

Comments

on EBA discussion paper on a STS framework for synthetic securitisations

Register of Interest Representatives

Identification number in the register: 52646912360-95

Contact:

Felix Krohne

Advisor

Telephone: +49 30 1663-2190

Fax: +49 30 1663-2199

E-Mail: felix.krohne@bdb.de

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent approximately 1,700 banks.

True Sale International GmbH (TSI) emerged in 2004 from a banking initiative in Germany to promote the German securitisation market. Today, the topics of the TSI go far beyond this and cover broad areas of the asset-based finance market.

Coordinator:

Association of German Banks

Burgstraße 28 | 10178 Berlin | Germany

Telephone: +49 30 1663-0

Telefax: +49 30 1663-1399

www.die-deutsche-kreditwirtschaft.de

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Questions

Question 1: Do you have any comments on this introductory section of the Discussion Paper?

Especially the European **SME sector**, which is mostly financed through loans, **should benefit from** all types of credit programme financed through the securitisation markets instead of being excluded. **Synthetic securitisations** are a major part of securitisation markets and important instruments of credit risk transfer and therefore should be included in a framework for simple, transparent and standardised securitisations.

Considering the relatively **positive acceptance of the STS label in traditional securitisations** by market participants since March 2019, moreover, we recommend building on this development, avoiding any further fragmentation and complexity in regulations, and therefore apply the existing STS framework to synthetic securitisations as much as possible. This relates to the STS criteria themselves as well as the regulatory benefits connected to the STS label such as reduced capital risk weights. As a general rule, the same portfolio of receivables should be treated in a very similar and consistent way regardless of whether a traditional securitisation is carried out (funding purposes only, or for both funding and capital benefits in the case of a full stack transaction or SRT) or a synthetic securitisation ('only' seeking capital and risk transfer). However, in order to reflect the particularities of synthetic transactions, certain adjustments of STS criteria are obviously needed. In addition, the required level of transparency should be analysed carefully: the high STS standard of transparency towards affected parties (which are very few in synthetic transactions) should not lead to public disclosure requirements.

Question 2: Do you agree with the analysis on the market developments? Please provide any additional relevant information to complement the analysis.

Yes, we agree.

Question 3: Do you agree with the analysis of the historical performance? Please provide any additional relevant information to complement the analysis.

Yes, we agree.

Question 4: Do you agree with the analysis of the rationale for the creation of the STS synthetic instrument? How useful and necessary is synthetic securitisation for the originator and the investor? What are the possible hurdles for further development of the market?

The essential **benefit** of **synthetic securitisation** for many originating banks is the **transfer of credit risk** to third parties **when (i)** true sale transactions (traditional securitisations) cannot be employed since bank customers do not want the bank to sell their loans (**transfer clause limitations**) or when (ii) the analysis of further parameters such as achievable level of risk transfer, liquidity requirements, transaction costs and timing prove a synthetic securitisation to be far more efficient compared to a traditional securitisation. Balance sheet synthetic securitisations performed consistently better than arbitrage synthetics and were typically structured to be far less complex than the latter. Therefore the

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ban of arbitrage synthetic transactions was an important step. Nevertheless, there is a need for balance sheet synthetic securitisations for risk management and for risk transfer outside of the banking sector. The consideration of this point is particularly important given the potentially rising capital requirements of banks in the EU (+EUR 135bn according to the EBA impact assessment study of July 2019) and rising uncertainties from a geopolitical and macroeconomic perspective. The availability of synthetic securitisations as an instrument for capital and risk management and with established markets is key for EU banks going forward.

Risk transfer products are suited for **experienced investors** who should have the knowledge and a comprehensive need for relevant data. So these skilled investors **might invest without a STS label anyhow. Nevertheless to achieve "level playing field"** with the regulatory treatment of true sale STS deals, the **label creation could be positive**. For banks the synthetic securitisation is a powerful instrument to manage risk/balance sheet. Regulatory uncertainty, uneven treatment and detailed reporting requirements in a bilateral market are possible hurdles.

Question 5: Do you agree with the assessment of the reasons that could eventually support a preferential capital treatment?

Yes, a preferential capital treatment (of senior tranches) should be the logical consequence of the STS label. It should be noted in this context that lower risk weights for bank investors (and capital charges for insurance investors under Solvency II respectively) and the consideration in the LCR ratio have been the prevailing reason for the wide acceptance and implementation of STS in traditional securitisations.

Question 6: Please provide any additional relevant information on potential impact of the creation of the STS synthetic securitisation on (STS) traditional securitisation, and any other information to complement the analysis.

