

16 August 2013

European Banking Authority
Tower 42
25 Old Broad Street
London EC2N 1HQ

By email: EBA-CP-2013-14@eba.europa.eu

cc: Mr Emil Paulis, Director, Financial Markets, European Commission

Consultation paper on draft technical standards on securitisation retention rules – EBA/CP/2013/14

On behalf of the Association for Financial Markets in Europe (**AFME**)¹ and its members, we welcome the opportunity to comment on the consultation paper (EBA/CP/2013/14) (**Consultation Paper**) published by the European Banking Authority (**EBA**) on its draft technical standards with respect to the securitisation retention rules under the Capital Requirements Regulation (**CRR**). In particular, we wish to provide feedback with respect to the draft regulatory technical standards included in the Consultation Paper on the risk retention and due diligence requirements (**RTS**) and with respect to the draft implementing technical standards included in the Consultation Paper on the risk weights which may apply in the case of a breach of such requirements (**ITS**).

This response seeks to summarise the key concerns and comments raised by members with respect to the proposals outlined in the Consultation Paper and, in keeping with the instructions provided, to specifically address in turn each of the questions raised.

The continuing engagement of the EBA with market participants on issues related to the European risk retention regime is greatly appreciated. We would be pleased to meet with you to further discuss any of the matters referred to in this letter.

¹ AFME represents a broad array of European and global participants in the wholesale financial markets, and its 197 members comprise all pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME was formed on 1 November 2009 by the merger of the London Investment Banking Association and the European operations of the Securities Industry and Financial Markets Association. AFME provides members with an effective and influential voice through which to communicate the industry standpoint on issues affecting the international, European, and UK capital markets. AFME is the European regional member of the Global Financial Markets Association (GFMA) and is an affiliate of the U.S. Securities Industry and Financial Markets Association (SIFMA) and the Asian Securities Industry and Financial Markets Association (ASIFMA). AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

Introduction and overview

European securitisation market remains fragile

The European securitisation market remains very fragile and new issuance is very low. AFME's most recent data report shows that while total issuance for 2012 was €251 billion, only some €85 billion – just over one third – was placed with investors. The rest was retained by issuers and used for repo purposes under the central bank frameworks. In 2007, the market was €454 billion of which nearly all was placed, so the market has shrunk by 80% over five years.

Placed issuance in Q1 2013 was only €17 billion compared with €27 billion in the previous quarter. €1.65 trillion was outstanding at the end of Q1 2013, a continued decline, of which more than half was retained.

History of the risk retention rules

As noted in the letter submitted by AFME members to the EBA following the roundtable meeting convened in late 2012, in general, European market participants have adjusted well to the risk retention and due diligence requirements since they came into force at the start of 2011. This is largely because risk retention has always been a feature of the mainstream European securitisation markets, where securitisation has been just one funding tool for regulated banks which have other wholesale borrowing options such as covered bonds, unsecured borrowing and retail deposits. The much-criticised “originate-to-distribute” model has not been a material feature of securitisation in Europe. Therefore, the industry had no objection in principle to the concept of risk retention when first introduced.

Having said that, there was much “devil in the detail” and significant work on the part of both the authorities and market participants went into the establishment of the current well-functioning risk retention regime. This functionality is due in large part to the detailed guidance on the requirements provided by the CEBS guidelines and the EBA Q&A document. Indeed many of our members have indicated that it would not be possible to make sense of the risk retention and due diligence requirements in the context of the full range of relevant transactions without this guidance.

AFME and its members were (broadly) content with the above settlement of the issue of risk retention. Because of this, during the passage of what is now the CRR we deliberately chose not to re-open any of the detailed discussions that took place leading up to the enactment of article 122a. We were keen to demonstrate our commitment to the legislation and to the agreement that had been reached with regulators.

It is therefore disappointing that a step backward has now been taken with the draft RTS. We appreciate that technical standards are different in nature from the previous guidance, and that the EBA has a mandate which is constrained, but new regulation which increases uncertainty and removes flexibility is unhelpful to the hoped-for

recovery in European securitisation, which in turn is so crucial to helping Europe recover from recession.

Had we known this would be the case, we would have taken a different approach to the passage of the primary text in the CRR, and addressed directly the various gaps, shortcomings and ambiguities contained within it, many of which were clarified by the CEBS guidelines and the EBA Q&A document. This option is now, of course, no longer open to us.

Proposals in the Consultation Paper

It is against this background that we have reviewed the proposals set out in the Consultation Paper. The experience gained by AFME members since the requirements took effect at the start of 2011 has provided important insights into the components of the current regime that are essential to its operation. Bearing this in mind, we consider that certain key elements are not adequately addressed in the draft technical standards and, as a result, that certain changes and clarifications are required to ensure the functionality of the CRR regime.

We consider the case for making changes to be clear. The arbitrage prevention sought with the intended move to a harmonised regime will be most successfully achieved if the technical standards are made in a form which is clear in all respects. Moreover, to the extent that the technical standards adopted under the CRR do not support a recast regime which provides sufficient compliance certainty for relevant investors, such standards will operate in effect to create significant disincentives for such investors to participate in securitisation positions. This outcome would restrict the revival of the securitisation market in Europe and, as a result, limit the available funding options for real economy assets. Recent statements made by the EU authorities in support of high-quality securitisations suggest that this is not a desired result. We discuss current EU funding needs and the role of high-quality securitisations below.

Summary of key comments

Based on the foregoing, we respectfully request the EBA and the European Commission (working with other EU authorities as necessary) to use all tools available, including if necessary amendments to the Level 1 text, to address the key issues identified by AFME members under the proposed technical standards in the Consultation Paper (including certain issues relating to the primary Level 1 text of the CRR). These key issues include, amongst others:

- *the need for protection for existing positions structured to be compliant* – the uncertain position of existing transactions structured to be compliant with the risk retention and due diligence requirements on the basis of the current guidance under the CRR regime and the current lack of protection for these positions and for corresponding investors who sought to comply in good faith;

- *confusion regarding the compliance standard for consolidated entity trading activities* – the lack of certainty that an adjusted compliance standard (taking into account the overall risk profile of the group) may continue to be applied under the risk retention requirement in the context of trading book activities undertaken by consolidated entities, which uncertainty will put EU banks at a competitive disadvantage in their trading book activities;
- *confusion regarding the position of pre-2011 previously grandfathered transactions* – the new confusion with respect to whether certain pre-2011 transactions are grandfathered given the removal of the guidance on what will constitute an existing securitisation and a relevant asset substitution under the scope of application provisions;
- *removal of essential retainer flexibility* – the proposed removal of the flexibility for another (“most appropriate”) entity to retain the required interest, which flexibility has been essential to date for a range of transactions which lack an involved originator, sponsor or original lender;
- *significant constraints on making the sponsor definition work* – the numerous technical constraints which arise in respect of the CRR sponsor definition (and corresponding investment firm definition), which constraints will operate to significantly reduce the range of eligible retainers without a clear policy rationale;
- *the need for certainty regarding retention on a consolidated or other related entity basis in all cases* – the lack of certainty that retention may be met on a consolidated group or other related entity basis in all circumstances, regardless of whether or not the identified originator or sponsor is a regulated entity and regardless of its jurisdiction of establishment; and
- *the need for certainty that the originator’s interest in UK mortgage master trusts will satisfy the retention requirements* – the proposals with respect to retention of the originator’s interest under holding option (a) are not clear and clarification is required to ensure that retention of an originator’s interest in this context will be compliant.

Please see our response below for full details with respect to these key issues and a number of other specific concerns.

As a more general matter, we note that concerns have been raised that aspects of the proposed technical standards could be construed to represent a shift to a regime where compliance may be based on a form over substance compliance standard. We note that the current CEBS guidelines indicate that, as a general principle, the economic substance of the entire transaction should be taken into account when assessing whether the retention arrangement meets the requirements. Given the principle-based goal of risk retention (i.e. interest alignment) and that it is not possible for the technical standards to address the full range of possible securitisation structures, AFME members consider that a substance over form approach should

continue to be applied in general and it would be helpful if this was expressly confirmed in the technical standards.

While we understand that the EBA may be unable, on its own, to address all of the concerns raised by members with respect to the Consultation Paper, we have sought with this response to provide comprehensive feedback as we consider that the EU authorities should be aware of the full range of issues which may arise under the recast CRR regime. We are keen to continue to work with the EBA, the European Commission and any other authorities as necessary to identify appropriate solutions.

We thank the EBA for its practical and helpful approach in a number of areas

As a final introductory matter, and while broadly we view the proposed recast risk retention and due diligence requirements as a backward step, we wish to emphasise that we appreciate the practical and helpful approach taken by the EBA in a number of areas of the draft technical standards. While our response focuses on key areas of concern and the required changes, there are a number of items in the proposals which we consider should be maintained. These items include:

- the maintenance of the acknowledgement that certain arrangements achieve alignment of interests automatically;
- the continuing express provision for retention on a synthetic or contingent basis and via a liquidity facility or certain credit support arrangements in certain circumstances;
- the maintenance of an adjusted compliance standard under the due diligence requirements in the context of certain trading book activities (although we note that further clarification would be helpful in this regard, as noted below);
- the maintenance of certain key principles to be applied when considering provisions such as the hedging restriction and the level of information to be provided under the disclosure obligation.

More generally, we welcome the level playing field that the technical standards should bring by being made in the form of a regulation. In this regard, some of our members have noted significant differences, including possible translation errors, between the English version and one or more other language versions of the CRR. We encourage the EBA to be as precise as possible in its final advice on the technical standards as otherwise it is possible that material differences in interpretation may arise between supervisors as a result of the translation process.

EU funding needs and the securitisation market

As a starting point, we wish to highlight that securitisation, sensibly deployed and prudently regulated, has a crucial role to play in providing finance for real economy assets, particularly in light of current economic conditions and as the global banking system continues to undergo major deleveraging.

Recent reports have highlighted that high-quality securitisation provides a number of economic benefits and that securitisation transactions have performed well over the course of the financial crisis (with certain well known and defined exceptions).² The importance of securitisation has been expressly acknowledged by the International Organisation of Securities Commissions (**IOSCO**) in its recent final report on the global regulation of securitisation, where it noted that "securitisation, when functioning properly, is a valuable financing technique contributing to economic growth and an efficient means of diversifying risk".³ This is also acknowledged in the European Commission's Green Paper on long-term financing of the European economy, which paper notes that securitisation "can help financial institutions free capital, which can then be mobilised for additional lending, and manage risk".⁴ Commissioner Barnier has said that securitisation needs a "second wind"⁵ and President Draghi of the ECB has acknowledged that the regulatory constraints on securitisation need to be addressed, and "should acknowledge the credit performance and ensure an unbiased level playing field with other securities".⁶

A large number of regulatory initiatives focused on addressing perceived deficiencies in the securitisation market have been put forward by European and other authorities since the beginning of the financial crisis. These initiatives relate to a range of topics including risk retention, due diligence, transparency and disclosure, regulatory capital requirements, shadow banking and rating arrangements. Regrettably, aspects of this large wave of new legislation and regulation broadly target securitisation as a product rather than targeting specific behaviours.

In the context of risk retention and other reforms, AFME members strongly encourage the EU authorities to ensure that the policy framework does not restrict the continued revival of the securitisation markets. In respect of the proposed technical standards, we encourage the EBA and the European Commission (working with other EU authorities as necessary) to address the concerns highlighted in our response. In the absence of the requested clarifications, we are concerned that material challenges will arise for a much wider segment of the securitisation market than is described in the impact assessment section of the Consultation Paper.

Key comments

Set out below are certain key points which arise under the Consultation Paper that we consider clearly justify further consideration and action. To be clear, AFME members regard each of these points to be vital to the proper functioning of the recast regime

² Please see the September 2012 report by the Association for Financial Markets in Europe (AFME) entitled "The Economic Benefits of High Quality Securitisation to the EU Economy", linked here <http://www.afme.eu/Documents/Statistics-and-reports.aspx>. Please also see Annex II for a summary of updated performance information for certain key asset classes.

