

Consultation Paper

on Draft Regulatory Technical Standards

On the retention of net economic interest and other requirements relating to exposures to transferred credit risk (Articles 394, 395, 397 and 398) of Regulation (EU) No [xx/2013]

and Draft Implementing Technical Standards

Relating to the convergence of supervisory practices with regard to the implementation of additional risk weights (Article 396) of Regulation (EU) No [xx] of [xx/2013]



Consultation Paper on Draft Regulatory Technical Standards on the retention of net economic interest and other requirements related to exposures to transferred credit risk under Articles 394, 395, 397 and 398) of Regulation (EU) No [xx/2013]

and on

Draft Implementing Technical Standards relating to the convergence of supervisory practices with regard to the implementation of additional risk weights Article 396) of Regulation (EU) No [xx/2013]

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1. Responding to this Consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in page 43 and 44.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which they relate;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Please send your comments to the EBA by email to EBA-CP-2013-14@eba.europa.eu by 22.08.2013, indicating the reference 'EBA/CP/2013/14' on the subject field. Please note that comments submitted after the deadline, or sent to another e-mail address will not be processed.

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please indicate clearly and prominently in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an e-mail message will not be treated as a request for non-disclosure. We may be asked to disclose a confidential contribution in accordance with the law on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose your response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.eba.europa.eu under the heading 'Legal Notice'.

2. Executive Summary

The proposed Capital Requirements Regulation (CRR) sets out requirements concerning the retention of net economic interest and other requirements related to exposures to transferred credit risk which are expected to apply from 1 January 2014 and mandates the EBA to prepare draft regulatory technical standards (RTS) in this area. The proposed CRR also sets out requirements concerning the convergence of supervisory practices with regard to the implementation of additional risk weights which are expected to apply from 1 January 2014 and mandates the EBA to prepare draft implementing technical standards (ITS) in this area. The CRR mandates the EBA to submit both these RTS and ITS to the Commission by 1 January 2014.

Main features of the RTS

This Consultation Paper proposes draft RTS in accordance with Article 399(2) of the CRR regarding the securitisation retention rules and related requirements. In particular it requires the EBA to further specify:

- i) the requirements in Articles 394-395 applying to institutions becoming exposed to the credit risk of a securitisation position;
- ii) the retention requirement, including the qualifying criteria for retaining a material net economic interest as referred to in Article 394 and the level of retention;
- iii) the due diligence requirements in Article 395 for institutions becoming exposed to a securitisation position;
- iv) the requirements in Articles 397 applying to sponsor and originator institutions and the requirements in Article 398 applying to sponsor, originator and original lender institutions.

Main features of the ITS

This Consultation Paper proposes draft ITS in accordance with Article 399(3) of the CRR relating to the convergence of supervisory practices with regard to the implementation of Article 396 of the CRR. In particular, such Article 399(3) requires the EBA to further specify the measures to be taken in case of breach of the obligations in Articles 394, 395 or 398 of the CRR.

The ITS proposal provides the assessment criteria for infringements, the implementation conditions of the additional risk weights and the calculation of the additional risk weight to be used by the competent authorities.

3. Background and rationale

Background and rationale for retention rules and other related requirements in securitisation

Securitisation markets before the crisis were affected by what are termed 'misaligned incentives' or 'conflicts of interest'. These refer to situations where certain participants in the securitisation chain have incentives to engage in behaviour which, while furthering their own interests, is not in the interests of - and may be detrimental to - others in the securitisation chain or the broader efficient functioning of the market. These misalignments and conflicts are generally thought to have contributed to the loss of investor confidence in securitisation products. They are also seen as a barrier to recovery of the market.

The G20 Leaders' statement from the Pittsburgh Summit in September 2009 recommended that securitisation sponsors or originators retain part of the credit risk of the underlying assets in order to induce a stronger alignment of the interests of the issuers of securitisations and the final investors. Furthermore, IOSCO, in its September 2009 report 'Unregulated Financial Markets and Products', also recommended that consideration be given to requiring originators and/or sponsors to retain a long-term economic exposure to securitisations to appropriately align interests in the securitisation value chain. IOSCO specifically recommended that the introduction of any retention requirement needed to be carefully tailored to appropriately align interests and suggested a number of principles to assist regulators in considering retention requirement approaches for their jurisdictions.