The **missing legal transfer of the assets** – which in many cases is **owed to bank secrecy, data protection and privacy laws** on European or national level – **is mitigated by other structural features** (cash deposit by investors, early termination in case of protection buyer insolvency). All other STS criteria are already fulfilled. In addition **synthetic securitisations are less costly** than true sale transactions (no SPV, less documentary burden, fewer external counterparties involved) and have a **positive impact on** the ability of a bank to lend to **SME**.

The successful establishment of STS for synthetic securitisation will lead to a much stronger overall market for securitisations in the future, and the choice between traditional (funding and potentially risk transfer) or synthetic ('only' risk transfer) securitisation will be part of banks capital management strategy. We do not expect any negative consequences for traditional STS securitisations.

Question 7: Do you agree with the criteria on simplicity? Please provide comments on their technical applicability and relevance for synthetic securitisation.

The **double hedging** situation **should be clarified** as an intended double hedging to evade documentation or regulatory requirements. A **risk neutral substitution mechanism** to mitigate modelling effects to ensure an effective risk transfer structure should be considered eligible.

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Open lines should be clarified as an eligible component within synthetic STS structures. (“...made at least one payment”)

Question 8: Do you agree with the criteria on standardisation? Please provide comments on their technical applicability and relevance for synthetic securitisation.

Criterion 22: We do agree with the proposal of a **reference register** to support standardisation and avoiding conflicts between transaction parties. The above mentioned aspect of confidentiality should be considered, assuring that data protection law in general and contractual arrangements in the underlying loan documentation is complied with, e.g. limiting access to such reference register to the protection buyer, the protection seller and banking supervisors/regulators.

Question 9: Do you agree with the criteria on transparency? Please provide comments on their technical applicability and relevance for synthetic securitisation.

- Risk transfer trades are predominantly bilateral contracts. Investors should feel adequately informed by the data history provided. There are situations where a **five-year consistent history** is not easily achievable.
- To install an **external verification** prior to closing is - for in most cases replenishing structures - an expensive and not ultimately helpful third party appointment.
- The **publication of a precise cash flow model** for synthetic transactions is not intuitive, availability should be limited to the protection buyer, the protection seller and banking supervisors/regulators. The risk premiums will be paid by the protection buyer despite potential cash flow issues.
- All **transparency requirements** should be simplified for bilateral deals where no further investor is involved.

Question 10: Do you agree with the specific criteria for synthetic securitisation?

- The **verification agent** should be activated when losses are allocated to investors or certain threshold levels (pool/assets) are reached, to avoid complexity and costs.
- **Excess spread** is a helpful mechanism for investors and originators. It can be defined as a straight forward mechanism and should not be generally treated as STS ineligible, especially if it is structured in the same way as in traditional securitisations, i.e. excess spread inherent to the underlying portfolio, not guaranteed in terms of timing and size. We therefore propose to clarify that excess spread is generally allowed and that committed forms of excess spread may contribute to a less complex structure on the one hand but might prevent the recognition of SRT and capital relief on the other hand.

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Question 11: Do you agree with the criterion 36 on eligible credit protection agreement, counterparties and collateral? Please provide any relevant information on the type of credit protection and different collateral arrangements used in market practice and their pros and cons for the protection of the originator and the investor.

It is unclear who should specify the “**sufficient credit quality**” of the cash collateral counterparty. In most cases rating agencies are no part of a synthetic risk transfer transaction anymore.

Question 12: Please provide suggestions for any other specific criteria that should be introduced as part of the STS framework for simple, transparent and standardised securitisation.

To have a “level playing field” the handling of **accrued interest / enforcement cost** could be addressed.

Question 13: Do you see a justification for possible introduction of a differentiated regulatory treatment of STS synthetic securitisation? If yes, what should be the scope of such treatment and how should it be structured – for example only for senior tranche retained by the originator bank, or more limited/wider?

We see **no economic argument to treat traditional and synthetic STS differently** in the regulation. As stated above, the introduction of a preferential regulatory treatment will be key to success to establish STS for synthetic securitisations and is well justified by historical performance data.

Question 14: What would be the impact if no differentiated regulatory treatment is introduced? In that case, is the introduction of the STS product without differentiated regulatory treatment relevant for the market?

If the STS label is not supported by a different regulatory treatment this label will have no serious benefits. As a consequence **the label will have no relevance**. The existing investor side is comfortable with the product even without the label. New investors should develop the required skills anyhow and should not rely on a label.

Question 15: What would be the impact of potential differentiated regulatory treatment from level playing perspective with regard to third countries where STS framework has not been introduced?

The market outside a potential European STS label, e.g. **US is special anyhow** with a strong **dominance of the two government sponsored mortgage agencies**.

Question 16: Should a separate explicit recommendation be included in the Recommendations section on whether or not such treatment should be introduced?

Yes