The potential development of a High Quality Securitisation market in the EU

The answers of the True Sale International GmbH (TSI), Germany

Part Two – ABCP Market

Apart from the term ABS market, Europe and particular German industry makes most use of the ABCP market for its financing purposes. According to Moodys figures the volume of multi-seller conduits transactions in Europe has reached approx. EUR 36 bn in 2013 (as measured by CP outstanding and not taken into account any drawn liquidity lines or unused lines).

In Germany the so called real economy is the main beneficiary of the ABCP market. The mayor importance of the ABCP market for corporate finance in Germany should be reason enough to include it in a high quality ABS discussion. Because of that and because of the structural particularities of ABCP transactions we have divided our response to the questionnaire in two and will in a second part dealing in detail with the ABCP market. Putting the answers for both market segments into one response could otherwise cause confusion.

Current state of the securitisation market in the EU

1. Please provide an overview on the current state of play of securitisation in the European financial sector (outstanding, volume, issuance, types of issuances).

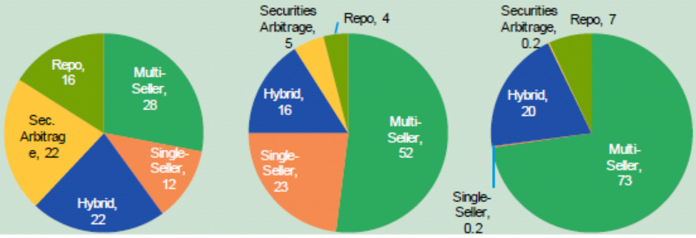
The conduit business market:

- Multi-seller conduits dominate the ABCP market – SIVs have disappeared.
- The volume has shrunk significantly due to the exit of arbitrage conduits / SIVs.
- Multi-seller conduit business is directly linked to the real economy and serves as a liable funding tool for the corporate sector, especially for small and medium sized enterprises.

EMEA Conduit Activity

How has the Market Changed Since the Peak of Activity?

$billions	July 2007	September 2012	September 2013
Issuance ($Bn)	**524**	**85**	**68**
Number of Conduits Rated by Moody's	68	39	30
ABCP/Purchased Assets (%)	100	78	86**
USCP(%)	53	58	49
Conduits Type (% of ABCP Outstanding)			



Source: Moody's

* Excluding data for Churchill ($22bn of ABCP and purchased assets in September 12 and $3.7bn ABCP and purchased assets in September 13)