³ A copy of the report is linked here <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD394.pdf>.

⁴ A copy of the report is linked here http://ec.europa.eu/internal_market/finances/financing-growth/long-term/index_en.htm.

⁵ A copy of the speech is linked here http://europa.eu/rapid/press-release_SPEECH-13-150_fr.htm?locale=en.

⁶ A copy of the speech is linked here <http://www.ecb.int/press/key/date/2013/html/sp130708.en.html>.

under the CRR. We refer you to Annex I for further discussion of the issues for managed CLOs which arise under the Consultation Paper.

- *Failure to protect and affirm pre-CRD IV transactions structured on the basis of the current guidance punishes those who have sought in good faith to comply, and will cause market instability*

We note that the Consultation Paper does not refer to the position of existing transactions under the CRR regime and, as such, gives rise to significant uncertainty for such transactions where any aspect of the current guidance is relied on and not expressly carried over under the CRR regime. This will be relevant with respect to a large number of transactions.

In circumstances where existing transactions have been structured in good faith to comply with the risk retention requirements on the basis of the current guidance (which is frequently relied on given the lack of clarity of the primary legislative provisions as noted above), we consider that it would be highly problematic if adequate safeguards were not provided to preserve the compliance position of such arrangements for the life of the relevant securitisation position. It would be extremely difficult retrospectively to make changes to such positions given that securitisations in general are long-term transactions involving numerous parties with competing interests who may or may not agree to such changes. In addition, it is not clear that compliance would be feasible through such “retro-fitting” of new requirements in any event.

Given the manner in which the risk retention requirements are framed, a failure to protect existing transactions will effectively penalise relevant investors by restricting the liquidity and, as a result, possibly the valuation of the relevant position. This is notwithstanding that such investors would have fully complied with the requirements to the best of their ability at the time that the position was acquired. Such an outcome would be contrary to the fairness principles of natural justice. We strongly disagree with the statement in the Consultation Paper that the proposed RTS is “not expected ... to have a material impact on transactions that are currently being structured/carried out within the most relevant segments of active securitisation markets”. We encourage the EBA and the European Commission (working with other EU authorities as appropriate) to protect the compliance status of positions issued under securitisations established since the start of 2011. To the extent that changes to the primary Level 1 text are required, we respectfully ask that this be considered at the earliest legislative opportunity.

If this is not considered acceptable, then we respectfully request that confirmation should be provided that credit risk assumption activities undertaken prior to the provisions of the recast CRR regime taking effect (including investments made to date and those made in the coming period before the recast regime is finalised and in full force) will not be at risk of

being subject to additional risk weights. We consider that such reassurance would reflect the fact that relevant investors should not be construed to have been negligent or to have omitted to take any required action where all (final and currently in force) guidance applicable at the relevant time the exposure was assumed has been relied upon. This also reflects the fact that the EBA's mandate in article 410 of the CRR to specify the risk retention and due diligence requirements in greater detail refers to this being done in respect of "the requirements... applying to institutions *becoming exposed* to the credit risk of a securitisation position" (emphasis added). We consider that the wording of article 410 supports the view that the technical standards should not apply retrospectively to positions already held.

In the absence of this confirmation, concerns have been raised that relevant investors may consider that they need to dispose of possible non-compliant positions in the coming period before the CRR regime takes effect, thereby resulting in forced sales and, potentially, market instability in general. It would also create undue uncertainty in the market, as it will be unclear to relevant investors as to the exact requirements which must be complied with at a particular point in time. This concern also illustrates the need for guidance on this point at the EBA level, so as to avoid market disruption as a result of different treatment as between national regulators.

However, to be clear, even if the comfort described above is provided, current investors in existing transactions are likely to see reduced liquidity (and possibly valuations) with respect to the positions held by them unless grandfathering is provided for the life of that position based on the application of the requirements as they were in force at the time the relevant securitisation was issued.

- *The incomplete guidance provided on the compliance standard to be applied by consolidated entities will put EU banks at a competitive disadvantage in their trading book activities*

Under the current regime and also the recast CRR regime, the risk retention and due diligence requirements are in general interpreted to apply from an exposure perspective to EU regulated institutions on a consolidated basis. In other words, the assumption of credit risk exposure to a securitisation position by a regulated institution itself or by its consolidated entities will trigger the application of the requirements.

That said, the current guidance expressly acknowledges that adjusted measures for compliance may be applied by consolidated entities under the risk retention and due diligence requirements in the context of certain trading book activities (taking into account the group's overall risk profile) and also acknowledges that competent authorities may take similar factors into account when judging the materiality of any infringements (see paragraphs 8 and 9 of the CEBS guidelines). This guidance is regarded as providing

essential flexibility for EU banking groups undertaking market-making activities and otherwise operating in non-EU jurisdictions where their activities may involve the assumption of credit risk exposure in respect of primarily local securitisations.

Unhelpfully, the draft technical standards do not expressly carry over this flexibility in the context of the risk retention requirement (i.e. existing paragraph 8 of the CEBS guidelines is not carried over) and article 14(2) of the CRR refers only to adjustments in the context of assessing whether additional risk weights should be applied to infringements by third country related entities. This may operate to provide some relief from the imposition of additional risk weights but the extent of this is uncertain and would appear to turn at least in part on views taken by national supervisors. These views may not be consistent between supervisors, thereby reducing the likelihood of a harmonised regime being achieved as intended. While proposed article 19 of the RTS is helpful from a due diligence perspective, this does not expressly adjust the risk retention compliance standard. Moreover, we understand that the explanatory box in article 19 which refers to market-making activities is not proposed to be included in the final technical standards and we consider that the removal of this wording would reduce the clarity of the guidance intended to be provided in this regard in the context of the due diligence requirements.

The reduction of the current flexibility for certain trading book activities undertaken by consolidated entities raises significant potential operational issues for relevant institutions in general and may operate as an effective restriction on the ability of EU banking groups to remain active in important non-EU securitisation markets. In short, EU banking groups would be placed at a significant competitive disadvantage as compared to domestic (non-EU) entities operating in third country jurisdictions, calling into question the viability of these business lines conducted in third countries.

In addition, heightened issues will arise where different (but not necessarily directly conflicting) retention requirements apply in the relevant third country. While article 14(3) of the CRR provides relief in respect of activities undertaken by certain subsidiaries where it can be shown that the application of the risk retention requirements is unlawful under the laws of the third country where the subsidiary is established, this does not address a scenario where local requirements are different but not directly conflicting (meaning that it may be necessary to retain twice, using two different methodologies) and/or a scenario where the third country retention regime imposes requirements directly on originators and sponsors (rather than investors as under the EU regime) meaning that the third country subsidiary seeking to assume credit risk exposure to third country transactions is not itself directly subject to both regimes and, as a result, that compliance with the EU regime is unlikely to be unlawful per se.

By way of illustration, we note that several EU banks have U.S. broker-dealer subsidiaries which are active in the U.S. domestic securitisation market and which commonly undertake dealing and other trading activities in respect of U.S. deals likely to trigger the application of article 122a (recast as article 405 of the CRR). These domestic transactions are unlikely to be structured to be compliant with the EU risk retention rules as a matter of course (indeed the only EU connection may be through the broker-dealer sitting within a consolidated group with an EU-regulated bank). Moreover, once the U.S. risk retention rules are finalised, such transactions are likely to be subject to the U.S. requirements, which currently propose the imposition of obligations on sponsor entities (rather than investors) and differ in a number of respects from the EU requirements, thereby making compliance with both regimes extremely difficult in the context of certain deals (in the absence of mutual recognition between retention regimes, which unfortunately seems a long way off).

For further information on these differences and the corresponding negative consequences which will arise as a result of the adoption of inconsistent retention regimes as between the U.S. and Europe, please see the detailed submission prepared by the Global Financial Markets Association (**GFMA**) in response to the IOSCO consultation on global developments in securitisation regulation.⁷ Through 2012, AFME was also constructively engaged with various U.S. agencies on how best to coordinate the European and U.S. risk retention regimes, and has made detailed submissions to the U.S. agencies (copied to the EBA) in this regard.

Based on the foregoing, we ask that the EBA include guidance consistent with the current regime (i.e. with paragraphs 8 and 9 of the CEBS guidelines) in its technical standards. We consider that the EBA should be able to fully carry over the current guidance given that it has a general mandate to develop technical standards on the retention and due diligence requirements applying to institutions becoming exposed to the risk of a securitisation (as described in article 410(2)(a)) and this naturally extends to how the requirements should apply to consolidated entities. We also consider that the requested guidance is necessary for the flexibility contemplated by article 14(2) of the CRR to operate sensibly.

Please also see our comments below on the scope of article 14(3) of the CRR and the general concerns which arise under the U.S. Volcker Rule proposals.

- *Securitisations established before 2011 may no longer be clearly grandfathered in the absence of confirmation as to what is an existing/new securitisation and a relevant asset substitution*

⁷ A copy of the response is linked here <http://www.gfma.org/correspondence/item.aspx?id=338>. A copy of AFME's response to the consultation on the U.S. risk retention rules is linked here <http://www.sec.gov/comments/s7-14-11/s71411-111.pdf>.

Whereas the current guidance provides important clarification with respect to matters relating to the grandfathering provision for pre-2011 transactions (see paragraphs 131 to 137 of the CEBS guidelines), the Consultation Paper does not refer to this. In particular, the Consultation Paper does not clarify the position of pre-2011 established transactions (including programmes and conduits) and liabilities issued under them and/or confirm what will constitute a relevant asset substitution or addition which could put the current grandfathering treatment at risk.

This approach runs the risk of creating new confusion in the market with respect to the timing of application of the requirements, particularly for arrangements established prior to 2011 and including where such arrangements involve the issuance of new liabilities (see paragraph 132 of the CEBS guidelines). The absence of any guidance on these issues is highly problematic. In particular, if the proposals are adopted in their current form, national supervisors may assess what is an existing securitisation differently. For example, arrangements involving new issuances could be classified differently and/or certain common asset adjustment provisions could be regarded to be relevant asset substitutions, thereby bringing pre-2011 transactions within scope notwithstanding that such arrangements are not typically understood by market participants to be asset substitutions per se.

For example, the removal of the current guidance raises questions with respect to the circumstances described in paragraph 134 of the CEBS guidelines, including:

- asset replacements and cash repurchases in connection with specific contractually defined events such as breaches of warranties;
- product switches; and
- amendments to underlying exposures (such as maturity extensions).

The treatment of these arrangements as relevant asset substitutions would not be consistent with our understanding of the policy objective of the existing grandfathering provisions, which is to capture pre-2011 issuances involving an actively revolving or dynamic pool of underlying assets or asset substitutions or additions resulting in a material increase in the originally agreed risk profile.

We note separately that the proposed removal of the current guidance presents related issues for managed CLOs which are outside of their reinvestment period after 31 December 2014 and these are discussed in Annex I.

As it will be extremely difficult for documents for existing transactions to be amended to remove the relevant provisions (owing to the fact that such transactions will involve numerous parties with competing interests who may

or may not agree to such changes), under the new regime affected investors may be forced to sell their pre-2011 non-compliant positions prior to 2015 to avoid punitive capital charges or suffer from decreased liquidity in their investment.

While we understand that the EBA's mandate to prepare technical standards does not expressly refer to the scope of application of the relevant requirements of the CRR (set out in article 404), we consider that matters related to scope are implicitly drawn into the EBA's mandate to specify in greater detail the risk retention and due diligence requirements, as the starting point for compliance with such requirements is being able to identify with certainty when such requirements apply. The importance of this issue should not be underestimated. Any clarification that the EBA is able to provide in this regard would be welcomed.