In addition, IOSCO also recommended in its report 'Global Developments in Securitization Regulation' of November 2012, that 'All jurisdictions should evaluate and formulate approaches to aligning incentives of investors and securitisers in the securitisation value chain, including where appropriate, through mandating retention of risk in securitisation products'.

While some degree of risk retention has already occurred in practice, formalising the requirement for alignment of interests has the potential to incentivise originators, issuers and investors to properly conduct quality screenings, improve underwriting standards and adequately monitor for credit risk.

In response to the concerns raised by the crisis, governments, regulators and industry standard-setters have implemented and are considering a number of initiatives intended to re-establish securitisation on a sustainable basis.

Regulatory initiatives to date have focused on measures to remove incentive misalignments and conflicts which distorted markets before the crisis and measures intended to support accurate pricing of credit risk. They have included amongst others the following:

- i) measures that directly address the conflicts of interest created by misaligned incentives within the securitisation chain;
- ii) measures that address information asymmetry within the securitisation process by increasing transparency of the securitisation structure;
- iii) measures that address inappropriate incentives created by accounting revenue recognition principles and compensation systems for securitisers or originators; and

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- iv) reforms designed to enhance oversight of credit rating agencies governance and reduce regulatory reliance on ratings.

The nature of RTS and ITS under EU law

The draft RTS are produced in accordance with Article 10 of the EBA Regulation¹. According to Article 10(4) of the EBA Regulation, they shall be adopted by means of regulations or decisions.

The draft ITS are produced in accordance with Article 15 of EBA Regulation². According to Article 15(4) of EBA regulation, they shall be adopted by means of regulations or decisions.

The EBA expects that the majority of its RTS and ITS, including the ones contained in the present consultation, will in due course be adopted as Commission regulations.

According to EU law, regulations are binding in their entirety and directly applicable in all Member States. This means that, on the date of their entry into force, they become part of the national law of the Member States automatically without need for further transposition into national law.

Presenting these rules in the form of a draft Commission regulation should ensure a level-playing field by preventing divergent national interpretations in transposition and thereby facilitating the cross-border provision of EU financial services.

Background to these draft RTS and ITS

Article 122(a) of the Capital Requirements Directive (CRD II), 2006/48/EC, only allows investor institutions to assume exposure to a securitisation if the originator, sponsor, or original lender has explicitly disclosed to the institution that it will retain, on an on-going basis, a material net economic interest of no less than 5% and imposes due diligence requirements on investors. It also contains disclosure requirements for sponsor and originator institutions towards investors and obligations for sponsors and originators to ensure the application of the same sound and well defined criteria for credit-granting with respect to exposures to be securitised and exposures to be kept in the institution's books.

The Committee of European Banking Supervisors (CEBS) issued Guidelines on Article 122a of the CRD II with the objectives of achieving a common understanding amongst EU competent authorities on the implementation and application of Article 122a. The Guidelines furthermore aimed at increasing transparency for market participants in order to promote compliance with the applicable requirements. Additionally, common guidance on the implementation of Article 122a was regarded as an important

¹ Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC.

² Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC.

tool in restoring confidence in the securitisation market and, in turn, in helping the recovery of an additional source of funding to the real economy.

Articles 393 to 399 in the new CRR replace Article 122a in CRD II. In its drafting of these RTS and ITS, the EBA has taken into account: i) the changes in the level 1 text of CRR compared to CRD II ; ii) the current Guidelines on Article 122a and the associated Q&A published in September 2011 and iii) relevant market developments.

The EBA has developed these RTS and ITS proposals on the basis of the legislative texts for the CRR agreed by the European Parliament and the Council in April 2013.³ These texts will be subject to legal-linguistic review before being formally adopted and the final text is published in the Official Journal of the European Union. The EBA will review the RTS and ITS proposals to ensure that they take account of any changes made in the final text of the CRR, as well as to take account of any changes arising out of the consultation process.