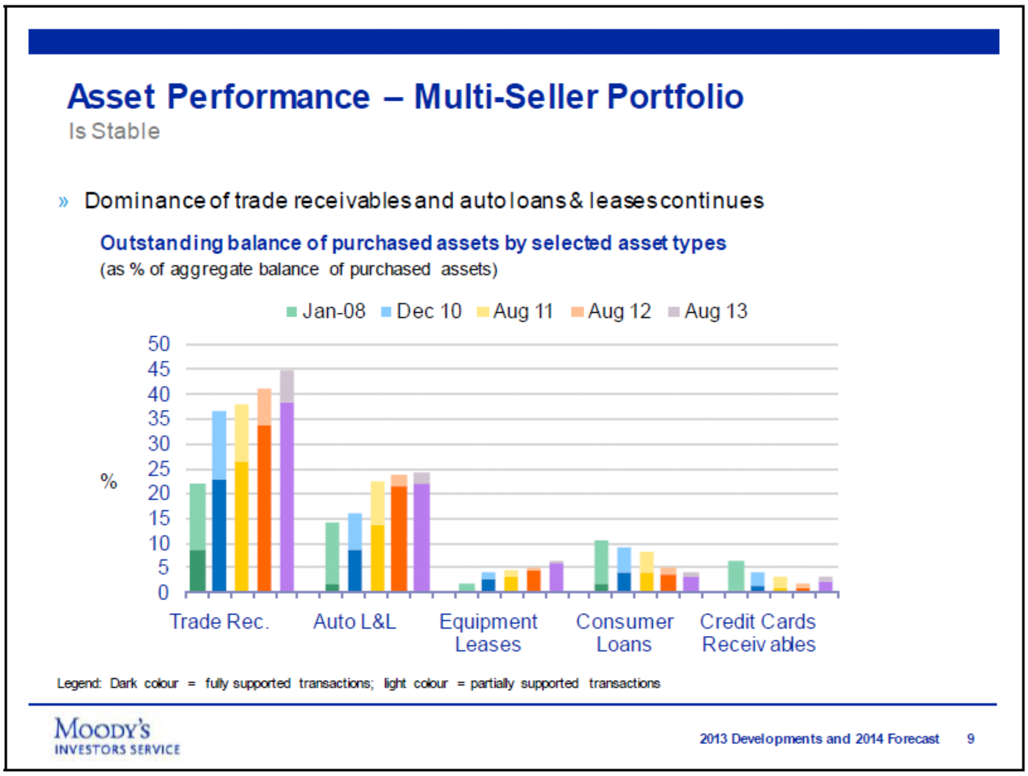
** Data as of August 13

Moody's Investors Service

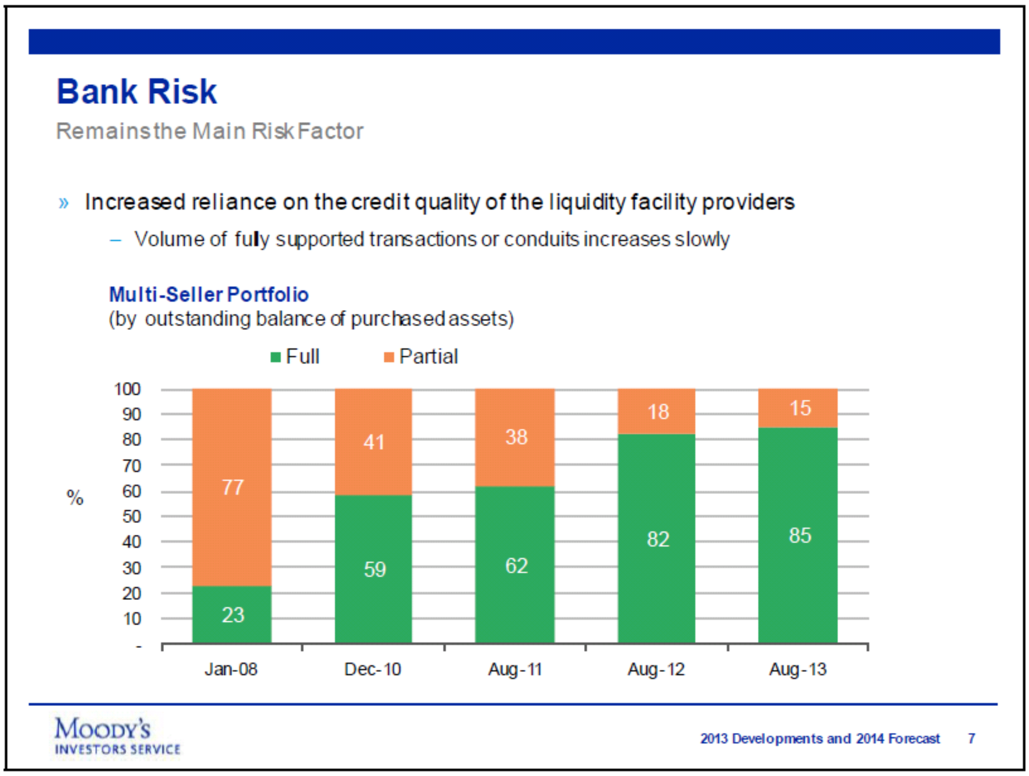
2013 Developments and 2014 Forecast 3

The multi-seller conduit market

Multi seller conduits mainly securitise trade receivables and auto loans and leases. To a lesser extent, also equipment leases, consumer loans and credit cards.



All these asset classes benefit from highly granular portfolios, originators with a direct link to the real economy and in most instances fully support liquidity lines provided by the sponsoring bank, i.e. the sponsoring bank has significant skin in the game.