- *The proposals do not maintain the existing flexibility for retention by other appropriate entities which is important for a range of transactions*

We note that the Consultation Paper does not carry over the current guidance which provides (limited) flexibility for an entity other than the originator, sponsor or original lender to retain the required interest in certain circumstances (set out in paragraphs 25 and 26 of the CEBS guidelines and certain corresponding provisions in the EBA Q&A document).

As acknowledged in the Paper, this omission is problematic in particular for managed CLOs given the challenges such transactions present from a retention perspective and the reliance placed on the current guidance in certain recent transactions (portions of which guidance we note were expressly labelled by the EU authorities as being intended for use in a managed CLO context). While the Consultation Paper suggests, in the impact assessment section, that other options will be available under the CRR framework for managed CLOs in particular, we would note that such options do not take account of the full regulatory picture for CLO managers and as such do not necessarily present a meaningful way forward (see Annex I for our detailed comments on the issues for managed CLOs).

In addition, it should be noted that the issues which arise in connection with the removal of the current guidance are not restricted to managed CLOs. The securitisation definition draws in a range of transactions under the risk retention requirements, a number of which do not fit neatly within the traditional template assumed by the provisions. Accordingly, the current guidance has been relied on in various different types of securitisations to date, including a number of funding and disposal transactions related to bank deleveraging initiatives.⁸ These transactions are often done on a private basis

⁸ For instance, these transactions may involve an entity disposing of a portfolio of assets, where that entity has no intention of having an on-going stake in the assets or in the financing of the acquisition – such as a bank selling a portfolio of non-performing loans as part of a deleveraging programme. Often, the bidder/purchaser of these assets is

and their significance in terms of market share is therefore more difficult to quantify. It is our understanding that there is a relatively substantial amount of bank deleveraging activity still to come and we consider that these activities could be obstructed by the removal of the current flexibility. It is important that these arrangements are appropriately considered and that the full consequences of the removal of the current flexibility are understood.

Without any flexibility, significant concerns have been raised that it would no longer be possible to effectively structure these transactions to be compliant, meaning that relevant regulated investors would be effectively restricted from investing in these arrangements and, in turn, that available funding and asset disposal options would be restricted. To be clear, the issues in this regard are not addressed by the changes made to the sponsor definition under the CRR and/or by the proposed addition of a definition of original lender in the technical standards (discussed below).

- *The investment firm definition fails to broaden the range of eligible sponsors as intended and does not reflect a clear policy rationale*

While it is suggested in the impact assessment section of the Consultation Paper that the new reference to investment firms in the sponsor definition in the CRR will provide meaningful increased flexibility and assist with the identification of an eligible retaining entity in certain circumstances (including in the context of managed CLOs, discussed further in Annex I), this is unlikely to be the case given the inherent constraints of the relevant definitions.

In this regard, we note that amendments made to the investment firm definition in the CRR mean that firms lacking authorisation to undertake certain services and which are not allowed to hold client monies will not be investment firms for these purposes. It is difficult to see why an authorisation to hold client monies should be relevant in determining whether an entity is an eligible retainer, as performing the function of sponsor and retainer does not create an exposure to that entity which would warrant the higher regulatory burden of performing custodial services. Moreover, to the extent that firms are required to become regulated as alternative investment fund managers (AIFMs) under the Alternative Investment Fund Managers Directive, they will not be able to be investment firms.

The investment firm definition is also limited by the fact that only entities established in Europe may fall within it, which is unduly restrictive given the potential global scope of application of the risk retention provisions. This required EU nexus is also out of step with the credit institution definition

a special purpose vehicle (SPV)), established by the "equity" investor (such as a private equity group or joint venture). The SPV will be funded by (i) senior bank debt and (ii) subordinated debt from the equity investor or a related party. These are private deals with sophisticated investors, but unfortunately in certain cases they may fall within the broad definition of "securitisation". As the originator/original lender is disposing of the assets, it would not make sense for it to retain the 5%, nor is there a sponsor in a deal such as this. Accordingly, the 5% is held by the subordinated debt provider, which makes sense as it is taking the risk and reward. Numerous sales of assets by banks have been funded in this manner.

(which would appear to be available to EU and non-EU entities equally). It has been queried whether the EBA may be able to provide guidance which permits “recognised third country investment firms” (as defined under the CRR) also to be regarded as being within the sponsor definition. If possible, such an extension may be helpful but further analysis would be required with respect to the usual authorisation arrangements and practices for relevant entities in key third countries in order for any meaningful benefit to be determined. Given that the definition of recognised third country investment firm cross-refers to the CRR definition of investment firm (i.e. by referring to a firm which “if it were established in the Union, it would be covered by the definition of an investment firm”), the constraints described above regarding the required authorisation to hold client money would apply.

The definitional constraints outlined above will mean that a wide community of firms will not be sponsors, notwithstanding that this is unlikely to be intended and that, from a policy perspective, it would make sense for all types of regulated entities (regardless of their jurisdiction of establishment or regulation) to be eligible to retain if they otherwise fall within the sponsor definition. We appreciate that the definitions are Level 1 text matters but, to the extent that there is any scope for change, we ask that this be pursued to ensure that appropriate interest alignment arrangements are structured on a compliant basis.

- *The market needs clarifications to enable eligible sponsors to be identified*

In addition to the constraints of the investment firm definition described above, it should be noted that other aspects of the sponsor definition may operate to significantly reduce the range of entities which may fall within it unless an appropriate interpretation is adopted. In particular, we note that the definition excludes originator institutions but it is not clear that this should only be the case where the relevant entity acts as originator in respect of all of the assets (rather than just some). In the absence of confirmation that an originator of *some* of the securitised exposures may be the sponsor, it will be difficult for market participants to make the sponsor definition work sensibly in a non-conduit context. The policy rationale for preventing an entity from being a sponsor in such circumstances is not clear.

Once again, we appreciate that the sponsor definition is a Level 1 text matter but we consider that it should be possible for clarification to be provided in the technical standards that the exclusion of the originator from the sponsor definition would only exclude an entity acting as the *sole* originator in the transaction.

As a general matter, we note that, if the limited flexibility for another appropriate entity to retain is not maintained (as the proposals suggest will be the case), the definitions of originator, sponsor and original lender will come under heightened focus as market participants seek to make sense of the

requirements in a range of scenarios. All available clarifications will therefore be key.

- *The treatment of multiple originators or sponsors needs clarification to function sensibly*

Under the Consultation Paper, it is proposed that, “where the securitised exposures in a transaction were created or sponsored by multiple originators, sponsors or original lenders, the retention shall be fulfilled...” by each originator, sponsor or original lender (as the case may be) in proportion to the total securitised exposures for which it is the originator, sponsor or original lender, respectively.

While the current guidance refers to the application of a similar principle in general (in paragraph 29 of the CEBS guidelines), it also permits one originator to retain on behalf of others in certain limited circumstances (i.e. where that originator is the originator with respect to a majority of the securitised exposures and undertakes certain structuring and asset selection activities) (see Q16 of the EBA Q&A document). The flexibility for one (more actively involved) originator to retain on behalf of others in certain circumstances is a sensible alternative which in certain contexts is likely to achieve more appropriate alignment of interests with investors and clearer retention commitment disclosures for investors.

The Level 1 text does not restrict this alternative interpretation as it refers only to retention by an entity which is an originator and does not require that entity to be the originator with respect to all of the assets. As such, we are seeking flexibility for retention in proportion (as contemplated by the Consultation Paper) and also for one (more actively involved) originator to retain on behalf of others.

Moreover, we note that proportionate retention is not meaningful in the case of sponsors given that, in general, the nature of the sponsor role is one which applies in respect of the arrangement as a whole (and this is consistent with the references to involvement in the establishment and management of the scheme in the definition), rather than in respect of certain aspects of the arrangement or in respect of certain securitised exposures. In this regard, it is unclear what is meant by the reference in article 4 of the draft technical standards to “securitised exposures in a transaction... sponsored by multiple... sponsors”. If an entity is a sponsor, we consider that it will be a sponsor with respect to the entire scheme and it should be able to retain on this basis, regardless of whether or not there may be other entities involved in the transaction that might also be construed to fall within the sponsor definition.

We encourage the EBA to clarify the matters referred to above in the technical standards.

- *Flexibility for retention on a consolidated basis or by other related entities is essential*

It is not clear under the draft technical standards whether in all circumstances the retained interest may be held on a consolidated basis (i.e. by an entity within the eligible retaining entity's consolidated group for regulatory or accounting purposes) or by other related entities.

While the current guidance indicates that this is acceptable (on the basis of the regulatory or accounting consolidated group) (see paragraphs 70 and 71 of the CEBS guidelines and Q21 of the EBA Q&A document), the proposals set out in the Consultation Paper refer to retention on a consolidated basis only indirectly in the context of draft article 14, which refers to article 394(2) (finalised as article 405(2)) of the CRR. This does not make it sufficiently clear that retention on a consolidated basis (from a regulatory or an accounting perspective) is permitted outside circumstances where a relevant regulated entity or a subsidiary securitises exposures from several institutions included in the scope of supervision on a consolidated basis. In addition, this does not provide sufficient flexibility for unregulated entities and/or non-EU entities.

We understand that the lack of clarity on this point may be unintended, which makes sense given that provision for retention on a consolidated or other related entity basis is justified and consistent in principle with various matters under the Level 1 text, including the references in the originator definition (and the proposed original lender definition) to "related entities" in general and also with article 13 of the CRR and the approach of applying the risk retention requirements to relevant regulated institutions and their consolidated entities (as this indicates that an institution is generally considered to be exposed to the credit risk of a position by virtue of the relevant activities of related entities).

To be clear, the ability for retainers to hold the required interest on a consolidated or other related entity basis is essential for EU and non-EU entities, and for regulated and unregulated entities, alike. To ensure that this point is sufficiently clear, we strongly encourage the EBA to expressly confirm in the technical standards that retention on a consolidated basis (from a regulatory or an accounting perspective) or by another related entity is acceptable in all circumstances, regardless of the nature of the eligible retaining entity (including whether or not the relevant entity is regulated and whether or not it is established in the EU).

We further note that aspects of article 405(2) are confusing and any further guidance that the EBA can provide on this provision would be helpful. For example, it would be helpful if the EBA could confirm that this provision should not be read to apply only where exposures are securitised by several institutions within the scope of supervision on a consolidated basis.

- *Significant real economy funding raised by UK mortgage master trusts will be at risk without clarification of the availability of a holding option based on the originator's interest*

Whereas the current guidance clearly confirms that the originator interest holding option is available not only for securitisations of revolving exposures, but also for revolving securitisations of non-revolving exposures (see paragraph 48 of the CEBS guidelines), the draft technical standards do not include this confirmation. This gives rise to potential new compliance issues in the context of relevant revolving transactions, including UK mortgage master trust programmes, which programmes have operated to provide important access to capital markets funding for UK credit institutions in recent years.⁹

Given this background, AFME members consider it to be essential that a holding option is made available on a basis which clearly works for the originator's interest in all revolving securitisations, regardless of the nature of the underlying assets. To the extent possible, we encourage the EBA (working with other EU authorities if necessary) to replicate the current guidance so that the holding option which expressly – and clearly – provides for retention through an originator interest (i.e. option (b)) is available equally for revolving securitisations of non-revolving exposures.

If this is not possible and it is instead necessary to use the vertical slice holding option as described in the Consultation Paper, then we would note that concerns have been raised that the proposals may not operate as intended and certain clarifications are required. Please see our response to Q3 below for details. We would be happy to work with the EBA as necessary to ensure that a solution is identified on this front.

- *Need for protection for all positions encompassed by the correlation trading portfolio, including trades on bespoke baskets*

Whereas the current guidance clearly addresses the position of all securitisation positions held in the correlation trading portfolio under both the risk retention requirement (through clarification of the exemptions) and the due diligence requirement (see paragraphs 73, 74 and 81 of the CEBS guidelines), the proposals in the Consultation Paper do not. In particular, the proposals do not properly pick up trades on bespoke baskets as described in article 338(1)(b)(i) of the CRR in the reference to “single-name instruments, including single-name credit derivatives, for which a liquid two-way market exists”.

