions within the meaning of point (3) of Article 2 of Regulation (EU) 2015/1017 of the European Parliament and of the Council; or

(e) the multilateral development banks listed in Article 117 of Regulation (EU) No 575/2013."

Further, in order to encourage a broader use of the new designation ‘simple, transparent and standardised securitisation’ which would foster the confidence in the European market for securitisations, the retention requirement should not apply to simple, transparent and standardised (STS) securitisation, as defined in point (10) of Article 242 CRR\textsuperscript{25}. The exemption may or may not be limited to those STS securitisations that comply with the additional criteria set out in Article 243 CRR.

"6a. Paragraph 1 shall not apply to STS securitisations [that meet the criteria set out in Article 243 of Regulation (EU) No 575/2013]."

**Ban on resecuritisation (Article 8 Reg 2017/2402)**

According to Article 8 Reg 2017/2402, the underlying exposures used in a securitisation shall not include securitisation positions. As mentioned above, it is unclear who is supposed to comply with Article 8 Reg 2017/2402. While the Securitisation Regulation applies to originators, sponsors, original lenders and institutional investors, some provisions make it clear to whom the different rules apply, e.g. the due diligence requirements in Article 5 Reg 2017/2402 apply to institutional investors.

\textsuperscript{23} See § 15(a): “Commercial loans, commercial real estate loans, and automobile loans that are securitized through a securitisation transaction shall be subject to a 0 percent risk retention requirement under subpart B, provided that the following conditions are met...”

\textsuperscript{24} See § 19(b)(1)(ii): ABS that are collateralized solely by residential, multifamily, or health care facility mortgage loan assets or interests in such assets, and servicing assets.

\textsuperscript{25} ‘Simple, transparent and standardised securitisation’ or ‘STS securitisation’ means a securitisation that meets the requirements set out in Article 18 of Regulation (EU) 2017/2402.
We believe that the wording 'underlying exposures used in a securitisation' in paragraph (1) and the sentence 'competent authority [...] may grant permission to an entity under its supervision to include securitisation positions' in paragraph (2) implies that Article 8 Reg 2017/2402 only applies to originators, sponsors and original lenders, i.e. not to investors. To make this explicit, we would propose the following changes:

"The originator, sponsor or original lender shall not use securitisation positions as underlying exposures in a securitisation."

Non-Credit Impaired Criteria (Articles 20(11)(a) and 24(9)(a) Reg 2017/2402)

With respect to Articles 20(11)(a) and 24(9)(a) Reg 2017/2402, the requirement that the underlying exposures of a STS securitization should, to the best of the originator’s or original lender’s knowledge, not include exposures to a defaulted or credit-impaired debtor or guarantor may be difficult to comply with in practice. In some countries, information on defaulted or distressed borrowers is not available or is not allowed to be stored for a three years period, which makes it difficult to comply with this requirement.

The due-diligence standard “to the best knowledge” is unclear. Recital (26) of the Reg 2017/2402 implies that originators and original lenders may rely on “information obtained from debtors on origination of the exposures, information obtained from the originator in the course of its servicing of the exposures or in the course of its risk-management procedure or information notified to the originator by a third party.” Additional guidance has been provided by the two EBA Guidelines on STS criteria\(^{26}\), which clarify that an originator or original lender “is not required to take all legally possible steps to determine the debtor’s credit status but is only required to take those steps that [it] usually takes within its activities in terms of origination, servicing, risk management and use of information that is received from third parties”. The EBA Guidelines also clarify that the best knowledge standard “should not require the originator or original lender to check publicly available information, or to check entries in at least one credit registry where an originator or original lender does not conduct such checks within its regular activities.”

We appreciate the clarification provided in the two EBA Guidelines, especially the reference to the originator’s or original lender’s “regular activities”. However, in order to avoid any change of the credit institutions’ current origination procedures and the supporting systems and controls, we would like to construe the term “regular activities” as including the national rules and regulations governing those activities (i.e., the laws of the country where the borrower is incorporated, organized or resident), each as construed and applied by the local courts and competent authorities. Going beyond such national rules and regulations would require credit institutions to adapt their current origination procedures, to extend or increase the origination timeframe (raising competitiveness issues), and would increase costs on IT development and staff.

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The other issue is linked to the access to historical information over a three years period prior to the date of origination or transfer: "within three years prior to the date of origination or […] within three years prior to the date of transfer or assignment of the underlying exposures to the SSPE […]". Unfortunately, the EBA Guidelines do not clarify how to manage the absence of historical data on non-performing exposures over a three years’ period. For instance, this situation could occur if such database does not exist at all or if the database consulted does not store such data if the borrower is no longer in default or subject to a debt-restructuring process.