³ The CRD/CRR text as agreed by the Council can be found at
<http://register.consilium.europa.eu/pdf/en/13/st07/st07746.en13.pdf> /
<http://register.consilium.europa.eu/pdf/en/13/st07/st07747.en13.pdf>

4. Draft on the RTS and ITS on the securitisation retention rules

Contents

- 4.1 Draft RTS on the retention of net economic interest and other requirements related to exposures to transferred credit risk (Articles 394,395, 397 and 398) of Regulation (EU) No [xx/2013]
- 4.2 Draft ITS Relating to the convergence of supervisory practices with regard to the implementation of additional risk weights (Article 396 of Regulation (EU) No [xx/2013])

COMMISSION DELEGATED REGULATION (EU) No .../...

supplementing Regulation (EU) No xxxx/2013 of the European Parliament and of the Council by way of regulatory technical standards specifying the requirements for investor, sponsor, original lenders and originator institutions relating to exposures to transferred credit risk

of dd mmmm 201y

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No xxxx/2013 of the European Parliament and of the Council of dd mmmm yyyy on⁴, and in particular Article 399(2) thereof,

Whereas:

1. Experience to date of the application of the retention, due diligence and related requirements for securitisation positions imposed by Union legislation has demonstrated that further specification is needed to ensure a uniform application in all Member States.
2. A general principle underlying the approach to these requirements is that institutions should satisfy the applicable obligations in relation to each of the roles that they assume.
3. Institutions should only be required to fulfil the requirements related to the retained interest and due diligence requirements in relation to transactions, or levels of transactions, in which they are in fact exposed to the credit risk of the securitisation position. So, in the context of a re-securitisation, where an institution has only assumed exposure to the second, “repackaged” level of the transaction, the institution only needs to ensure at that level of the re-securitisation that the originator, sponsor or original lender has explicitly disclosed that it will retain the economic interest. If the institution assumes exposure not only to the level of the re-securitisation but also to the level of the securitisation that constitutes the first, “underlying” layer of the re-securitisation, then it should ensure that the originator, sponsor or original lender in relation to both levels of the transaction has fulfilled the requirements.
4. In order to ensure a uniform approach, this Regulation deals with issues relating to the application of the retention commitment including compliance when there are multiple originators, sponsors or original lenders, details regarding the different retention options, how to measure the retention requirement at origination and on an on-going basis, and how to apply the exemptions.
5. The term original lender should be understood to refer to an entity which, either itself or through related entities, directly or indirectly, originally created the obligations or

⁴ OJ...

potential obligations of the debtor or potential debtor giving rise to the exposure being securitised and which is not the originator.

6. In order to ensure the ongoing maintenance of the net economic interest, institutions should ensure that there is not any embedded mechanism in the securitisation structure by which the minimum retention requirement at origination would necessarily decline faster than the interest transferred. Similarly, the retained interest should not be prioritised in terms of cash flows to preferentially benefit from being repaid or amortised such that it would fall below 5% of the ongoing nominal value of the tranches sold or exposures securitised. Moreover, the credit support provided to the institution assuming exposure to a securitisation position should not decline disproportionately relative to the rate of repayment on the underlying exposures.
7. The purpose of the requirement related to the retained interest is to achieve an alignment of interests between the parties respectively transferring and assuming the credit risk of the securitised exposures. Where an entity securitises its own liabilities, and the originator is the final debtor in first recourse to the investor, such alignment of interests is established automatically, regardless of whether the final debtor collateralises its debt (for example when the liabilities take the form of covered bonds). In such cases it is clear that the credit risk remains with the originator throughout, so the retention of interest by the originator is unnecessary and would not improve on the pre-existing position.
8. Institutions should be able to make use of financial models developed by third parties, other than ECAs. Institutions should only use third party financial models where they have taken due care, prior to investing, to validate the relevant assumptions in, and structuring of, the models and to understand the methodology, assumptions and results of such models.
9. In order to ensure a consistent application of the due diligence obligations it is essential to specify how frequently institutions should review their compliance with such due diligence requirements, how financial models developed by third parties may be used, how to assess whether the use of different policies and procedures for the trading book and non-trading book is appropriate and how to assess compliance when the positions pertain to the correlation trading portfolio.
10. Institutions should keep in mind, in compliance with Article 13(3) of Regulation (EU) No xxx/2013 that the obligations on transferred credit risk in relation to subsidiaries in third countries shall not apply only if institutions can demonstrate that the application of such requirements would involve a breach of the laws of the relevant third country.
11. Initial and ongoing disclosure to investors on the level of the retention commitment and of all materially relevant data, including on the credit quality and performance of the underlying exposure, is necessary for effective due diligence on the securitisation positions. Disclosed data should include details of the identity of the retainer, the retention option chosen and the original and ongoing commitment to retain an economic interest. Where applicable, there should be explicit disclosure of securitised transactions where the retention requirement does not apply and the reason for disapplication should be specified.
12. Satisfactory completion of the templates provided by the ECB on the ABS loan-level data reporting requirements and by the Bank of England on ABS transparency

