

TSI Opinion on the EBA Consultation Paper, Draft  
Regulatory Technical Standards.

On the determination of the overall exposure to a  
client or a group of connected clients in respect of  
transactions with underlying assets under Article 379  
of the proposed Capital Requirements Regulation.

Consultation deadline: 16. August 2013

We appreciate being given an opportunity to express our opinion on the Draft Regulatory Technical Standards

“On the determination of the overall exposure to a client or a group of connected clients in respect of transactions with underlying assets under Article 379 of the proposed Capital Requirements Regulation”.

In keeping with the field in which TSI and its partner organisations work, we will limit our comments to the proposed treatment of securitisation investments.

### **Grandfathering and transitional rules are vital**

- » The draft RTS is based on the CEBS Guidelines of December 2009 and, as stated, has incorporated the experience of national supervisory authorities of applying those Guidelines. The German supervisory authority has expressed its opinion on this matter, in particular in the circular of 15 July 2011 (FAQs).

In our opinion, the experience gathered by the German supervisory authority with the present rules is satisfactory and sufficient. It is therefore very surprising that changes, some of them extensive, are to be made to the current proven and tested practice without any grandfathering or transitional rules.

In particular, the existing grandfathering rule in the CEBS Guidelines, according to which transactions received before 31 January 2010 may be dealt with until 31 December 2015 in accordance with the regime applicable until 31 December 2010, is thus annulled (see line no. 75 of the CEBS Guidelines). Also, the newer positions entered into after that date are nonetheless subject to the new legal provisions without any further transitional rules.

We advocate maintaining the present CEBS grandfathering rules for those old cases as well as establishing appropriate transitional rules for all other existing transactions.

### **The RTS proposals are difficult and expensive to implement**

- » Article 6 of the draft RTS deals with the identification and allocation of “underlying assets” to an institution’s direct credit exposures. In contrast to the currently applicable rules under the CEBS “Guidelines on the implementation of the revised large exposure regime” of 11 December 2009 and the future rules proposed in the BCBS Consultative Document “Supervisory framework for measuring and controlling large exposures” of 26 March 2013, the draft RTS makes no provision for any materiality or granularity thresholds in implementation of the rules.

This means that every securitisation transaction, regardless of its volume, struc-

ture or granularity, would first have to be examined with regard to its underlying assets. However, in the German market the vast majority of securitisation transactions have highly granular receivables portfolios. Allocating those underlying borrowers to the potential internal credit exposures would involve the investing institutions in an unreasonable amount of time and effort, without any substantial gain in knowledge for the institution or for the supervisory authority.

Furthermore, owing to the unavailability of some data, it would not be possible to treat most securitisation transactions as required. As it happens, legal impediments, e.g. the German data protection laws prohibiting the forwarding of names of private customers, often mean that the information required for the classification cannot be forwarded to the investors.

As a result, the vast majority of transactions would be allocated to the "unknown client".

The sense and purpose of the look-through rule, which is intended to lead to more adequate risk assessment by banks, would therefore be missed completely. Instead, a series of unintentional knock-on effects would occur (see below).

For this kind of rule to be beneficial, it is vital to ensure prior "filtering" of the relevant transactions with regard to materiality and granularity.

The introduction of a materiality threshold is called for in order to strike a balance between the necessary time and effort involved and the benefits of the rule for the credit institution concerned (regardless of whether it is a sponsor or an investor). Following the definition of large exposures, account will need to be taken of the size of the credit institution compared with the investment. To that end, it could be helpful, for example, if the national supervisory authority were to stipulate an adjustable percentage of the investing credit institution's eligible capital (e.g. 2%) as the materiality threshold per transaction. Accordingly, securitisation positions with an exposure below that materiality threshold would not be affected by the RTS rules.

The positions relevant to the materiality threshold would then only need to be analysed for their granularity.

We advocate maintaining the current granularity threshold of 5% per transaction as it has proved appropriate. We are opposed to lowering the threshold to e.g. 1% (as proposed in the BCBS paper) as real economy securitisation transactions of trade or leasing receivables frequently reveal a borrower concentration of 1-5%. The risk is that, because of inadequate systems or insufficient information, these transactions would have to be allocated to the "unknown client", with the related consequences (see below).

### **Criticism of the application to trading book positions**

- » Furthermore, the EBA draft would have an extremely negative impact on the trading book positions. This would have unforeseeable repercussions on the market liquidity of securitisations. Market-making for established granular securitisations such as auto or leasing transactions, for example, would be almost impossible. There would be a drastic hit to the corresponding liquidity of these products. This could have an adverse affect on prices and lead to depreciations in the bank balance sheet, without any negative change in the performance or quality of the securitisation.

For that reason too, it is imperative for materiality and granularity thresholds to be introduced.