It is essential that trades on bespoke baskets are also expressly confirmed to be within the relevant exemption and the due diligence guidance in order to

⁹ Please see the issuance information set out in Annex III for further details on this.

preserve the functionality of the requirements in the context of these arrangements.

Please see our response to Q9, 10, 12 and 13 below for details with respect to our concerns and also for our suggested minor amendments to the relevant articles in the proposed technical standards.

- *Liquidity facilities should be within scope based on credit risk exposure, not conditions for “eligible liquidity facilities”*

The legislative provisions under the current regime and also under the CRR with respect to the risk retention requirement indicate that the requirement applies where a relevant entity assumes credit risk exposure to a securitisation position. The current guidance seeks to explain when this may be triggered in the context of liquidity facility providers and swap counterparties and, as a bottom line, confirms (consistent with the Level 1 text) that the analysis should turn on whether the relevant arrangement involves the assumption of exposure to credit risk arising from principal losses on the securitised exposures or positions (see paragraphs 12 and 13 of the CEBS guidelines).

While this principles-based guidance is effectively carried over in the draft technical standards in the context of swaps, the proposed guidance on liquidity facilities is more restrictive and appears to seek to set a different standard (i.e. different from the current guidance and, more importantly, different from the underlying legislative provisions). In particular, the relevant proposed provision indicates that a liquidity facility provider will be deemed to become exposed to the credit risk of a securitisation position unless the (restrictive) conditions for “eligible liquidity facilities” (as they are referred to under the current CRD regime in Annex IX, part 4, paragraph 2.4.1) are satisfied.

We agree that such eligible liquidity facilities should not be within the scope of the requirements (because the provider does not assume credit risk exposure in these circumstances) but this is not the only type of liquidity facility in respect of which the provider will not be exposed to the credit risk of the securitisation. For example, in the case of liquidity facilities provided in term ABS transactions (as opposed to in ABCP conduits), these usually contain provisions which prevent further drawdowns if there is an event of default or potential event of default and drawn amounts will generally be payable in the next interest period at the top of the priority of payments.

On this basis, we respectfully request that the EBA does not seek to effectively gold-plate the requirements in this regard and we ask that it clarifies (in keeping with the current guidance) that liquidity facility providers will not be subject to the risk retention requirements in general where such providers are

not assuming exposure to credit risk arising from principal losses on the securitised exposures or securitisation positions.

- *EU risk retention requirements may conflict with the U.S. Volcker Rule and U.S. risk retention rules*

Concerns have been raised that the Volcker Rule, if adopted by the U.S. authorities on the basis of previously published proposals, may restrict European institutions from retaining an interest in securitisations as required to achieve compliance with the EU requirements.

Under the U.S. proposals, covered banking entities (which would include a non-U.S. banking organisation with a branch or agency in the U.S.) would be prohibited in general from retaining an interest in respect of certain securitisation vehicles and/or from entering into certain transactions with such vehicles. Relevant interests and transactions are proposed to be widely defined for these purposes and would extend to retention arrangements which would operate to achieve compliance with the EU retention regime. While the proposals include certain exemptions, including a risk retention exemption, the relevant provisions would not address the full range of potential issues and the risk retention carve-out is limited to arrangements required under the U.S. Dodd-Frank Act (with no provision being made for compliant arrangements under the EU requirements).

To be clear, article 14(3) of the CRR would not assist in providing relief in this regard. As noted above, article 14(3) of the CRR indicates that the risk retention and due diligence requirements shall not apply in respect of third country subsidiaries if it can be demonstrated that the application of such requirements is unlawful under the laws of the third country where the subsidiary is established. Given the manner in which the Volcker Rule provisions would apply to non-U.S. banking groups (i.e. to restrict retained interests held by a banking group originator or sponsor) and that the EU risk retention provisions apply to relevant entities as investor (rather than as retainer), the application of the EU risk retention and due diligence requirements to third country subsidiaries seeking to invest in securitisations would not be unlawful under the proposed Volcker Rule provisions as such provisions would not apply to an entity *as investor*. The retention of the required interest by the bank originator or sponsor would instead be unlawful under the proposed Volcker Rule and of course this is not directly required under Part Five of the CRR (as the EU retention regime imposes obligations primarily on investors instead), meaning that article 14(3) would not provide any relief.

While we appreciate that the EBA may be unable to address these issues on its own, we wish to highlight our concerns regarding the Volcker Rule in this response as this represents another issue which may interfere with the sensible operation of the EU retention regime. For further details with respect

to the concerns of AFME members in this regard, please see the detailed submission submitted by AFME to the U.S. authorities in response to the Volcker Rule proposals.¹⁰

Lastly, as noted above, we also have significant concerns with respect to the interaction of the EU retention regime with the proposed U.S. retention regime. For further information on the negative consequences which will arise as a result of the adoption of inconsistent retention regimes as between the U.S. and Europe, please see the detailed submission prepared by the GFMA in response to the IOSCO consultation on global developments in securitisation regulation.¹¹

When risk retention regimes come into effect in the U.S. or other jurisdictions, it is possible that some existing securitisations which currently satisfy a form of risk retention under the CRR may need to satisfy these additional risk retention regimes. For example, an existing securitisation structure may issue new notes to U.S. investors and be obliged to comply with the U.S. risk retention rules. Although the potential for restructuring securitisations to satisfy multiple risk retention regimes may not be readily available in all circumstances, it would be helpful if the RTS would expressly recognise that a retainer may change the form of risk retention in order to deal with the application of new risk retention rules from other jurisdictions. We respectfully request that the RTS include provisions which would allow a retainer to modify the form of risk retention if the modification is being implemented to satisfy the risk retention requirements of another jurisdiction and the new form of risk retention otherwise satisfies the requirements of the CRR. This clarification would appear to be within the remit of the EBA under article 410(2)(b) and might alleviate some of the potential conflicts noted in the IOSCO final report on the global regulation of securitisation.

¹⁰ This submission can be accessed via the following link: <http://ftp.sec.gov/comments/s7-41-11/s74111-239.pdf>.

¹¹ A copy of the response is linked here <http://www.gfma.org/correspondence/item.aspx?id=338>. A copy of AFME's response to the consultation on the U.S. risk retention rules is linked here <http://www.sec.gov/comments/s7-14-11/s71411-111.pdf>.

Responses to specific questions

A. Questions relating to Draft RTS on the retention of net economic interest and other requirements related to exposures to transferred credit risk

Q1. The EBA would like to know to what extent securitisations rely on paragraphs 25-26 of the CEBS Guidelines in order to achieve the retention commitment and would also like to understand if these transactions could also meet the requirements set out in article 394(1) of the CRR [finalised as article 405(1)] without applying the criteria provided in paragraphs 25 and 26 of the CEBS Guidelines on articles 122a of Directive 2006/48/EC taking into account the definition of securitisation according to article 4(37) of the CRR [finalised as article 4(61)] and the respective definitions of originator, sponsor or original lender.

The (limited) flexibility provided by paragraphs 25 and 26 of the CEBS guidelines (and certain corresponding provisions included in the EBA Q&A document) for another appropriate entity to retain is a key component of the current guidance and is considered by AFME members to be essential to the proper functioning of the risk retention regime in general. As acknowledged in the Consultation Paper, managed CLOs are an important example of the types of transactions which have sought to date to rely on the guidance. The concerns which arise under the proposals in respect of CLOs are set out in Annex I.

However, it is important to note that reliance on paragraphs 25 and 26 has not been limited to managed CLOs. Indeed the current guidance has been applied to various types of funding and disposal arrangements involving real economy assets since the risk retention requirements took effect. This reliance has been driven in part by the wide range of transactions caught by the securitisation definition which applies to determine the scope of application of the risk retention requirements. As the authorities are aware, the securitisation definition is broadly drafted and potentially captures a spectrum of credit risk tranching transactions, including arrangements which may lack an involved originator or sponsor.

In general, market participants have worked hard in the context of the transactions done to date in reliance on the guidance to find a way forward and, importantly, to comply with the spirit of the principles referred to therein. Given that these principles require the identification of the entity whose interests are most appropriately aligned with investors (including in circumstances involving an entity which might technically fall within the originator definition), the removal of the current flexibility will not only present significant compliance challenges for relevant arrangements but may result in the use of alternative retention arrangements going forward (to the extent that an alternative can be found) which are technically compliant but do not clearly achieve the most appropriate alignment of interests. The current guidance operates to deliver an appropriate outcome by permitting another “most appropriate” entity to retain in certain circumstances and, in general, we consider that a substance over form approach best achieves the general policy objectives of the risk retention regime.

It should also be noted that a number of the arrangements which have relied on the current flexibility have been driven by bank deleveraging initiatives. In particular, certain of these arrangements have involved the disposal of asset pools through arrangements involving the creation of a new funding vehicle sponsored (in a traditional sense) by an entity which typically maintains the first loss position but does not satisfy the sponsor definition (as it is not a credit institution or, after CRD IV takes effect, an investment firm). It is hoped that changes to the risk retention regime through the revised guidance will not jeopardise the feasibility of these transactions going forward. We note that these transactions are often done on a private basis and their significance in terms of market share is therefore difficult to quantify. Nevertheless it is important that these arrangements are appropriately considered and that the full consequences of the removal of the current flexibility are understood. It is our understanding that there is a relatively substantial amount of bank deleveraging activity still to come.

To be clear, in the absence of the current guidance, it may not be feasible for the transactions described above to comply with the risk retention requirements. This would not change with the expansion of the sponsor definition under the CRR to also include (certain) investment firms and/or with the addition of the proposed original lender definition. The current guidance has been used to date in general in the context of arrangements which have otherwise challenged the transaction template assumed by the retention requirements.

Alarming, if the current guidance is not carried over, it appears that compliance may be an issue not only for new arrangements, but also for those issued to date in reliance on the current guidance, notwithstanding that such guidance encapsulated the only formal EU-level guidance available from the authorities on how to achieve compliance from a risk retention perspective. This is a key issue. As noted above, we have significant concerns with the current lack of provision for protection for the compliance position of existing arrangements. A failure to provide this protection will ultimately penalise investors and potentially threaten the wider stability of the market. We strongly encourage the EBA (working with the other EU authorities as necessary) to provide the necessary safeguards to protect existing positions.

Q2: The EBA would also like to understand if, for new securitisations - there are transactions that are likely not to be able to meet the retention requirements following the CRR and associated draft RTS.

Based on the draft technical standards, we are concerned that compliance issues would arise in the context of various new transactions under the recast retention regime. In particular, based on the proposed removal of the flexibility for another entity to retain the required interest, we consider that significant issues are likely to arise in the context of managed CLOs (discussed in Annex I) and other types of transactions falling within the securitisation definition that lack an involved originator, sponsor or original lender. To be clear, the issues in this regard are not

addressed by the changes made to the sponsor definition under the CRR and/or by the proposed addition of a definition of original lender in the technical standards.

As noted above, compliance issues would also arise for transactions involving multiple originators or entities which could be construed to be multiple sponsors as the guidance to retain in proportion does not work in general. Also, in the absence of clarification regarding retention through the originator's interest, potential issues would also arise under the recast regime for revolving securitisations involving non-revolving assets (including UK mortgage master trusts, discussed below).

It should also be noted that compliance challenges may arise for third country market participants seeking to access EU-regulated investors, particularly given that the sponsor definition would appear not to be available in respect of non-EU regulated investment firm entities. This would limit the universe of entities permitted to retain in the context of non-EU transactions in general. As noted above, the jurisdictional scope constraints of the investment firm definition (which is cross-referred to in the sponsor definition) do not make sense in the context of the risk retention requirements, which may apply regardless of the jurisdiction of the relevant securitisation.