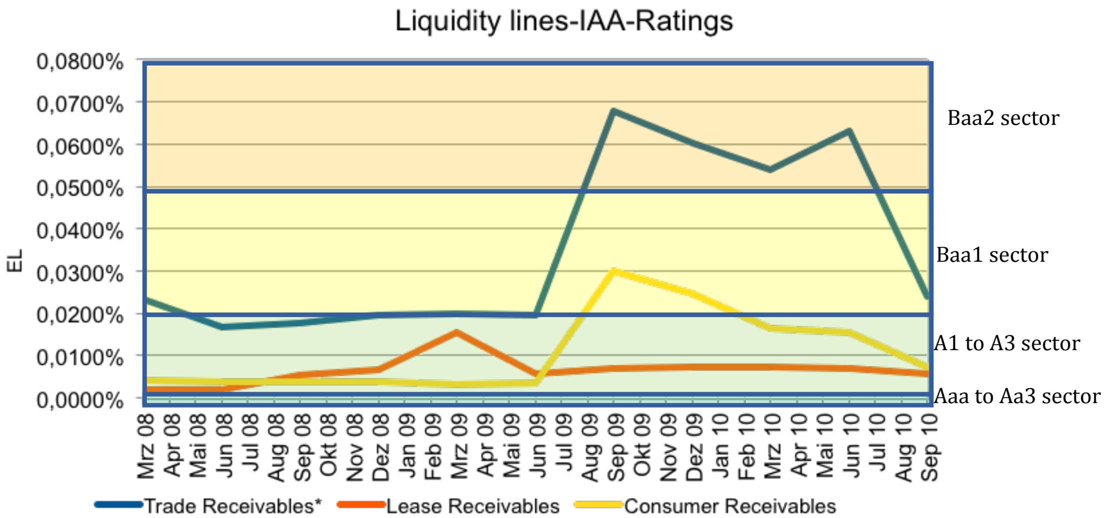
Performance of multi-seller conduits:

The conduits business, especially the real economy related multi-seller conduit business, has experienced a stable and sound performance development, also through the financial and economic crises of 2007/2008 and subsequent years:

- No ABCP investor in a multi-seller-conduit has ever suffered a loss (zero loss experience);
- Pool assets are based on economic transactions such as delivery of goods or selling/leasing of motor vehicles;
- Underlyings and structures are extremely resilient so that no seller/ servicer default has ever caused losses to an investor or (to our knowledge) to a sponsor bank;

- Structures are typically relatively simple, therefore very low structural or model risk;
- Liquidity facilities are subject to a strict regulatory regime (IAA-approval, LCR) and benefit from the flexibility of the transaction and programme structures (triggers, covenants, dynamic credit enhancements, credit insurance, etc).

Performance data from 89 German conduit transactions (collected by TSI in 2010) provide evidence of the stability of the structures during the financial/economic crises (fluctuations are in line with the economic cycle):



The above diagram shows the IAA ratings of the liquidity facilities from 6 German multi-seller conduits, representing 89 transactions (67 trade receivables, 18 leases, 4 consumer loans). Rating fluctuations do not exceed 3 rating notches and recover to the old levels within one year. The peek between mid-2009 and mid-2010 reflects the economic downturn in Germany during the financial crises. However, where IAA-ratings had a high-low-range of 0.05%, the respective corporate ratings (of the same sellers – see also question 12) had a span of 0.5% - ten times the volatility. It thus demonstrates that multi-seller conduits are closely linked to the real economy and perform well even in times of economic stress.

Investor position in ABCP

Sponsor banks are willing to take the risk of the securitisation on their own books by providing fully supported liquidity facilities. Investors are protected twice: (a) by the portfolio and its structure (as shown above) and (b) through the full support by the liquidity/sponsor bank, which caters for funding and asset default coverage beyond the transaction specific credit enhancement. This also leads to an alignment of interest between the sponsoring bank and investors since both are interested in a stable and robust collateral pool.

2. Please provide an overview of the investor base for securitisation products.

(German) Multi-seller conduits

There are no public statistics on investors in multi-seller conduits. However, an estimated breakdown of the investors of the main German conduits shows the following picture:

Corporates	30%
Insurance	20%
Money market funds	10%
Banks (incl. drawn liquidity)	40%

3. Following on from the previous question, securitisation products may be purchased by both banks, insurers, and certain other parties. Each of these investors may be exposed to different risks (credit risk, spread risk, etc), depending on whether they are trading or holding to maturity. Can you provide evidence to support the relative split of activity in these types (for example, share of ABSs held to maturity, share of ABSs held for trading; split by banks, insurers, as well as other investor types)?

ABCPs are short term products. They are held solely as a short-term liquidity buffer. There is almost no secondary market or trading.

The risk to which investors are exposed is mainly the bank counterparty risk from the full liquidity support. Investors often allocate the ABCPs to their respective (internal) bank lines. Usually investors do not buy conduit programmes sponsored by banks that they have not approved.

Impact of current and expected regulation on the revival of the EU securitisation market

4. Please specify all current and expected regulation in the EU and international that is impacting the revival of the securitisation market. Please specify why and how each specific regulation (CRR, Solvency II, EMIR, AIFMD, Basel, etc) of the regulation is impacting the recovery of the securitisation market.