If the originator or original lender had to perform additional checks on the origination date to comply with this criterion, such checks would be impossible to perform on a “retroactive basis”. It would require reconstructing the information in relation to the historical information on non-performing exposures over a three years’ period before the origination date. This is, in practice, not feasible due to the absence of such historical data in some cases. Reg 2017/2402 does not allow for any “grandfathering” in relation to the underlying exposures as it has been done for securities issued before 1 January 2019 under provisions of Article 43 Reg 2017/2402. In case credit institutions do not have access to such data, they will not be in a position to take the risk of not being fully compliant with Articles 20(11)(a) and 24(9)(a) Reg 2017/2402. Consequently, we would like to have confirmation on that the absence of such historical data in some cases is not an obstacle to compliance with Articles 20(11)(a) and 24(9)(a) Reg 2017/2402.

Competent Authorities (Article 29 Reg 2017/2402)

The competent authorities that are responsible for the supervision of compliance with the Securitisation Regulation are designated in Article 29 Reg 2017/2402. In doing so, Article 29 Reg 2017/2402 distinguishes between (i) the due-diligence requirements set out in Article 5 Reg 2017/2402, (ii) the risk retention, transparency and credit-granting requirements and the prohibition of re-securitisations set forth in Articles 6 to 9 Reg 2017/2402 and (iii) the requirements for the use of the designation STS securitisation specified in Articles 18 to to 27 Reg 2017/2402, secondly, whether the supervised entities are already subject to prudential regulation or for other reasons, e.g., because they are credit institutions or investment firms as defined in Directive 2013/36/EU (CRD IV).

Lacking Designations

What are still missing are designations for the supervision of the requirements specified in Article 3 and 4 Reg 2017/2402: the selling of securitisation positions to retail clients and the requirements for securitisation special purpose entities. We would propose to modify Article 29 (2), (3) and (4) Reg 2017/2402 by replacing the words “Articles 6, 7, 8 and 9 of this Regulation” with “Articles 3, 4, 6, 7, 8 and 9 of this Regulation”.

Responsibilities of the European Central Bank (ECB)

Article 29(1)(e), (2) and (3) Reg 2017/2402 provides for an explicit designation of the European Central Bank (ECB), but only with respect to those tasks conferred on the ECB by Regulation (EU) No 1024/2013. The tasks are specified in Article 4(1) of Regulation (EU) No 1024/2013.
They include, amongst others, to ensure compliance with the European laws which impose prudential requirements on credit institutions in the area of securitisations (point (d) of Article 4(1) of Regulation (EU) No 1024/2013) and in respect of establishing robust governance arrangements which include processes that identify, manage and mitigate material risks (point (e) of Article 4(1) of Regulation (EU) No 1024/2013). The ECB’s responsibility is limited to significant credit institutions established in the euro zone. Further, Article 4(1) of Regulation (EU) No 1024/2013 explicitly clarifies that the ECB will carry out its tasks for prudential supervisory purpose only.

In its opinion of 11 March 201627, the ECB agrees that it should be competent to ensure compliance by significant credit institutions with due diligence requirements (finally set out in Article 5 Reg 2017/2402) and with the criteria for credit granting (finally Article 9 Reg 2017/2402). On the other hand, as far as the risk retention and transparency requirements (finally Articles 6 and 7 Reg 2017/2402) is concerned, the ECB views them as primarily relating to the supervision of product markets and to be clearly outside the tasks relating to the prudential supervision of credit institutions. A broader interpretation of Article 29 Reg 2017/2402 would conflict with Article 127(6) of the Treaty only permits the conferral of tasks on the ECB in policy areas relating to the prudential supervision of credit institutions.

We agree with the ECB’s position and would propose the following amendments: The deletion of the words "the ECB with regard to specific tasks conferred on it by Regulation (EU) No 1024/2013" wherever they appear in Article 29(1)(e), (2) and (3) Reg 2017/2402 and the introduction of a new paragraph (3a):

"The tasks conferred on the ECB by point (d) of Article 4(1) of Regulation (EU) No 1024/2013 include the obligations set out in Articles 5 and 9 of this Regulation."