The issues for third country originators and sponsors will be heightened to the extent that the relevant third country originator or sponsor is subject to a local retention regime which does not line up in all respects with the European regime. This is expected to be an issue for U.S. entities. For further information on the concerns of AFME members with respect to the proposed risk retention requirements put forward in the U.S., we would direct the EBA to the detailed response prepared by the GFMA¹² in response to the IOSCO consultation on global developments in securitisation regulation.¹³ As the GFMA response makes clear, our concerns in this regard relate in large part to the significant mismatches (rather than direct conflicts) between the EU regime and the U.S. proposals and to what we consider to be a clear need for a mutual recognition and acceptance process to preserve cross-border market access and liquidity.

While this question seeks input in the context of new securitisations, based on the draft standards, it should also be noted that key compliance issues will arise in respect of existing securitisations structured to be compliant with the current guidelines (see our comments above on the need for protection for existing arrangements) and also in respect of pre-2011 established transactions (see our comments above on the need for guidance on the scope of application provisions). It will be extremely difficult for many of these transactions to be made compliant as this will not be contemplated by the documents and transaction parties may not agree to

¹² The Global Financial Markets Association brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA.

¹³ A copy of the response is linked here <http://www.gfma.org/correspondence/item.aspx?id=338>. A copy of AFME's response to the consultation on the U.S. risk retention rules is linked here <http://www.sec.gov/comments/s7-14-11/s71411-111.pdf>.

changes and, as a result, relevant investors will experience constrained liquidity for relevant positions and possibly consider themselves forced to sell their positions to avoid punitive capital charges.

Q3: To the extent securitisations have relied on paragraph 48 in the CEBS Guidelines on article 122a of Directive 2006/48/EC to meet the retention requirements, would there be any material impact (be it economic, operational, etc.) to now complying with retention option (a) of article 394(1) [finalised as article 405(1)] of the Regulation (EU) No 575/2013 rather than relying on the provisions of paragraph 48 in the CEBS Guidelines on article 122a of Directive 2006/48/EC in order to meet the retention requirements?

A significant level of reliance has been placed on the guidance currently provided in paragraph 48 of the CEBS guidelines for use of the originator interest holding option in the context of revolving securitisations of non-revolving exposures.

In particular, this guidance has been relied upon in the context of UK mortgage master trusts. While most of these arrangements were established prior to 2011 – meaning that, under the current guidance, compliance with the retention requirements is not yet required – relevant investors have been keen to understand how compliance will be achieved when the transactions come within scope and originators have sought to accommodate such requests by providing preliminary retention commitments. In general, these commitments have been provided in reliance on the current guidance which indicates that the originator interest holding option (option (b)) may also be used in the context of revolving securitisations of non-revolving assets.

Unfortunately, this aspect of the current guidance is not proposed to be carried over in the technical standards. The lack of provision for the use of the originator interest holding option in this context gives rise to new compliance uncertainty. To the extent possible, we encourage the EBA (working with the EU authorities if necessary) to replicate the current guidance so that the holding option which expressly – and clearly – provides for retention through an originator interest (i.e. option (b)) is available equally for revolving securitisations of non-revolving exposures. We can think of no reason why there should be a difference in treatment for these transactions from a policy perspective.

To the extent that it is not possible to carry over the current guidance and retention option (a) is instead to be made available for certain originator interest arrangements, we agree that care must be taken to ensure that the proposed flexibility would work for relevant arrangements as intended. In this regard, we note that the proposals indicate that, in the context of revolving securitisations, an originator's interest would be deemed to fall within the holding option provided that such interest "was for at least 5% of the credit risk of each of the securitised exposures and ranked at least pari passu with the credit risk that has been securitised with respect to those same exposures". Certain questions have been raised in respect of these conditions and we consider that it would be necessary for these points to be

addressed in order to ensure that retention option (a) would work in practice for an originator's interest in the context of revolving securitisations. The current lack of clarity gives rise to uncertainty as to whether the proposals would work for a typical originator's interest in the context of UK mortgage master trusts.

Firstly, as noted above, the reference to "at least pari passu" in the context of the originator's interest is confusing. In particular, this reference could be read to require the originator's interest to rank pari passu or in priority to the credit risk that has been securitised, which would seem inconsistent with the objective of interest alignment and would not reflect the usual terms of relevant arrangements such as UK mortgage master trust transactions. Under the terms of such transactions, credit losses on the securitised assets will be allocated on a pro rata and pari passu basis and revenue/interest receipts will be allocated on a pro rata and pari passu basis, but distributions of principal receipts will be made to the funding entity (being an intermediary entity which effectively represents the interest with respect to the credit risk that has been securitised) in priority (in respect of time) to amounts paid to the seller if the funding entity has a repayment requirement or a requirement to accumulate cash and provided that an "asset trigger event" has not occurred. As a result, the funding entity's interest may be prioritised over the originator's interest in respect of certain payments in certain circumstances.

We note that the confusion described above turns in part on what is meant in the proposals by the reference to the "credit risk" of the securitised exposures (i.e. in the reference to the originator's interest ranking "at least pari passu with the *credit risk* that has been securitised"). If this concept is intended to mean the risk of principal losses based on the nominal amount of the exposures, then the proposed condition may work for UK mortgage master trust transactions given that, as noted above, credit losses on the securitised assets will be allocated on a pro rata and pari passu basis at all times (whereas receipts may be distributed as described above). If it is intended that this concept should correspond to the risk of principal losses then it would be very helpful if confirmation of this could be provided. Such confirmation would also provide clarity with respect to the calculation and measurement of the retained interest (making it clear that such interest should correspond to at least 5% of the nominal value of the securitised exposures, consistent with retention holding option (b)).

Q4: Do you consider that this way [liquidity facilities in ABCP programmes] to comply with the retention requirement under option (a) should be explicitly mentioned in the RTS?

In general, the inclusion in the technical standards of specific examples of the forms which may be used to satisfy the various retention holding options is very helpful and is welcomed by AFME members.

We consider that the confirmation provided in the draft technical standards (in keeping with the current guidance) that the vertical slice holding option may be held in the form of a liquidity facility in the context of ABCP programmes (subject to the

satisfaction of certain requirements) is positive. Indeed, AFME members consider that the proposed article provides essential certainty that relevant liquidity facilities may be used to satisfy the retention requirements.

This certainty is expected to become increasingly important when most conduits (as pre-2011 established arrangements) have to comply with the risk retention and due diligence requirements after the end of 2014 when new assets are added (assuming that pre-2011 established arrangements are still intended to be caught only after the end of 2014, which is an area of uncertainty under the draft standards as noted above).

Based on the foregoing, we welcome proposed article 6(1)(b) and strongly encourage the EBA to ensure that this provision is included in its final advice.

In the absence of explicit mention in the RTS, there is a concern that relevant investors would not be able to determine with sufficient certainty that retention via a liquidity facility as described would be an acceptable form under retention holding option (a). This would be a particular concern given that the current guidance expressly refers to this, meaning that its absence from the technical standards would beg the question as to whether relevant arrangements are still considered acceptable.

Q5: Do you consider that the conditions enumerated in article 6.1(b) are correct and sufficient? If not, which conditions would you add/change/remove? Why?

In general, we consider the conditions set out in proposed article 6.1(b) to be correct and sufficient.

That said, there is one point which AFME members would like to clarify with respect to proposed condition (i) which refers to the facility covering “100% of the credit risk (on a contingent or drawn basis) of the underlying exposures”.

We assume that this condition is intended to mean that the facility should cover the full amount of the assets financed by the vehicle (i.e. to cover the full amount of the issued commercial paper, which will take into account any discounts or other first loss absorption features in the underlying sale arrangements). This approach is consistent with a vertical slice holding option and reflects the reference in the condition to the “credit risk” of the underlying exposures (taking into account that this should be assessed from a programme-wide perspective). However, to avoid possible confusion, it would be helpful to receive express confirmation of this interpretation in the technical standards.

Q6: Do you consider that the retention option (d) under article 8.1(b) via the provision of a liquidity facility should be explicitly mentioned in the RTS? Please also specify reasons why this provision should explicitly remain in the RTS?

Please see our response to Q4 above. The same points would apply here.

In short, AFME members consider the inclusion of this guidance to be very helpful and it is expected that significant reliance will be placed on this when many conduit arrangements (as pre-2011 arrangements) come within scope after the end of 2014. We strongly encourage the EBA to maintain reference to this holding form in its final advice.

We would like to clarify certain matters relating to the available first loss tranche holding options in the context of ABCP programmes. As we understand it, when a liquidity facility does not meet the conditions proposed to apply in the context of article 8.1(b), it is still possible for the retention requirement to be satisfied via a letter of credit (or other form of credit support) provided that the conditions in article 8.1(a) are satisfied. Alternatively, the required interest may be retained via the original sellers through a first loss exposure at the underlying transaction level (although a combination of programme-wide and transaction-level arrangements may not be used). If the EBA does not agree with this summary, then it would be helpful to better understand the view of the authorities in this regard.

We would also like to clarify our reading of proposed article 8.3. It is our understanding that this article is intended in part to confirm that the holding forms referred to in articles 8.1(a) and (b) will satisfy the first loss tranche holding option (option (d)), notwithstanding that such forms may technically constitute a second-loss exposure at the securitisation programme-wide level (e.g. where a first loss exposure has been retained at the level of the underlying transactions). Once again, if the EBA does not agree with this view, we would like to understand this as any other interpretation would present significant obstacles to the use of the holding options referred to in proposed articles 8.1(a) and (b) in practice.

Q7: Do you consider that the conditions referenced in article 8.1(b) are correct and sufficient? If not, which conditions would you add/change/remove? Why?

In general, we consider the conditions set out in proposed article 8.1(b) (which cross-refers to the conditions in article 8.1(a)) to be correct and sufficient.

Please see Q6 above for a summary of certain related confirmations sought by AFME members.

Q8: Are there other ways to comply with the retention options set out in article 394 [finalised as article 405] of the CRR which should be included in this RTS? Please be specific in your description of any additional ways to comply.

As noted above, in general the inclusion in the technical standards of specific examples of the forms which may be used to satisfy the various retention holding options is very helpful and is welcomed by AFME members.

It should also be noted that to the extent that the current guidance expressly refers to the accepted use of a particular form and the relevant provision is not carried over in the technical standards, this will beg the question as to whether the relevant

arrangement is still considered acceptable. That is, it is not clear if the relevant item has not been included in the draft technical standards owing to a change in policy or for some other reason which is not clear. This is an issue for new transactions and also for existing arrangements which have relied on the relevant guidance (see our comments above regarding the need for full grandfathering of existing positions structured to rely on the current guidance).

In this regard, we note that the current guidance expressly refers to the use of certain forms to satisfy particular retention holding options that are not included in the draft technical standards. These forms include, in the context of the first loss tranche holding option, a subordinated note, a funded reserve account that has the capacity to absorb principal losses on the underlying exposures, an equity interest, a preference share interest, a deferred purchase price element and overcollateralisation (e.g. see paragraphs 55 and 58 of the CEBS guidelines). While it seems unlikely that the absence of reference to these forms is intended to mean that they cannot be used (particularly given that certain “classic” forms of a first loss tranche such as subordinated notes and equity interests are on the list), we strongly encourage the EBA explicitly to confirm in the technical standards that these forms remain available and acceptable.

In general, in order to ensure that there is a proper functioning retention regime under the CRR, we consider that it is necessary for certainty to be provided where possible.

Lastly, with respect to new retention holding option (e), we agree with the comments raised by the Commercial Real Estate Financial Council Europe (CREFC) in its response to the Consultation Paper. In keeping with such comments, we seek confirmation that use of this holding option will not be regarded as giving rise to a re-securitisation position. In addition, we agree that it may be difficult to rely on option (e) where the commercial real estate securities financing involves underlying exposures comprised (i) in part of A/B loans and in part of whole loans (given that it is not possible to mix retention holding options) or (ii) of A/B loans where the B loans are held by different junior lenders.