As described above, investors in ABCP are sourced from different sectors. As ABCP are securitisation positions – even if fully supported by a liquidity bank – investors have to treat them according to their own regulatory environment. With banks, insurance companies and money market funds (MMF) as investors, ABCPs have to cope with CRR, Solvency II, AIFMD and the MMF regulation. For the sponsor or liquidity bank, the applicable regulations are mainly the CRR, CRA III and Basel III.

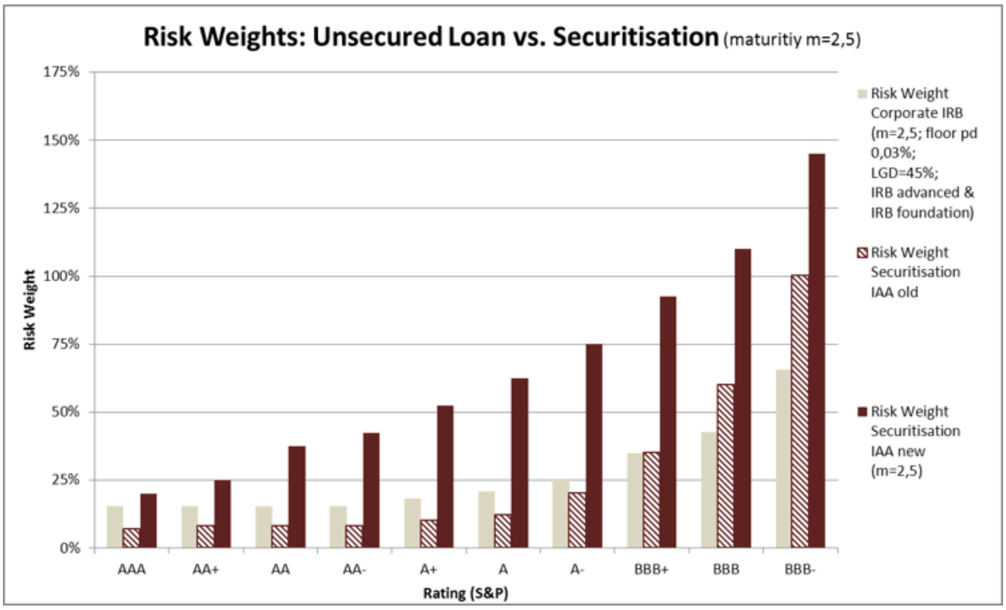
The following table provides an overview of the regulations to which conduits are exposed:

<table>
<tr><th></th><th>Impact on securitisation</th><th>Potential consequences</th></tr>
<tr><td>Revision Sec. Framework (BCBS 269)</td><td>- IRBA: unusually no IRBA possible due to lack of loan-by-loan data/Pool KIRB in ABCP conduits since these are no bank assets and high in number (several 100,000s)
- ERBA link of IAA: capital disadvantage to IRBA although IAA = internal rating;
- Maturity definition: no recognition of contractual limitations to WAL</td><td>Risk weights for liquidity banks will multiply 3-4 times compared to current framework and exceed risk weights for senior unsecured loans, ABCP financing will become very expensive for sellers and unattractive for sponsors.</td></tr>
<tr><td>Solvency II</td><td>EIOPA HQ definition not applicable to multi-seller ABCP conduits (trade receivables not eligible, no listing, no loan-by-loan reporting)</td><td rowspan="2">Insurance companies and money market funds will no longer be able to invest in ABCP. This will have severe pricing implication to the disadvantage of the real economy.</td></tr>
<tr><td>MMF Regulation (Art. 10)</td><td>The current condition for ABCP is too narrow and leads to a factual investment stop (exclusion of leasing receivables locks out most ABCP programmes)</td></tr>
<tr><td>CRA 3 (Art. 8b)</td><td>Disclosure requirements for confidential transaction documentation are critical (documentation on ABCP transactions contains highly confidential information such as terms of trade, dunning process, etc)</td><td>Companies will not accept the disclosure of business secrets and terminate their ABCP financing.</td></tr>
<tr><td>LCR (Art. 424 (5))</td><td>Liquidity outflow assumption on ABCP liquidity lines is 100% as opposed to 10% for corporate credit lines</td><td>Liquidity costs will cause a rise in liquidity fees.</td></tr>
<tr><td>Large exposure (RTS final draft)</td><td>Look-through approach for large underlyings may prevent sponsors from establishing new conduits and/or restrict volumes. Exposure allocation to the unknown client may hinder growth of conduit.</td><td>Corporates may not be able to securitise all their trade receivables due to restrictions of the sponsor bank on large exposures.</td></tr>
<tr><td>CRR/CRD IV (RTS on Art. 405 – 409)</td><td>Risk retention of liquidity lines, due diligence and stress tests sufficiently clear, disclosure of materially relevant data sufficiently clear</td><td>Most sponsors of ABCP conduits should be able to comply with the rule.</td></tr>
</table>

5. Please illustrate the differences in regulatory treatment of loans, covered bonds and securitisation of the same asset type, and the consequences of such differences?