### **Concentration risks are distorted**

- » Pursuant to Article 6.3 (4), in contrast to the present procedure based on the CEBS Guidelines, partial look-through would no longer be possible. We do not see the point of this rule. If, for example, 90% of a portfolio can be identified and only 10% cannot be identified (e.g. for data protection reasons), as we understand it, the entire transaction would have to be allocated to the exposure of the "unknown client". This would neither make concentration risks more transparent, nor would the investing institution's risk management be improved. Instead, the exposure of the "unknown client" would be unreasonably inflated and distorted. We therefore consider the possibility of a partial look-through to be an very essential requirement.

The approach also overlooks the fact that every kind of credit enhancement is ignored and hence the potential risk is exaggerated.

### **Substitution principle for fully supported ABCP**

- » The financing of trade and leasing receivables via ABCP programmes is of particular importance for the real economy. Following the collapse of the ABCP markets in the course of the financial crisis, these customer transactions recovered and, with new structures, developed a new investor base in Europe. In many cases the sponsoring bank provides full risk coverage of the portfolio through fully supported liquidity lines. Consequently the investor in the ABCP programmes focuses primarily on the liquidity bank. A look-through to the underlying assets would not only distort the actual risk assessment but would fail to take account of the actual risk taker (the liquidity bank). We advocate being able to add the securitisation position in cases of third party risk coverage to the actual risk taker (i.e. to the liquidity bank's exposure) as a substitute for a

look-through to the underlying assets.

**Not applying granularity thresholds leads to unintended consequences for the real economy and its options for refinancing via the securitisation markets**

- » In accordance with Article 6 of the draft RTS, an underlying asset exposure would be allocated to the “unknown client” if the underlying borrowers cannot be identified “after all reasonable steps have been taken”. According to the present draft, this is likely to occur regularly for securitisation transactions (see above), affecting, in particular, investors and sponsors of securitisation transactions.

For European institutions, the allocation of basically all securitisation positions without look-through to the “unknown client” implies a de facto massive restriction on investments in Asset Backed Securities.

We are not convinced by the argument in the paper that only the proposed procedure guarantees the safety required from the supervisory perspective with regard to compliance with large exposure rules.

- The granularity thresholds in the current rules have proved effective. They effectively limit large exposure risks resulting from unidentified positions and can be acceptably implemented by the institutions.
- If, in individual cases, the supervisory authorities suspect abuse in connection with the granularity thresholds, they already have sufficient instruments to manage those cases within the framework of customary auditing procedures and sanctioning options.

We do not therefore consider it necessary to impose a fundamental ban on the use of granularity thresholds.

In addition, the implementation of the proposal would go hand in hand with further considerable negative secondary effects for banks. In particular, we would like to draw attention to the following points:

- The proposal affects first and foremost securitisation transactions with highly granular underlying portfolios – in other words the very positions that institutions use to actively reduce counterparty risk in their loan portfolio (in accordance with the present objectives of the large exposure regime).
- For many institutions, the allocation of securitisation positions to the “unknown client”, which, according to the conclusions of the proposal, would be required on a regular basis, will pose a new, artificial set of

large exposure problems. In addition it creates immense internal administrative time and effort without any economic basis or relevance. The envisaged lowering of the large exposure limits by the BCBS and the reduction of the permissible regulatory capital base for banks under Basel III will further reinforce that effect.

- The proposal discriminates an asset class (meaning granular, real economy ABS und ABCP) which cannot be linked to the problem of undetected concentration risks in some underlying portfolios (e.g. CLOs) during the financial crisis. We therefore see no need to abolish the granularity thresholds.
- In the securitisation markets, the short-term implementation of the draft RTS rules would put long-term pressure on divestments, not as a result of economic developments but solely because of regulatory considerations. In particular, this would affect transactions that are clearly linked to the real economy, that are performing well and that have to date represented investments in demand. Implementing the draft RTS rules in Europe would place considerable burdens on investors and sponsors of securitisation transactions around the world, arising from depreciations or from the regulatory capital regime. The negative consequences for the financing of consumers and SME borrowers in Europe in the medium-term cannot yet be estimated but it is likely to be substantial.
- The different approaches to a granularity threshold taken by the EBA and the BCBS contradict the idea of an international level playing field. The recently released Final Rules to Basel III of the US regulatory bodies seem not to address the same concerns and hence giving US regulated investors and sponsors a competitive advantage.
- It is rendered impossible for banking institutions to finance corporate customers and leasing companies on borrowing base principles. Institutions are therefore compelled to provide those customers to an increasing extent with fairly risky unsecured financing or to reduce the volume of finance available to those customers. The regulation thus either increases the credit risks for banks or reduces the financing resources available to the real economy.