requirements should generally be considered to satisfy the relevant disclosure obligations.

13. This Regulation is based on the draft regulatory technical standards submitted by the European Supervisory Authority (European Banking Authority) to the Commission.
14. The European Supervisory Authority (European Banking Authority) has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093x/2010.

HAS ADOPTED THIS REGULATION:

CHAPTER I
GENERAL PROVISIONS

Article 1 - Subject matter

1. This Regulation specifies:
 - a. the requirements in Articles 394-395 of Regulation (EU) No xxxx/2013 applying to institutions becoming exposed to the credit risk of a securitisation position;
 - b. the retention requirement, including the qualifying criteria for retaining a material net economic interest as referred to in Article 394 of Regulation (EU) No xxxx/2013 and the level of retention;
 - c. the due diligence requirements in Article 395 of Regulation (EU) No xxxx/2013 for institutions becoming exposed to a securitisation position;
 - d. the requirements in Articles 397-398 of Regulation (EU) No xxxx/2013 applying to sponsor and originator institutions.

Explanatory Box

For the avoidance of doubt and in line with the CRR, originator institutions include institutions acting as originator or original lender.

Article 2 - Definitions

1. For the purposes of this Regulation the following definitions apply:
 - (1) ‘*retainer*’ means the entity acting as originator, sponsor or original lender which retains a net economic interest in the securitisation in accordance with Article 394(1) of Regulation (EU) No xxxx/2013;
 - (2) ‘*ABCP programme*’ means a programme of securitisations, the securities issued by which predominantly take the form of commercial paper with an original maturity of one year or less, as defined in Article 237(9) of Regulation (EU) No xxx/2013.

CHAPTER II

EXPOSURE TO THE CREDIT RISK OF A SECURITISATION POSITION

Article 3 - Particular cases of exposure to the credit risk of a securitisation position

1. Where an institution acts as a liquidity facility provider to a securitisation, it shall be deemed to become exposed to the credit risk of a securitisation position where the conditions in Article 250 of Regulation (EU) No xxxx/2013 are not met.

2. Where an institution acts as a derivative or hedge counterparty to a securitisation transaction, it shall be deemed to become exposed to the credit risk of a securitisation position when the hedge assumes the credit risk of the securitised exposures or the securitisation positions.

Explanatory Box

An example of a hedge that assumes the credit risk of the securitised exposure or the securitisation position is a total return swap.

3. Where an institution assumes exposure to a securitisation position, in the context of a re-securitisation with more than one level or a securitisation with multiple discrete underlying transactions, it shall be deemed to become exposed to the credit risk of only the individual securitisation position or transaction to which it is assuming exposure.

Explanatory Box

The investor institution, when investing in a re-securitisation, should verify that the retainer of the re-securitisation meets the requirement in Articles 394 of Regulation (EU) No xxxx/2013.

CHAPTER III

RETENTION OF NET ECONOMIC INTEREST

Article 4 - Retainers of net economic interest

1. The retained economic interest shall not be split amongst different types of retainer. The retention shall be fulfilled in full by either the originator, the sponsor or the original lender.
2. When the securitised exposures were created or sponsored by multiple originators, sponsors or original lenders, the retention shall be fulfilled:
 - a. by each originator, in relation to the proportion of the total securitised exposures for which it is the originator; or
 - b. by each original lender, in relation to the proportion of the total securitised exposure for which it is the original lender; or
 - c. by each sponsor, in relation to the proportion of the total securitised exposures for which it is the sponsor.