For many larger corporates financing via conduits is one of various means of obtaining funding. Others are bilateral or syndicated loans, corporate bonds or "Schuldscheindarlehen" (certificates of indebtness).

In all these instances, investors in such alternative instruments are directly exposed to the (usually unsecured) corporate risk, i.e. have to compare the regulatory treatment of the corporate risk with the securitisation risk that they have if they buy an ABCP. The situation for the sponsoring bank is similar: it compares the regulatory situation of an (unsecured) corporate exposure with the treatment of the alternative liquidity line. The new proposal of the BCBS (BCBS 269) significantly increases the capital requirements for liquidity lines to multi-seller conduits (if using the IAA) and makes it disadvantageous for a (sponsor) bank to offer a securitisation. Instead, the unsecured corporate loan provides much better capital treatment for the same risk, which conflicts with the secured character and granularity of the securitisation.



6. Following on from the previous question, is it justifiable for whole loan portfolio to attract less regulatory capital than senior tranches of such portfolio securitisation - why or why not? Should the regulatory treatment of whole loan portfolios and of their securitisations be harmonised - why, how, consequences?

As shown above, banks will be discouraged from offering (secured) securitisations and instead be incentivised to offer (unsecured) direct lending (via loan or bond). The multi-seller conduits market would dry up or only be attractive for those corporates that are not able (any longer) to borrow money from the banking or capital markets in their own name. This does not seem to be an appropriate and reasonable development since it

- shifts corporate exposures from secured into unsecured;
- constrains the corporate sector to obtain funding;
- increases the counterparty risk to large corporates on the bank side;
- makes the remaining multi-seller transactions very expensive for the sellers and less secure for the liquidity banks (as mainly weaker sellers will use the instrument);
- makes the banking sector more vulnerable to economic crises.

Therefore, multi-seller conduit transactions and direct lending business to the corporate sector should have a level playing field in terms of the regulatory regime.

Rationale for public authorities developing a "high quality" securitisation product

7. How would you define a "high quality" and "low credit risk" securitisation product/tranche (without reference to external ratings)? Please provide historical performance evidence to justify your answer.

As multi-seller conduits differ from the usual structure of a term securitisation there should be specific high quality criteria for multi-seller conduits independent of the nature of the assets that they securitise. There should also be separate treatment of (bank) investors vs liquidity banks as their roles and regulatory rules differ.

For ABCP investors, possible criteria for "high quality" are:

- Underlying assets of the ABCP do not contain securitisation positions (no re-securitisation) or other securities that are publicly or privately distributed in the market ("no security arbitrage business");
- The conduit must have five or more sellers ("multi-seller");
- The conduit refinances only real economy receivables, i.e. receivables originated by a corporate/SME or receivables arising out of the financing of goods ("real economic link");

- The ABCP is fully covered by a liquidity line that also covers the credit risk of the assets (*"fully supported liquidity"*);
- The sponsor fulfils the disclosure requirements under Article 408 of the CRR and Articles 22 – 24 of the RTS from 17 December 2013, as applicable to ABCP transactions (*"transparency"*);
- An information memorandum for the ABCP programme is available that describes the structural features (including a detailed investment policy) of the programme and the names and roles of the various counterparts involved (except for seller and/or debtor names) ("documentation").

For liquidity banks, possible criteria for "high quality" are:

- The liquidity bank also acts as the sponsor of the programme (*"sponsor"*);
- The liquidity line ranks at least pari passu with the ABCP and in senior position (*"senior tranche"*);
- The underlying assets fulfil the criteria *"no security arbitrage business"* and *"real economic link"* as above;
- The seller(s) retain an economically relevant portion of the risk [1] (*"skin in the game"*);
- The seller continues to act as the servicer of the assets sold in the same manner as for its unsold receivables and is not insolvent. The sponsor or an independent third party (e.g. an auditor) must have undertaken an initial ample due diligence of the quality of the receivables management process and further due diligences on a regular basis on the validity and soundness of the receivables (*"high servicer quality"*);
- The liquidity bank monitors the performance of the underlying assets and the structure at least monthly (*"monthly monitoring"*).