Q9: Is the qualification “securitisation positions in the correlation trading portfolio containing only reference instruments satisfying the criterion in article 327(1)(b)(ii) [finalised as article 338(1)(b)(ii)] of Regulation (EU) No 575/2013” introduced in article 13(1) correct/necessary? Should this qualification be removed? If not, why?

The guidance which applies under the current risk retention regime clarifies that the exemption which refers to “transactions based on a clear, transparent and accessible index... or are other tradable securities, other than securitisation positions” is deemed to constitute a scope that equates with the correlation trading portfolio as defined in CRD III and expressly confirms that this extends to all positions that are encompassed by the portfolio definition and corresponding activities (see paragraph 73 of the CEBS guidelines). In contrast, proposed article 13 refers to only a portion of the correlation trading portfolio definition, i.e. it proposes to confirm that reference

instruments satisfying the criterion in article 338(1)(b)(ii) (referring to “commonly-traded indices based on those reference entities”) would fall within the exemption, but it does not also properly pick up trades on bespoke baskets (as described in article 338(1)(b)(i) in the reference to “single-name instruments, including single-name credit derivatives, for which a liquid two-way market exists”). It is essential that trades on bespoke baskets are also confirmed to be within the exemption.

By way of background, during industry engagement with the EU authorities on the enactment of article 122a, concerns were raised that, in order to avoid confusion (given the wide securitisation definition), explicit confirmation was required that all correlation trading activities (including trades based on bespoke baskets of reference obligations) would be outside the scope of the retention requirement. It is our understanding that these concerns were accepted and that the wording of the current exemption was amended at a late stage with the intention of providing full relief, although the wording which was added was not as clear as AFME members would have liked.

In order to avoid any confusion, explicit confirmation was sought via the CEBS guidelines in 2010 that the exemption extended to all correlation trading activities. As was highlighted to CEBS then, there are certain “clues” in the text which support its application in respect of correlation trading activities based on both indices and bespoke baskets. For example, the relevant text of article 122a(3) (recast as article 405(4)) explicitly covers index tranches and then goes on to specify that it also applies “where the underlying reference entities are identical to those that make up an index of entities that is widely traded” (i.e. bespoke baskets). This important distinction would be redundant within the provision if it were not intended to cover trades referencing liquid two-way entities other than those actually referencing a formal index.

Moreover, we note that the interpretation of the exemption to extend to activities based on bespoke baskets does not risk creating interest misalignment or information asymmetry issues and, as a result, should not give rise to objections from a policy perspective. Since a corporate CDS references public indebtedness, the information about the corporate reference obligation and related credit exposure is “clear, transparent and accessible”, and there is no misalignment of information between the correlation trading desk and the client bank. The correlation dealer is effectively on the public side of the deal, in the same way as his client bank, with no additional access to information. We therefore think the CDS should not have to reference a formal index to fall within the exemption (and, as noted above, this is not inconsistent with the Level 1 text).

These points were raised with the CEBS in 2010 and it was agreed that against the background outlined above and given the nature of correlation trading activities (being arrangements where corporate correlation trading exposures are purchased/sold from/to the client bank which has specified the transaction details to the corporate correlation trading desk, as opposed to the types of arrangements targeted by the risk retention requirements), the exemption should be explicitly

confirmed to extend to all correlation trading portfolio activities, including activities based on bespoke baskets. We respectfully request that the EBA provide explicit confirmation of the scope of the exemption on the same basis.

The changes required to the current proposals to address our concerns are limited. That is, instead of referring to article 327(1)(b)(ii) (which appears in the final CRR as article 338(1)(b)(ii)), article 13(1) of the technical standards should refer to article 338(1)(b) and the reference to “in such part of” in the second sentence should be removed. To be clear, with our suggested changes, revised article 13 would read as set out below:

“The exemption in article 405(4) of Regulation (EU) No 575/2013 shall include securitisation positions in the correlation trading portfolio containing only reference instruments satisfying the criterion in article 338(1)(b) of Regulation (EU) No 575/2013. The exemption shall also apply to any securitisation position which is eligible for inclusion in the correlation trading portfolio but has not been assigned thereto for risk management or other similar reasons.”

On a related point, we note that proposed article 22 of the draft technical standards seeks, in the case of transactions falling within the scope of the exemptions set out in articles 405(3) and (4) (which would include the exemption which refers to transactions based on a clear, transparent and accessible index), to require “institutions acting as originator, sponsor or original lender to disclose a confirmation of the exemption applied including the reasons for applying the exemption”. We provide general comments on this proposed requirement below but would like to note here that the proposed disclosure will not work in the context of the exemption dealt with in proposed article 13(1) given the nature of correlation trading portfolio activities.

Q10: Is the inclusion in the exemption of the cases that are eligible to be included in that part of the correlation trading portfolio but that do not pertain to it adequate? If not, why?

We consider the reference in draft article 13 to positions which are eligible to be included in the portfolio to be necessary to preserve the scope of the current guidance on this point, which provides relief with respect to the full range of positions which satisfy the definition of the correlation trading portfolio (rather than just those positions included within it). This confirmation is necessary to maintain the functionality of the regime in the context of the full range of relevant positions.

Q11: Should the broad stress testing requirement that institutions have to undertake be part of the Internal Capital Adequacy Process, in accordance with article 72 [finalised as article 73] of CRD IV, or should it, where applicable, be in accordance with article 173 [finalised as article 177] of the CRR and follow the credit stress testing requirements for IRB banks?

As a starting point, we note that article 406 of the CRR expressly permits institutions to rely on financial models developed by an external credit rating agency provided that such institutions can demonstrate their validation, and understanding of, certain matters in respect of such models. To the extent that institutions use such a model, clarification should be provided that further work is not required under article 18 of the RTS, as this would go beyond article 406.

With respect to the specific question raised, AFME members do not have a strong view on the broader stress testing process to be factored in, although it may be that non-IRB banks will be less comfortable with the IRB based test.

Q12: Is the qualification “...securitisation positions ... held in the correlation trading portfolio... as referred to in article 327(1)(b)(ii) [finalised as article 338(1)(b)(ii)] of Regulation (EU) No 575/2013” introduced in article 20 correct/necessary? Should this qualification be removed? If not, why?

Please refer to our response to Q9 above. Consistent with our views on the proper scope of the exemption set out in article 405(4), we consider that, for the purposes of the guidance on the due diligence requirements, it is essential that the correlation trading portfolio is interpreted to extend to correlation trading activities based on both indices and bespoke baskets (as under the current guidance, see paragraph 81 of the CEBS guidelines). Accordingly, we consider that article 20 of the technical standards should also refer to article 338(1)(b) (rather than article 338(1)(b)(ii)) of the CRR.

Q13: Is the consideration of the cases that are eligible to be included in that part of the correlation trading portfolio but that do not pertain to it adequate? If not, why?

Please refer to our response to Q10 above. Once again, we consider that reference to positions which are eligible to be included in the portfolio to be necessary to preserve the functionality of the regime in the context of the full range of relevant positions.

Q14: For which type of underlying assets do you think that the information on a loan level basis is not necessary for complying with the due diligence requirements under article 395 [finalised as article 406] of the Regulation (EU) No 575/2013? What kind of information is required in those cases? Please specify by type of underlying asset.

As a starting point, we would note that it is our understanding that the due diligence requirements and disclosure requirements of the CRR do not necessarily require loan-level information to be made available. Instead, the requirements impose a principles-based obligation which refers to the provision of “all materially relevant data” on, amongst other things, the credit quality and performance of the individual underlying exposures and that such data “shall be determined as of the date of the securitisation and where appropriate due to the nature of the securitisation thereunder”. In line with the current guidance (and the draft technical standards), this supports the view that a materiality assessment should be applied when considering whether loan-level information is required to be disclosed and that it is

appropriate to consider this on a case-by-case basis, at the relevant time and taking into account all of the features of the particular transaction.

On this basis, we consider that the current principles-based approach taken in the draft technical standards is the appropriate starting point in the context of the disclosure requirement. In keeping with this, we would have some reservations about any attempt on the part of the authorities to make more detailed or prescriptive guidance in this regard and we have concerns with any suggestion that any further guidance may seek to establish parameters by specific asset type. There is agreement amongst market participants in general that loan-level information may not be considered materially relevant information in the context of transactions involving highly granular asset pools (which would include, but not be limited to, ABCP conduit transactions and master trusts), but it is difficult to draw further lines given that the determination is inherently transaction and investor specific. Different investors may take different views.

To be clear, we support the inclusion in the draft technical standards of express confirmation that the provision of information on an aggregate basis is acceptable in certain circumstances and that the factors to be taken into account shall include the granularity of the underlying pool.

To allow for the situation where an investor concludes that the materially relevant information for a specific transaction does not include loan-level information (for example, in the context of a highly granular portfolio of auto loans with balances of a few thousand Euro each), we consider that a further principles-based assessment will be required to determine the relevant information that is required (once again, taking into account the specific features of the transaction etc.). In general, this will result in a conclusion that aggregate pool-level information is appropriate.

There are other matters, however, that we consider should be clearly addressed in the technical standards relating to the disclosure requirement and the information to be provided. In particular, clarification is needed to ensure that institutions are not required to provide information which would breach regulatory requirements such as the market abuse regime or confidentiality between firm and customer, whether such confidentiality arises from legislation (including data protection legislation), common law or equivalent custom (including bank secrecy principles), or the contractual provisions of the relevant documentation. This is a significant issue for originators and sponsors and an area where compliance confusion may arise if the existing guidance is not carried over. In this regard, we would suggest that the issue could be appropriately addressed by inserting the relevant confirmations from the current guidance (in the context of both the investor due diligence requirement (see paragraph 91) and the disclosure requirement (see paragraph 129)) in the technical standards.

Q15: Do you consider that the information in existing templates (e.g. ECB ABS loan-level data template or Bank of England ABS transparency requirements) meet the relevant due diligence and disclosure requirements under article 395 [finalised as article 406]

and article 398 [finalised as article 409] of the Regulation (EU) No 575/2013, respectively? Please differentiate in your response in terms of the types of underlying assets, if applicable.

The draft technical standards indicate that templates generally accepted by market participants may be considered to be an appropriate format to satisfy the disclosure obligations. We support the permissive approach adopted in this portion of the proposed guidance, as this acknowledges the transaction-specific nature of the assessment required under the disclosure obligations (meaning that it is not possible to anticipate accepted compliance parameters by asset type in general, as discussed above). Moreover, this approach appropriately serves only to confirm that the central bank templates may represent *one way* for certain transactions to comply with the due diligence and disclosure requirements.

However, we consider that care should be taken to avoid any suggestion that these templates are the only way or the most appropriate way to comply with the due diligence and disclosure requirements. The central bank arrangements were conceived for purposes related to the eligible collateral frameworks and, as such, are targeted at and available for the types of securities accepted as collateral only (meaning that the templates are not available for the full range of relevant transactions subject to the due diligence and disclosure requirements). In addition, as arrangements which require information to be presented in a standardised format and through electronic platforms, they draw in concepts which do not form part of the package of requirements which apply under the risk retention regime and it would not be appropriate for enhanced obligations (over and above those required by the disclosure and due diligence provisions) to be effectively introduced in this way.

Lastly, to the extent that the EBA chooses to confirm that the use of certain specific templates are available options which may satisfy the due diligence and disclosure requirements, we note that it would be helpful if certain industry-led standards were also confirmed to achieve compliance. For example, we note that the Commercial Real Estate Finance Council – Europe (CRE FC Europe) has developed a comprehensive reporting format for European CMBS transactions (commonly known as the CMSA Investor Report Package (E-IRP)).¹⁴

Q16: Do you find the accessibility conditions (e.g. search, availability, costs) regarding the information provided in existing templates (e.g. ECB ABS loan-level data template or Bank of England ABS transparency requirements) adequate?