Explanatory Box

In accordance with the text of the CRR requirement the retaining entity has to be either the i) 'originator', according to Article 4(42(a) or (b)) of the CRR, ii) 'sponsor', according to Article 4(43) of the CRR or iii) 'original lender' taking account of Recital 5 of this draft Regulation, (with no exceptions).

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 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 and the respective definitions of originator, sponsor or original lender.

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.

Article 5 - Fulfilment of the retention requirement on a synthetic or contingent basis

1. The retained interest may be met in a manner equivalent to one of the options set out in Article 394(1) of Regulation (EU) No xxxx/2013 on a synthetic or contingent basis, including through the use of derivatives, so long as the following conditions are met:
 - a. the amount retained is at least equal to the requirement under the option to which the synthetic or contingent form of retention can be equated; and
 - b. the retainer has explicitly disclosed that it will retain, on an ongoing basis, a material net economic interest in this manner, including details of the form of retention, the methodology used in its determination and its equivalence to one of the relevant options.

Explanatory Box

Only the retention requirement under option (a) of Article 394(1) of Regulation (EU) No xxxx/2013 refers to the nominal value of each of the tranches sold or transferred to investors, whereas the retention commitments under options (b), (c), (d) and (e) refer to the nominal value of the securitised exposures. So the way in which the required minimum level of retention (i.e. the minimum nominal value) is computed differs depending on whether option (a) or any of the other options is applied if the nominal value of all securitisation tranches sold or transferred is not equal to the nominal value of all securitised exposures (e.g. in case of overcollateralization).

Article 6 - Retention option (a): pro rata retention in each of the tranches sold or transferred to investors

1. A retention of no less than 5% of the nominal value of each of the tranches sold or transferred as referred to in option (a) of Article 394(1) of the Regulation (EU) No xxxx/2013 may be achieved by the following:
 - a. retaining at least 5% of the credit risk of each of the securitised exposures, provided this credit risk ranks at least *pari passu* with the credit risk securitised for the same exposures. In the case of a revolving securitisation, as defined in Article 237(1)(12a) of Regulation (EU) No XXXX/2013, this would occur through retention of the originator's interest assuming the originator's 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; or

Explanatory Box

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) of the Regulation (EU) No xxxx/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?

- b. the provision, in the context of an ABCP programme, of a liquidity facility, where the following conditions are fulfilled:
 - i. the liquidity facility covers 100% of the credit risk (on a contingent or drawn basis) of the underlying exposures;
 - ii. the liquidity facility covers the credit risk for as long as the retainer has to retain the economic interest by means of such liquidity facility for the relevant securitisation position;
 - iii. the liquidity facility is provided by the retainer in the securitisation transaction; and
 - iv. the institution assuming exposure to such securitisation has been given access to appropriate information to enable it to verify the above.

Explanatory Box

CEBS Guidelines on Article 122a of Directive 2006/48/EC explain at paragraph 47 that, in the case of liquidity facilities provided to ABCP programmes, the retention requirement under option (a) may be met by the provision of a liquidity facility under certain circumstances. One of those circumstances is that the facility covers 100% of the credit risk of the exposures. The EBA would like to know to what extent the industry relies on this possibility as a way to comply with the retention commitments.

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

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?

Article 7 - Retention option (c): retention of randomly selected exposures

1. When retaining randomly selected exposures in accordance with option (c) of Article 394(1) of Regulation (EU) No xxxx/2013, the retainer shall not receive protection against the credit risk of the retained exposures.

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2. The pool of at least 100 potentially securitised exposures from which retained and securitised exposures are randomly selected shall be sufficiently granular to avoid an overly concentrated selection result. When considering the selection process, the retainer shall take appropriate quantitative and qualitative factors into account in order to ensure, insofar as possible, that the distinction between retained and securitised exposures is genuinely random. The retainer of randomly selected exposures shall take into consideration, where appropriate, factors including, the stratifications of variables such as vintage, product, geography, origination date, maturity date, loan to value, property type, industry sector, and outstanding loan balance when selecting exposures.
 3. The retainer shall not designate different individual exposures as retained exposures at different points in time, unless this is necessary to fulfil the retention commitment in relation to a securitisation in which the exposures securitised fluctuate over time, either due to new exposures being added to the securitisation or to changes in the level of the individual securitised exposures.