8. Do you think the public authorities should set out criteria for a particular set of "high quality" securitisations? What do you consider the benefits of this approach would be?

YES. The variety of securitisations is so wide that a one-fits-all-approach for high quality would not be precise enough.

9. What type of firms would you consider the most appropriate investor base for "high quality" securitisation?

Regulated banks, insurance companies and money market funds.

High quality should be equally defined in all relevant regulations (Basel/CRR, Solvency II, MMF regulation).

[1] Not necessarily 5%, due to accounting reasons on the corporate side (retention must not substantially exceed the expected loss in order to gain risk transfer).

10. Are there any trades-offs between encouraging low risk securitisations and encouraging securitisation as a funding tool to benefit the real economy?

See question 6

Corporates (as sellers) and/or structures that do not fulfil the requirements for high quality can still use conduit structures for their funding needs. However, these low quality deals will most likely be more expensive for the sellers and the sponsor/liquidity bank so that there is a clear incentive to bring these deals into the high quality range. This will strengthen both banks and the real economy.

Historical performance of different classes of securitisations

11. Historical default/impairment data is one of the criteria commonly used to evaluate the performance of different securitisation classes. Data on default/impairment for the 2007-2009 time clearly that certain classes of securitization performed differently.

a. Where certain classes of securitisation suffered few losses over this period, what were the key drivers of their better performance?

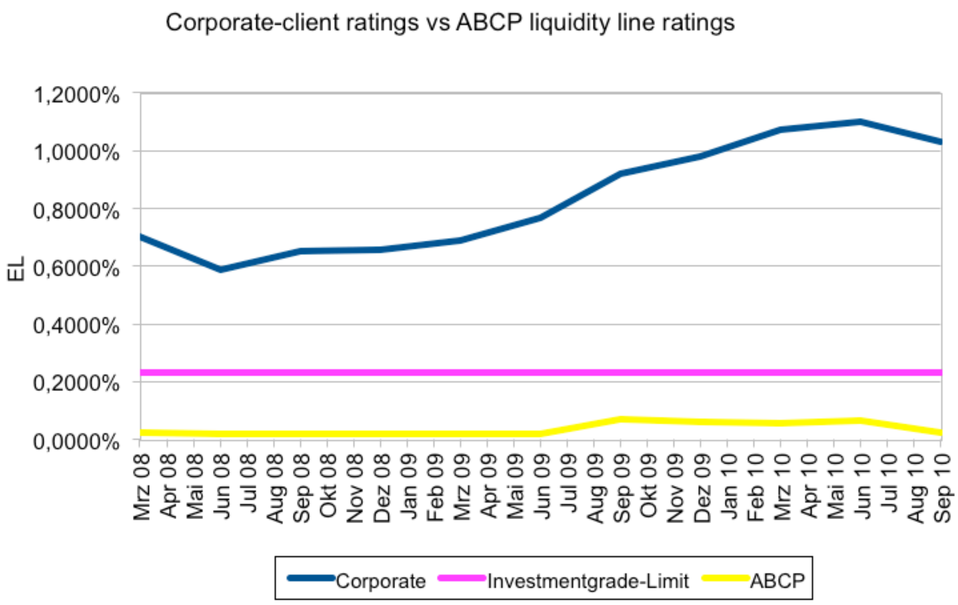
b. Where certain classes of securitisation suffered greater losses over this period, what were the key drivers of their worse performance?

Not applicable to multi-seller conduits. However, overall securitisation issues were:

1. Reliance on external rating only without market knowledge (US real estate sector);
2. Significant asset/liability mismatch, e.g. in real estate business funded with short-term products.

12. Are there any other insights which can be drawn from historical data on securitisation over a longer time period?

As shown in question 1, the performance of multi-seller conduit transaction with trade receivables, loans, leases or consumer loans has been very sound and stable. As these ABCP structures are used solely for funding purposes of corporate sector sellers, it should be considered what the performance of an alternative corporate loan or bond might have looked like. The TSI survey (see question 1) also compared the IAA-ratings of the liquidity lines with the respective ratings of the corporates that had been the sellers into the conduits. The corporate ratings had not only been worse than the respective conduits transaction; the rating volatility had also been much higher.



13. What criteria should be considered, beyond historical default/impairment performance, to assess the safety and quality of different securitisation products?

As shown in the question above, the high quality of a securitisation product should also be compared with the quality of an alternative product (e.g. unsecured corporate loans). This avoids unexpected consequences in terms of product shifts into less stable products.