**For the aforementioned reasons, when taking account of positions with underlying assets in the large exposure regime, we advocate:**

- » 1. Introducing a materiality threshold of 2% of the eligible capital of the institution in question
- 2. Maintaining the current granularity threshold of 5% of the portfolio volume per transaction
- 3. Incorporating the possibility of “partial look-through” per transaction
- 4. Allowing for an appropriate transitional period grandfathering rules
- 5. Harmonising the rules with the BCBS and the US regime so as to keep the time and effort required by institutions for implementation to a reasonable level and to achieve a level playing field for European banks

### TSI – What we do

Securitisation in Germany and TSI – the two belong together. True Sale International GmbH (TSI) was set up in 2004 as an initiative of the German securitisation industry with the aim of promoting the German securitisation market.

In the last nine years TSI has strongly supported the development of the German securitisation market. Its concern has always been to give banks an opportunity to securitise loans under German law on the basis of a standardised procedure agreed with all market participants. Another objective is to establish a brand for German securitisation transactions which sets a high standard in terms of transparency, investors information and underwriting as well as servicing standards. And finally the goal is to create a platform for the German securitisation industry and its concerns and to bridge the gap to politics and industry.

Nowadays TSI Partners come from all areas of the German securitisation market – banks, consulting firms and service providers, law firms, rating agencies and business associations. They all have substantial expertise and experience in connection with the securitisation market and share a common interest in developing this market further. TSI Partners derive particular benefit from TSI's lobbying work and its PR activities.

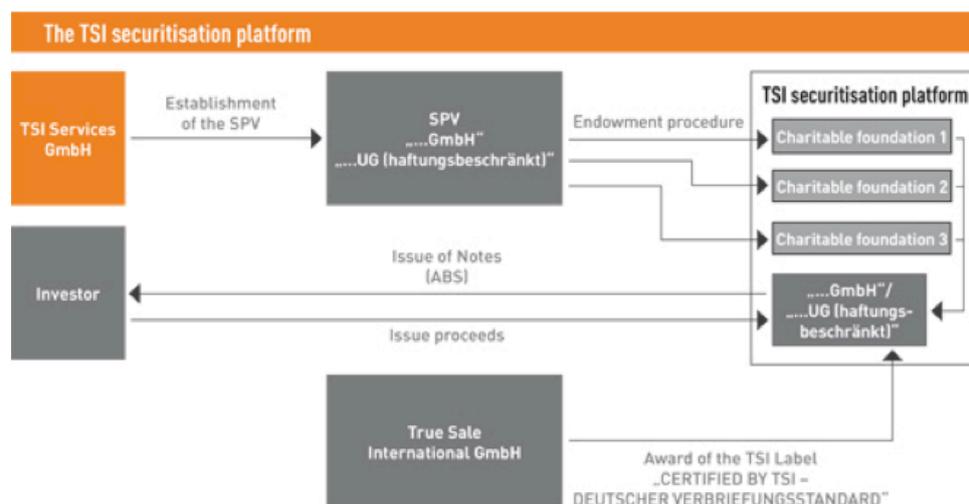
### TSI securitisation platform

TSI has been providing special purpose vehicles (SPVs) under German law since 2005. In far more than 80 transactions (as of 2013), German and other originators have already taken advantage of German SPVs as part of the securitisation process.

The TSI securitisation platform comprises three charitable foundations, which become shareholders in the SPVs set up by TSI. The charitable foundations provide support for academic work in the following fields:

- Capital market research for Germany as a financial centre
- Capital market law for Germany as a financial centre
- Corporate finance for Germany as a financial centre

The three charitable foundations are committed to promoting scholarship and science with a focus on capital market and corporate finance topics.



### **CERTIFIED BY TSI – DEUTSCHER VERBRIEFUNGSSTANDARD**



The high quality of German securitisation transactions reflects the high quality of the standards applied to lending and loan processing.

The brand label DEUTSCHER VERBRIEFUNGSSTANDARD is founded on clearly defined rules for transparency, disclosure, lending and loan processing. Detailed guidelines and samples for investor reporting ensure high transparency for investors and the Originator guarantees, by means of a declaration of undertaking, the application of clear rules for lending and loan processing as well as for sales and back office incentive systems. The offering circular, the declaration of undertaking and all investor reports are publicly available on the TSI website, thus ensuring free access to relevant information.

#### **Events and Congress of TSI**

Events of TSI provide opportunities for specialists in the fields of economics and politics to discuss current topics relating to the credit and securitisation markets. The TSI Congress in Berlin is the annual meeting place for securitisation experts and specialists from the credit and loan portfolio management, risk management, law, trade and treasury departments at banks, experts from law firms, auditing companies, rating agencies, service providers, consulting companies and investors from Germany and other countries. Many representatives of German business and politics and academics working in this field take advantage of the TSI Congress to exchange professional views and experience. As a venue, Berlin is at the pulse of German politics and encourages an exchange between the financial market and the world of politics.