Article 8 - Retention option (d): retention of the first loss tranche

1. The retention of the first loss tranche under option (d) of Article 394(1) of the Regulation (EU) No xxxx/201y shall be fulfilled by either on-balance sheet or off-balance sheet positions and may be fulfilled by using the following:
 - a. Provision of a letter of credit, guarantee or similar form of credit support, provided that the following criteria are met:
 - i. the retention covers at least 5% of the credit risk of the exposures;
 - ii. it constitutes a first loss position in relation to the securitisation;
 - iii. it covers the credit risk for the entire duration of the retention commitment;
 - iv. it is provided by the retainer in the securitisation; and
 - v. the institution assuming exposure to such securitisation has been given access to appropriate information to enable it to verify the above.
 - b. In the context of ABCP Programmes, if considered appropriate, by the provision of a liquidity facility (as defined in Article 237(3) of Regulation

(EU) No xxxx/201y) which is not senior in the securitisation waterfall and which fulfils all of the conditions set out in Article 8.1(a) of this Regulation.

Questions

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?

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?

2. Where the first loss tranche exceeds 5% of the nominal value of the securitised exposures, the retainer need only retain a vertical slice of such first loss tranche, so long as this slice is equivalent to at least 5% of the nominal value of the securitised exposures.
3. The designation of a first loss tranche at a securitisation programme-wide level for the purposes of risk retention would not be undermined by the existence of underlying transactions in which the originators or original lenders retain a first loss exposure at the transaction-specific level. In such cases, it is not permissible to retain less than 5% at the transaction level via seller's enhancement at the asset purchasing level and to complete retention up to 5% by the sponsor via programme-wide credit enhancement.

Explanatory Box

The above situation would, for example, be applicable to ABCP programmes.

Article 9 - Retention option (e): retention of a first loss in every securitised exposure

1. The retention of a first loss exposure at the level of every securitised exposure under option (e) of Regulation (EU) No xxxx/2013 shall be applied in so that the credit risk retained is always subordinated to the credit risk that has been securitised in relation to those same exposures.
2. This retention may be fulfilled by a discount in the sale of exposures by the originator or original lender, where this discount is not less than 5% of each exposure and is only refundable insofar as it is not absorbed by credit risk-related losses incurred on the securitised exposures.

Explanatory Box

The retention of B loans in the case of securitisations of the A parts of A/B loans would be considered to be an example of the application of retention option (e) of Regulation (EU) No xxxx/201y, as long as the retainer retains a first loss exposure in the form of B loans of not less than 5%.

Question:

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

Article 10 - Measurement of the level of retention

1. In measuring the level of retention of net economic interest, the following criteria shall be applied:
 - a. origination shall mean the time at which the exposures were first securitised, rather than when they were first created;
 - b. the calculation of the level of retention shall be based on nominal values and shall not be affected by the acquisition price of assets;
 - c. ‘excess spread’ as defined in Article 237(1) of Regulation (EU) No xxxx/2013 shall not count towards the retainer’s net economic interest since this is necessarily a contingent amount at origination;
 - d. The retention option and the methodology used to calculate the net economic interest shall not be changed during the life of a securitisation transaction, unless such change is required due to exceptional circumstances and is not used as a means to reduce the amount of retained interest; and
 - e. Provided there is not an embedded mechanism by which the retained interest at origination would decline faster than the interest transferred, the fulfillment of the retention requirement shall not be deemed to have been affected by the amortisation of the retention via cash flow allocation or through the allocation of losses, which, in effect, reduce the level of retention over time. A retainer shall not be required to constantly replenish or readjust its retained interest to at least 5% as losses are realised on its exposures or allocated to its retained position. The 5% shall be calculated based on the nominal value of the tranches sold or transferred to investors or the nominal value of the securitised

exposures respectively at origination, and shall not be affected by the allocation of losses.

Article 11 - Measurement of retention for the undrawn amounts in exposures in the form of credit facilities

1. The calculation of the net economic interest to be retained for credit facilities, including credit cards, shall be based only on amounts already drawn, realised or received and shall dynamically adjust with changes to those amounts.