It should also be borne in mind that a Multi-Seller conduit structure – unlike an ABS bond – has various possible ways of improving the stability of the structure during the lifetime of a transaction (e.g. dynamic credit enhancements, shortening of cash sweep intervals, etc).

Criteria for differentiating among securitisations

14. Which are the main **structural features** of the transaction relevant to the overall safety and quality of securitisation products from an investor perspective?

The full liquidity support by the conduit sponsor is clearly the most dominant factor for the safety and quality of an ABCP investment. However, further aspects such as high portfolio granularity (through various sellers from different industries), the close link to the real economy and additional transaction specific credit enhancement such as commercial credit insurance increase the safety for the investor.

15. Are there any **originator characteristics** that are relevant to the overall safety and quality of securitisation products from an investor perspective?

From the seller's perspective, the securitisation of receivables should be one (but not the only) means of funding its business. Such business must have a real economic link, i.e. it is not financing per se but is intended to be used to fund the distribution of goods or services. Sellers (or their parents) are typically non-banks. Accordingly, the definition of high quality should admit as sellers all companies that provide services or sell goods as a main part of their business or otherwise directly support the real economy (e.g. by the financing of goods via leasing or loans). Moreover, the sellers should continue to act as servicers of the assets sold within their normal business procedures and may not originate or service the receivables sold differently than any other receivables (no "originate-to-distribute"). The receivables management must be of high quality and be evaluated and regularly supervised by the sponsor bank (initial and regular due diligence by the sponsor or an independent auditor). Finally, sellers must retain a certain skin in the game (whether by means of a refundable purchase price reduction, reserves or otherwise).

16. Which are the main features of the **underlying assets** in the transaction to the overall safety and quality of securitisation products from an investor perspective? If you are in favour of including/excluding specific underlying asset types, which ones would you include/exclude?

The underlying assets must have been originated in the seller's normal course of business and should (to the extent possible) be secured by the goods delivered. This is usually the case with trade receivables as well as with auto loans and leases or with equipment leases.

17. Are the existing **transparency requirements** in EU legislation and other market standards sufficient to ensure the overall safety and quality of the securitisation products from an investor perspective?

Yes. The investor report in ABCP programmes gives investors sufficient information. It should be clearly mentioned that loan-by-loan data is not deliverable because of the immense number of data-points (estimated at around 800,000 to 1,000,000 single receivables in larger multi-seller conduits), the quick turnaround of the receivables and the risk coverage by the liquidity bank. Therefore, loan-by-loan data as a high quality criteria for investors in ABS term bonds is not an applicable criterion for ABCP investors.

18. Are **concentration/granularity** of portfolios relevant to the overall safety and quality of securitisation products? Would a definition of granularity based on economic sector and/or

geographical location be useful?

In principle, concentration/granularity are relevant factors. However when addressed appropriately (e.g. through larger credit enhancement or credit insurance), higher concentrations are not automatically an indicator of lower quality. Similarly, it would not be useful to demand a specific geographic or industry distribution in multi-seller conduits as this is dependent on the sellers' businesses and not on the programme sponsor and may – with regard to geographical stratification – also change over time. With the requirement to have a minimum number of transactions/sellers in the programme of a multi-seller conduit (e.g. at least 5), granularity will be created automatically for the investors.

19. Does the **synthetic vs "true sale"** type of transaction affect the overall safety and quality of the securitisation product?

Transactions within multi-seller conduits are usually structured as true sale.

20. Does the level of **leverage** affect the safety and quality of the securitisation products? In which asset classes?

Not applicable in multi-seller conduits. The structures usually only have a first loss and a senior tranche, which is the ABCP or the liquidity line. Leverage is minimal.

21. Does the level of **maturity mismatch (re-financing risk)** between underlying assets and liabilities affect the safety and quality of the securitisation products? In which asset classes?

In general, this is the case in some term ABS/CMBS but investors in ABCP are protected by the liquidity facility against maturity mismatches. On the other hand, the liquidity bank has a certain re-financing risk but this risk is already absorbed by the LCR requirement to hold high liquid assets against a 30-day outflow.

22. Do you consider the **criteria proposed by EIOPA** in their Technical report on Standard Formula Design and Calibration for Certain Long Term Investments (published on December 19th 2013) to differentiate between securitisations by Type A and Type B appropriate? What are the main benefits and drawbacks of this approach?

As described above, the criteria cannot be applied to ABCP conduits. Therefore, specific high quality criteria for ABCP conduits are necessary (see question 7).

23. How do the **PCS label criteria** differ from the **EIOPA criteria**?

Not applicable to ABCP conduits.