In general, the accessibility conditions which apply in respect of the ECB and Bank of England requirements seem adequate. However, the background to this question is not clear. To the extent that the EBA is interested in this for the purposes of making guidance on what constitutes “readily available access” under article 409 of the CRR, then AFME members would caution against this. Once again, we consider that this

¹⁴ Further information is available via the following link: <http://www.crefc.org/Global/europe.aspx?id=4970>.

will turn in part on the nature of the transaction (e.g. public or private) and on the underlying assets and, as such, is best identified on a case-by-case basis.

Questions relating to Draft ITS relating to the convergence of supervisory practices with regard to the implementation of additional risk weights

Q1: Does the formula in article 2 result in reasonable additional risk weights?

Notwithstanding that it is closely based on the current guidance, we consider that specific aspects of formula in article 2 may operate to deliver unreasonable additional risk weights in certain circumstances.

In particular, the passage of time factor which is automatically applied under the formula gives rise to additional risk weights which are arguably not proportionate as required by the Level 1 provisions. Under this factor, an investor is subject to an additional risk weight which automatically increases each year, regardless of the circumstances. This means that an additional risk weight is to be applied even in circumstances involving a one-off breach which the investor is unable to “cure” on its own through additional due diligence action and/or a sale of the (non-compliant) position (other than a sale on unreasonable terms). This may be the case where, e.g., an institution has inadvertently (as a “first-time offence”) failed to check the disclosure of the originator’s retention and the originator has not retained the required interest and, as a result, such investor holds a non-compliant position with restricted liquidity.

The legislative provisions do not expressly provide for the application of a passage of time factor. Instead, the provisions refer to the progressive increase of the risk weight with “each subsequent infringement”. We consider that, in this context, “subsequent” could be interpreted to mean each “repeated” infringement, rather than the passage of time in all cases. In particular, we consider that the provisions should be interpreted such that a static additional risk weight would apply to a failure to meet the due diligence requirements where the relevant entity can demonstrate to its authority that it has inadvertently invested in the relevant position and that it is not possible for the entity to rectify the breach on its own and/or to sell the position on reasonable terms. In such circumstances, we consider that the penalty should increase only if the investor later makes the same breach in relation to further investment activities in securitisation positions.

We consider that our interpretation more closely reflects the wording of the legislative provisions (i.e. by reflecting the ordinary meaning of “each subsequent infringement” and by also being more consistent with the later reference to the application of “proportionate” additional risk weights). Moreover, this interpretation more clearly supports a (sensible) policy intention to incentivise investors to rectify breaches where possible in a timely manner and to focus on breaches which are or which threaten to be systemic within the relevant institution, rather than imposing penalties which automatically increase over time for single breaches in all cases.

In addition, we question the proposed application of the formula in article 2 in the context of infringements by institutions of the disclosure requirement. While the current guidance also provides for the application of additional risk weights in this context (as referred to in paragraphs 11 and 19), express acknowledgement is also provided in the guidance that additional risk weights may not necessarily be appropriate in this context owing to the nature of the obligation (as an originator should not be penalised if it does not supply the investor with certain information as a result of the investor's own negligence, e.g. by it failing to ask for the information or choosing to invest without it) and also the fact that the relevant entity may not hold a position in respect of which the increased risk weight may be applied. We consider that this flexibility for adjustment should also be expressly provided for in the technical standards.

We note that, under the current guidance, a reduction variable equal to 0.25 is applied under the formula to correspond to the exemption provided for certain transactions based on a clear, transparent and accessible index (included in the CRR as article 405(4)), which has been interpreted to include correlation trading portfolio activities. The proposed technical standards do not carry this over. We understand that the CRR text which provides for a reduction in the penalty for exempt arrangements no longer refers to the exemption described above. However, the rationale for this is unclear. Given that these arrangements are also exempt from the risk retention requirement, we consider that a reduction variable should also apply to these arrangements, consistent with the current guidelines.

Lastly, we note that there is some confusion with respect to the intended interaction of the guidance on the compliance standard which may be applied under the due diligence requirements in the context of trading book activities (set out in article 19 of the RTS) and the materiality assessment to be applied under the additional risk weight provisions (referred to in article 1.4 of the ITS). We would welcome any clarification that the EBA can provide with respect to the level of flexibility that is appropriate for firms and supervisors to take when assessing compliance for trading book positions under the due diligence requirements. In particular, it would be helpful to better understand whether the EBA considers that flexibility should be applied in the context of a scenario involving, e.g., a firm which finds itself temporarily required to hold a position in its trading book (as a result of its market making obligations to a client) where the relevant position meets the firm's risk analysis criteria (taking into account its overall risk profile) but (owing to the location of the securitisation issuer) does not meet the retention requirement.

Q2: Would you suggest any changes to the formula that would lead to an improved framework for the application of additional risk weights? Do you believe the variable `article394ExemptionPct` equal to 0.5 if the exemption in article 394(3) [finalised as article 405(3)] applies is reasonable?

Please see our comments above with respect to our suggested changes and also with respect to the need for a reduction variable to be provided if the exemption in article 405(4) applies.

Q3: Would you suggest an alternative approach for calculating additional risk weights?

Please see our comments above with respect to the proposed disapplication of the automatic passage of time factor in certain circumstances. In particular, we propose that this should be disappplied in circumstances where the relevant entity can demonstrate to its authority that it inadvertently invested in the relevant position and that it is not possible for the entity to rectify the breach on its own and/or to sell the position on reasonable terms.

Additional comments not in response to specific questions

We have identified a number of other points in respect of the draft technical standards for which we would like to provide feedback. These are set out below.

- *Original lender definition* – we note that the recitals to the draft RTS include a definition of original lender. This definition is closely based on the first limb of the existing originator definition and it is not clear what it is intended to add. As noted above, if the limited flexibility for another appropriate entity to retain is not maintained (as the proposals suggest will be the case), the definitions of originator, sponsor and original lender are likely to come under heightened focus as market participants seek to make sense of the requirements in a range of scenarios. It would be helpful if the EBA could clarify what is intended to be added with the new original lender definition. In particular, we would welcome any examples of entities which would fall within the definition of original lender but not the originator definition.
- *Exemption reliance disclosures* – proposed article 22 of the draft technical standards seeks, in the case of transactions falling within the scope of the exemptions set out in paragraphs (3) and (4) of article 405 (which would include the exemption which refers to transactions based on a clear, transparent and accessible index), to require “institutions acting as originator, sponsor or original lender to disclose a confirmation of the exemption applied including the reasons for applying the exemption”. The rationale for this proposed additional disclosure obligation is unclear and we note that this is not required by the Level 1 text. Where transactions are clearly defined to be outside scope by the legislative provisions, we consider that this should be able to be relied upon without disclosure and/or explanation. Moreover, the proposed disclosure will not work in the context of the exemption which extends to correlation trading portfolio activities given the nature of such activities.
- *Explanatory boxes text* – it is our understanding that the text in the explanatory boxes included in the Consultation Paper does not form part of the proposed RTS and, as such, that such boxes are intended to be removed from the final standards. Leaving aside the consultation questions, the text in certain explanatory boxes provides helpful guidance on a number of points. For

example, we consider that important clarifications are provided in the explanatory boxes on page 13 (providing an example of when a hedge counterparty will be deemed to become exposed to the credit risk of a securitisation position), on page 19 (noting that the retention of B loans would be considered to be an example of the application of retention option (e)), page 24 (discussing whether different due diligence policies may be applied for certain trading book activities) and page 27 (confirmation that it may not be appropriate to provide loan-level information in the context of a securitisation involving a highly granular asset pool). The preservation of these statements would assist with the interpretation and application of the RTS. Accordingly, we would be keen for the relevant text to be included in the final RTS (in the form of a recital or in the text of the relevant articles if possible) and consider that the final standards would be less clear without these statements.

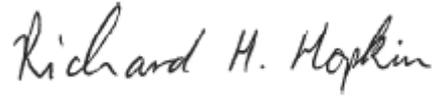
- *Securitisation definition; CRR recital* – compliance with the risk retention regime regularly gives rise to questions on the interpretation of the securitisation definition. In this regard, we note that the CRR includes a recital which seeks to clarify the definition (recital 50, set out below). This recital provides helpful clarification of those financing transactions not caught by the definition, including for certain corporate structured funding transactions and also for agency commercial real estate securities transactions (being transactions involving a loan from the SPV issuer to a borrower company which owns the properties which effectively back the securities issued). However, the discussion of certain CMBS transactions in the impact assessment section of the Consultation Paper (in particular, paragraph 35(a)) could be read as indicating that the EBA may take a different view on agency commercial real estate securities transactions, which would give rise to potential confusion with respect to the position of these arrangements. We assume that the EBA does not intend to seek to amend Level 1 clarifications on the securitisation definition through the draft technical standards.

“In order to ensure that the risks and risk reductions arising from institutions’ securitisation activities and investments are appropriately reflected in the capital requirements of institutions it is necessary to include rules providing for a risk-sensitive and prudentially sound treatment of such activities and investments. To this end, a clear and encompassing definition of securitisation is needed that captures any transaction or scheme whereby the credit risk associated with an exposure or pool of exposures is tranching. 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.”

In closing, we wish to reiterate that the continuing engagement of the EBA with market participants on issues related to risk retention is greatly appreciated and we

appreciate the opportunity to comment on the Consultation Paper. We would be happy to answer any further questions you may have.

Yours sincerely,

A handwritten signature in black ink that reads "Richard H. Hopkin". The signature is written in a cursive, slightly slanted style.

Richard Hopkin, Managing Director
Association for Financial Markets in Europe

ANNEX I

CONSIDERATIONS FOR MANAGED CLOs

The issues which arise for managed CLOs under the Consultation Paper are not entirely unique from those identified in the main body of our response but they are heightened and concentrated in certain respects. For this reason, we wish to focus on managed CLOs in this section and to respond specifically to certain comments included in the Consultation Paper with respect to these arrangements and their likely compliance position under the recast CRD IV regime.

Set out below are our key comments in this regard.

- *Retention arrangements used to date; lack of protection for existing arrangements* – the current (limited) flexibility for certain entities other than an originator, sponsor or original lender to retain has been an essential component of the recent revival of the European managed CLO market. Certain recent transactions have placed heavy reliance on the guidance, particularly those provisions of the guidance expressly addressed to, and provided for, managed CLOs. As a result, the proposed removal of the current flexibility presents immediate and obvious issues for the CLO market. Alarming, the lack of provision in the technical standards for the protection of existing arrangements structured to comply with the current guidance suggests that these issues are not confined to new transactions. Given the manner in which the risk retention provisions are framed (i.e. as requirements on investors), a failure to protect existing transactions will effectively penalise relevant investors (by restricting the liquidity and, as a result, possibly the valuation of the relevant position). This is a key issue in the context of certain recently completed managed CLOs. We respectfully request that the EBA explore all available options (working with other EU authorities if necessary) including if necessary amendments to the Level 1 text to address the issues as described in the main body of our response.
- *Fixing the “legal problem”; sponsor definition constraints* – it is suggested in the impact assessment section of the Consultation Paper that the “legal problem” for managed CLOs under the risk retention requirements (i.e. the lack of an involved entity which is an originator, sponsor or original lender as defined) will fall away under the CRR regime. In particular, it is suggested that this will be the case given that collateral managers will be investment firms subject to MiFID and, as a result, sponsors under the revised CRR definition. Unfortunately, the analysis is more complicated than this. Indeed, although most collateral managers may be authorised investment firms for MiFID purposes, the more restricted definition in the CRD results in a significant proportion of the collateral manager community being outside the scope of the sponsor definition, as they are unlikely to have (nor do they need to have for the purposes of conducting their business) the relevant authorisations (including, for example, authorisations to hold client monies or perform

custodial services). Indeed, if collateral managers were to seek the permissions necessary to bring them within the scope of the CRR definition of investment firm, it is not clear that supervisors would approve it if business lines did not support this. Furthermore, many collateral managers will seek authorisation to become AIFMs under the AIFMD (which likewise will bring them outside the sponsor definition) or are not established in the EU. These constraints will operate to restrict the number of eligible collateral managers. It is not clear why the sponsor definition is limited to credit institutions and the more restrictive CRD definition of investment firms, as it seems more appropriate from a policy perspective for all types of EU regulated entities and recognised third country firms to be eligible, as the authorisations required to be an investment firm are not necessary in order for an entity to perform its role as sponsor. We appreciate that the sponsor definition is a Level 1 text matter but, to the extent that there is any scope for change, this should be pursued. Lastly, as explained in the main body of our response, we are seeking confirmation that the sponsor definition should be interpreted to exclude an entity which may fall within the originator definition only where such entity is an originator with respect to all of the underlying assets (as opposed to a portion of the assets).