CRR AMENDMENT REGULATION ("Reg 2017/2401")

Maximum Risk Weight (Article 267 CRR)

Article 267(1) CRR provides that where an institution, as investor, has knowledge at all times of the composition of the underlying exposures it may assign to the senior securitisation position a maximum risk weight equal to the exposure-weighted-average risk weight that would be applicable to the underlying exposures as if the underlying exposures had not been securitised. The exposure-weighted-average risk weight of the underlying exposures has to be determined in accordance with Article 267(2) CRR, which distinguishes between exposures to which exclusively or partially the Standardised Approach (SA) or the Internal Ratings Based Approach (IRBA) is applied. Finally, Article 267(3) CRR specifies the calculation under the IRBA as to also include the full expected loss (EL) multiplied by 12.5.

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27 Opinion of the European Central Bank of 11 March 2016 on (a) a proposal for a regulation laying down common rules on securitisation and creating a European framework for simple, transparent and standardised securitisation; and (b) a proposal for a regulation amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms (COP/2016/11), OJ C 219, 17 June 2016, page 2.
The reference to the full EL is reasonable for most securitisations. However, where securitisations are collateralised by exposure, which have been acquired with a material purchase price discount, the reference to full EL is not appropriate. We would propose to replace point (a) of Article 267(3) CRR with a reference to the EL shortfall defined in Article 159 CRR. The EL shortfall would allow for a recognition of such discount28.

**Determination of K_{IRB}, Attachment Point and Detachment Point (Articles 255(2), 256 CRR)**

The three risk factors K_{IRB}, attachment point and detachment point, which are used in the SEC-IRBA formula set out in Article 259 CRR are defined inconsistently. K_{IRB} is calculated by dividing the product of 8% of the risk-weighted exposure amounts by the exposure values of the underlying exposures (Article 255(2) CRR). The attachment point and the detachment point are calculated by dividing the outstanding balance of the relevant tranches by the outstanding balance of the underlying exposures (Article 256(1) and (2) CRR).

The different denominators are no issue for securitisations that are exclusively collateralised by on-balance sheet exposures. However, where the securitised portfolio includes undrawn facilities, i.e., where the exposure value is determined in accordance with Article 166(8) CRR by applying a conversion factor to the committed but undrawn amount, the denominators are no longer aligned29. We would propose to amend Article 255(2) and Article 256(1) and (2) CRR to the effect that for purposes of calculating the risk-weights exposure amounts under SEC-IRBA the exposure value and the outstanding balance of a committed but undrawn amount should be the notional amount of the undrawn part of the commitment.

**Determination of K_{IRB} in Article 255 (2) and (3) CRR**

Article 255 (2) and (3) CRR describe the determination of K_{IRB}. Taking this literally, K_{IRB} would be calculated as follows:

\[
\frac{(RWAs + \text{expected loss}) \cdot 8\%}{\text{exposure value}}
\]

However, this must be an error since for the determination of the total capital requirements for non-securitisation exposures, the risk-weighted exposure amounts covering the unexpected losses are multiplied with 8% whereas the expected loss amount is not multiplied by a factor. Therefore, we believe that KIRB must be calculated as follows since the expected loss must be transferred into an 'RWA equivalent':

\[
\frac{(RWAs + 12.5 \cdot \text{expected loss}) \cdot 8\%}{\text{exposure value}}
\]

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28 See EBA-Op-2019-13, page 7 (no. 21): "The EBA, therefore, recommends that the European Commission take action to clarify that, where the caps for securitisations laid down in Articles 267 and 268 of the CRR are applied to NPE securitisations: a) the "expected losses" and "exposure value" referred to in paragraph (3) of Article 267 and paragraph (1) of Article 268 under the SEC-IRBA should be calculated net of the NRPPDs and, where applicable in the case of the originating institution, additional SCRAs ..."

Definition of ‘maturity’ in Article 257 CRR

Article 257(1)(b) CRR only refers to legal maturity, but does not specify whether the original or residual legal maturity is meant. We believe that the maturity of the tranche refers to the residual maturity of the tranche in years and not to the original maturity of the tranche. This is in line with paragraph 22 of the Basel Document on revisions to the securitisation framework (d374).

Definition of ‘5% of underlying exposures’ in Article 261(2) CRR

According to Article 261(2) CRR, the SEC-SA includes specific adjustments depending on transparency about the delinquency status of the underlying exposures in the pool. If, e.g., the delinquency status for more than 5% of the underlying exposures is not known, a risk weight of 1.250% applies as part of the SEC-SA. It is not entirely clear from the wording whether the 95% refers to the total number of exposures or to the total exposure values. We believe that a reasonable interpretation of Article 261(2) CRR would refer to the total exposures values in line with the pre-requisite to apply the SEC-iRBA.

Yours faithfully,

Fernando Conliedo
Vice-Chairman