24. Do you consider the PCS label criteria an appropriate way to identify "high quality" securitisations? What are the main benefits and drawbacks of this approach?

Not applicable to ABCP conduits.

25. Are there any other criteria (in the EU or abroad) that could inform the discussion?

Not as far as we know.

Preferential treatment for "high quality" securitisations

26. Should EU regulators differentiate the prudential treatment of securitisations by treating different product categories differently? If yes, please explain why.

The specific structure of multi-seller conduits differs significantly from "normal" ABS. Transactions within multi-seller conduits serve the sellers as an alternative funding tool versus other credit means. As shown in question 5, the regulatory treatment of multi-seller conduits needs to be adequately adapted to the regulatory treatment of corporate credit business. Otherwise unintended consequences and adverse affects for the economic sector and the stability of banks may occur.

27. In which regulatory areas (capital, liquidity, collateral, other) should a preferential treatment be given to "high quality" securitisations?

The capital and liquidity requirements (under BCBS 269 and the LCR in Article 424 of the CRR) make financing via multi-seller conduits relatively unattractive compared to the corporate credit business. Lower capital charges as well as the introduction of a conversion factor for the liquidity outflow assumption (e.g. 20-50% instead of 100%) would create a level playing field in corporate finance.

28. How would you differentiate between the capital requirements of "high quality" securitisation and other securitisations? How would you calibrate the credit risk of "high quality" securitisations to the regulatory capital requirements?

The benchmark should be the IRB risk weighting for corporates with the same credit quality (see chart under question 5). A level playing field would thus be achieved.

29. If you consider a preferential capital treatment for "high quality" securitisations is appropriate, is this differentiation appropriate regardless of the overall level of calibration of securitisation capital requirements? If yes why and how would you calibrate the capital requirements both in relation to the Basel II framework and the proposals currently under consultation?

Yes. See above.

30. Should "high quality" securitisations be treated differently in aspects other than regulatory capital such as due diligence, retention, liquidity, reporting? If yes, please explain why, in which areas and how?

No. Due diligence, retention, liquidity and reporting are measures for high quality and not the consequences. Only the LCR should be amended (see question 27).

Impacts of developing a "high quality" securitisation market in the EU

31. Do you see any risks or adverse impacts if different securitisation products receiving the same external rating are subject to different prudential treatment?

No because alternative products for corporate financing (e.g. unsecured corporate bonds) with the same rating currently also receive different capital charges (see question 26). Multi-seller conduit transactions differ significantly from other securitisation forms. This also justifies different capital treatments.

32. There is regulatory activity affecting banks/insurers/money markets funds/other entities, as well as on topics relating to capital/liquidity/transparency/other requirements, and further regarding securitisations/covered bonds/other fixed income. In your view, how can preferential treatment be granted in a consistent manner for securitisations across these various requirements?

It would be preferable if there is one single source for the definition of various terms and requirements. Not only the definition of high/low quality securitisation should be aligned but also expressions such as "sponsor", "originator" and "maturity" or requirements such as "due diligence", "stress-testing" and "disclosure" (e.g. the disclosure requirements for multi-seller conduits under the CRR, the money market fund regulation, CRA III and Solvency II should match).

33. Following on from the previous question, do you see any risks or adverse impacts if differentiation criteria are proposed, in banking prudential regulation, which are different from the criteria proposed in the insurance sector (EIOPA) or other sectors?

An uneven list of criteria would at least create additional costs for the sponsors, which in turn would be passed on to the sellers, i.e. the corporate sector. Financing costs for corporates would rise. In the worst case, unrealisable requirements (e.g. delivery of loan-by-loans data) would exclude important investor segments from the product so that pressure on funding costs may also arise from that angle.

34. How would the EU securitisation market develop if "high quality" securitisation was introduced in the CRR following the EIOPA criteria and if those "high quality" securitisations received the same regulatory treatment as covered bonds? Please include expected growth and volumes level per asset class.

Lower capital and/or liquidity costs would be transferred directly to the sellers as competition in the market will increase. New conduits sponsors may also enter the market and provide additional financing capacity for the corporate sector. Parts of the direct lending to corporates may also possibly shift into structured financing (via ABCP), which – in our view – should help to stabilise the banking sector. Unlike SME CLOs for example, transmission between the corporate sector and the securitisation market is much more direct so that the corporates will immediately and directly (through lower funding costs) benefit from any privileges for multi-seller conduits.

35. How would preferential treatment of certain securitisations benefit the long term financing of the EU economy?

See above.