- *Finding a way forward; need for clarification and flexibility on all possible fronts* – as a general matter, we note that, if the limited flexibility for another appropriate entity to retain is not retained (as the proposals suggest will be the case), the definitions of originator, sponsor and original lender and all other aspects of who may validly retain the interest will come under heightened focus as market participants seek to make sense of the requirements. Any clarifications that the EBA is able to provide in this regard will be crucial to the process of finding a way forward and there are certain points raised in the main body of the response that are worth reiterating in the context of managed CLOs. As noted above, we consider that aspects of the draft technical standards are presently not sufficiently clear. In particular, while it is our understanding that it is intended that retention on a consolidated basis (from a regulatory or accounting perspective) should be acceptable in all circumstances and regardless of where the relevant entities are established, the current draft does not clearly address this. We encourage the EBA to provide express confirmation of this in the technical standards to avoid possible confusion in this regard. We are also seeking confirmation that flexibility will be available for one originator to retain on behalf of others in certain limited circumstances and clarification that, if an entity is a sponsor, it will be a sponsor with respect to the entire scheme and it should be able to retain on this basis, regardless of whether or not there may be other entities involved in the transaction that might possibly also be construed to fall within the sponsor definition.
- *Changes in collateral manager* – we consider that clarification is needed with respect to what may happen in circumstances where a collateral manager is retaining as sponsor and it subsequently no longer acts as collateral manager.

This may occur under the terms of the transaction documents in certain circumstances whereby a replacement manager is appointed following the removal or resignation of the collateral manager. We consider that such a scenario should fall within the scope of exceptional circumstances where a change in the retention arrangement may be permitted and, if it is determined that interest alignment is best achieved through a change, that the retained interest could be held by the incoming collateral manager, in its role as the replacement sponsor of the transaction, and that such collateral manager should be deemed through its assumption of the collateral manager function to have been involved in the establishment of the arrangement as required by the sponsor definition. We would welcome any guidance that the EBA is able to provide in this regard and emphasise again the importance of certainty on these points of analysis.

- *Position of pre-2011 transactions; relevant asset substitutions and additions* – as noted in the main body of our response, significant concerns have been raised by members with respect to the lack of guidance in the draft technical standards on what will be a relevant asset substitution or addition for the purposes of triggering the application of the risk retention requirements to pre-2011 transactions. In the absence of clarification, many transactions may come within the scope of the requirements after the end of 2014. To be clear, this is a significant issue for historic managed CLO transactions, a sizable proportion of which will be outstanding in 2015. While the current guidance confirms that those transactions which are in a period permitting limited reinvestment only (i.e. where the only asset substitutions at a relevant time arise as a result of the application of proceeds of credit impaired obligations and unscheduled principal proceeds in accordance with pre-defined contractual terms in the transaction documentation) will not involve a relevant asset substitution and, as a result, will not trigger the application of the risk retention requirements and come within scope, the draft technical standards do not address this issue. For the reasons set out in our response, this is highly problematic and is unlikely to be able to be addressed through amendments to existing arrangements (for various reasons including that noteholders may not agree to this and that collateral managers have a duty to manage the portfolio). We consider that matters relating to scope are integral to the matters required to be addressed in the technical standards and that the EBA is therefore justified in providing clarification on this front.

As a final point, we wish to note that we are grateful for the engagement to date of the EU authorities (including the EBA) with CLO market participants. We are keen to continue working with the authorities to identify acceptable solutions for managed CLOs in the context of the risk retention requirements.

ANNEX II

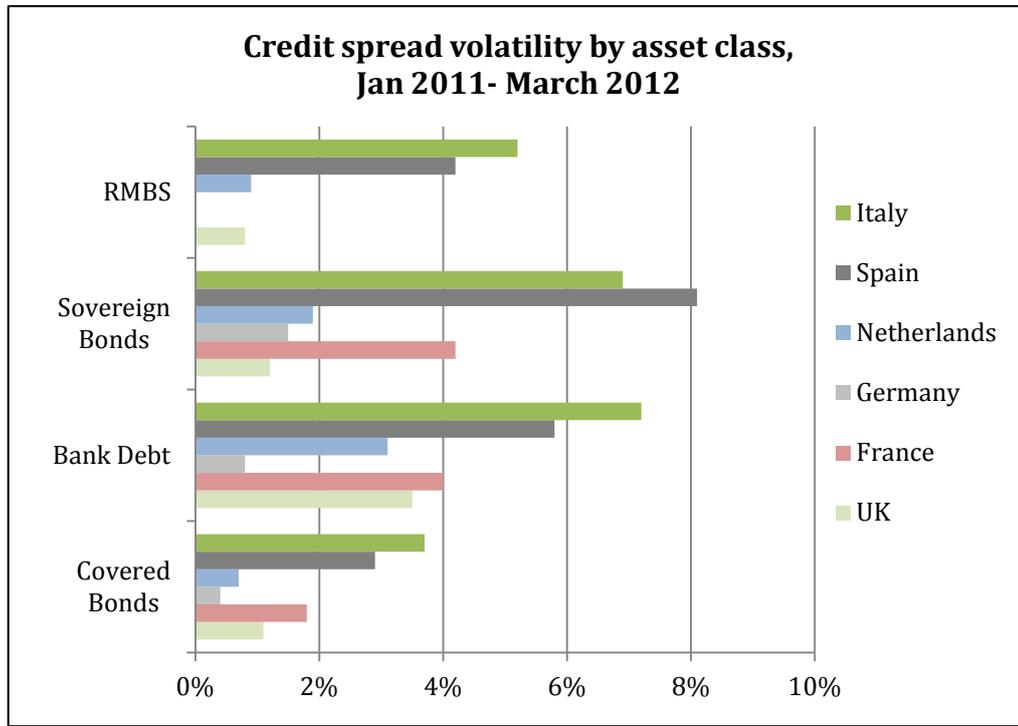
PERFORMANCE INFORMATION

Historical Default Rates for Securitisation: Mid-2007 to End Q1 2013

	Original Issuance (EUR billion)	Default Rate (%)
Europe		
Total PCS eligible asset classes	959.9	0.10
Credit Cards	33.2	0.00
RMBS	755.7	0.08
Other Consumer ABS	68.0	0.13
SMEs	103.0	0.29
<i>Only senior tranches to be PCS labelled, the default rate for which is zero, like Covered Bonds</i>		
Total Non-PCS eligible asset classes	732.6	5.30
Leveraged Loan CLOs	71.3	0.1
Other ABS	71.3	0.16
Corporate Securitisations	65.8	0.34
Synthetic Corporate CDOs	254.3	2.76
CMBS	163.2	9.08
Other CDOs	77.8	6.37
CDOs of ABS	28.9	40.21
Total European securitisation issuances	1,692.5	2.35
Covered Bonds	1,085.0	0.00
Total European issuances	2,777.5	1.43
Select US asset classes		
Credit Cards	295.4	0.04
Autos	198.2	0.04
Student Loans	266.8	0.29
RMBS	3,254.9	19.80

Source: Standard & Poor's

**European RMBS Market Price Performance in 2011
vs. Sovereign Debt, Bank Debt and Covered Bonds**



Source: BAML

ANNEX III

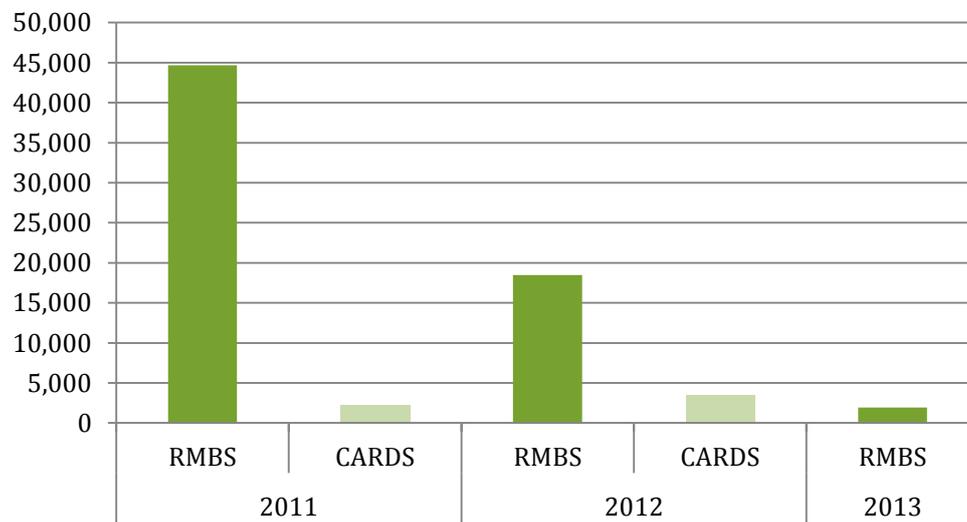
UK MORTGAGE MASTER TRUST ISSUANCE INFORMATION

DATE	ISSUER	SELLER	COLLATERAL	AAA EUR MILLION
2-Feb-11	Holmes	Santander	RMBS	2,400
6-Apr-11	Arran	RBS	RMBS	4,282
14-Apr-11	Permanent	Lloyds	RMBS	4,136
18-May-11	Fosse	Santander	RMBS	4,276
2-Jun-11	Penarth	Lloyds	CARDS	659
21-Jul-11	Arkle	Lloyds	RMBS	2,734
15-Sep-11	Holmes	Santander	RMBS	2,730
6-Oct-11	Turquoise	HSBC	CARDS	372
7-Oct-11	Gracechurch	Barclays	CARDS	748
10-Oct-11	Arran	RBS	RMBS	3,262
13-Oct-11	Silverstone	Nationwide	RMBS	12,851
26-Oct-11	Permanent	Lloyds	RMBS	3,557
11-Nov-11	Gracechurch	Barclays	RMBS	2,767
15-Nov-11	Penarth	Lloyds	CARDS	443
29-Nov-11	Fosse	Santander	RMBS	1,302
21-Dec-11	Swan	Lloyds	RMBS	383
Total 2011				46,902
13-Jan-12	Arran	RBS	CARDS	947
18-Jan-12	Holmes	Santander	RMBS	2,646
3-Feb-12	Arkle	Lloyds	RMBS	4,733
5-Mar-12	Gracechurch	Barclays	CARDS	340
15-Mar-12	Silverstone	Nationwide	RMBS	1,805
04-Apr-12	Penarth	Lloyds	CARDS	571
12-Apr-12	Holmes	Santander	RMBS	949
16-May-12	Fosse	Santander	RMBS	2,558
18-May-12	Gracechurch	Barclays	CARDS	469
30-May-12	Holmes	Santander	RMBS	645
7-Jun-12	Gracechurch	Barclays	CARDS	577
14-Jun-12	Gracechurch	Barclays	RMBS	3,807
22-Jun-12	Turquoise	HSBC	CARDS	597

DATE	ISSUER	SELLER	COLLATERAL	AAA EUR MILLION
20-Jul-12	Lanark	Clydesdale	RMBS	1,333
Total 2012				21,976
23-May-13	Holmes	Santander	RMBS	1,284
06-Jun-13	Lanark	Clydesdale	RMBS	639
Total 2013				1,923

Source: Deutsche Bank

Master Trust issuance by type of collateral



Source: Deutsche Bank