Explanatory Box

An example of the above would be a securitisation of credit card receivables. The retention requirement would apply only to the outstanding balance of the receivables, not to the full balances/limits available to the borrowers, but could dynamically adjust as such balances/limits become drawn to constitute receivables.

Article 12 - Prohibition of hedging or selling the retained interest

1. The prohibition in Article 394(1) on subjecting the retained net economic interest to any credit risk mitigation, short positions, other hedge or sale shall be applied in the light of the purpose of the retention requirement and taking account of the economic substance of the transaction as a whole. Hedges of the net economic interest may accordingly be permitted only where they do not hedge the retainer against the credit risk of either the retained securitisation positions or the retained exposures.
2. The retainer may use any retained exposures or securitisation positions as collateral for secured funding purposes, as long as such use does not transfer the credit risk of these retained exposures or securitisation positions to a third party.

Article 13 - Exemptions to Article 394(1) of Regulation (EU) No xxxx/201y

1. The exemption in Article 394(4) of Regulation (EU) No xxxx/201y shall include securitisation positions in the correlation trading portfolio containing only reference instruments satisfying the criterion in Article 327(1b)(ii) of Regulation (EU) No xxxx/2013. The exemption shall also apply to any securitisation position which is eligible for inclusion in such part of the correlation trading portfolio but has not been assigned thereto for risk management or similar reasons.

Questions:

Q9: Is the qualification “securitisation positions in the correlation trading portfolio containing only reference instruments satisfying the criterion in Article 327(1b)(ii) of Regulation (EU) No xxxx/201y” introduced in Article 13(1) correct/necessary? Should this qualification be removed? If not, why?

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?

Article 14 - Retention on a consolidated basis

1. An institution satisfying the retention requirement on a consolidated basis in accordance with Article 394(2) of Regulation (EU) No xxxx/2013 shall, in the case of the retainer becoming divested from the group, ensure that one or more of the remaining entities within the group assumes exposure to the securitisation so as to ensure ongoing fulfilment of the requirement.

CHAPTER IV

DUE DILIGENCE REQUIREMENTS FOR INSTITUTIONS BECOMING EXPOSED TO A SECURITISATION POSITION

Article 15 - Outsourcing and other general considerations

1. In the absence of information on the specific exposures to be securitised, such as where exposures accumulate before their securitisation or may be substituted into an existing revolving securitisation, an institution is deemed to fulfil its due diligence obligations for each of its individual securitisation positions on the basis of appropriate consideration of the relevant eligibility criteria for such exposures.
2. The outsourcing of certain operational aspects of the obligations set out in Article 395 of Regulation (EU) no xxxx/2013 shall be permitted only if the process remains within the full responsibility and control of the institution becoming exposed to the risks of the securitisation. Outsourcing shall not relieve institutions of their obligations to understand and assess the risk of the securitisation positions under that Article.

Article 16 - Frequency

1. After becoming exposed to a securitisation position, institutions shall review their compliance with Article 395 of Regulation (EU) No xxxx/2013 at least annually and more frequently, as soon as institutions become aware that the performance of the securitisation position, or the risk characteristics of the securitisation position, or the underlying exposures have materially changed or a breach of transaction documentation occurs.

Explanatory Box

Examples of events that may trigger the necessity for revision are: the breach of a contractual trigger, the insolvency of the originator, the sponsor or the original lender, or where there are changes in the risk profile of an institution's investment.

Article 17 - Specification of risk characteristics and structural features

1. The risk characteristics of the individual securitisation position referred to in Article 395(1)(b) of Regulation (EU) No xxxx/2013 shall include the most appropriate and material characteristics, such as:

-
- a. tranche seniority level;
 - b. cash flow profile;
 - c. any existing rating;
 - d. historical performance of similar tranches;
 - e. bond covenants;
 - f. credit enhancement.
2. The risk characteristics of the exposures underlying the securitisation position referred to in Article 395(1)(c) of Regulation (EU) No xxxx/2013 shall include the most appropriate and material characteristics, such as the performance information referred to in Article 395(2) of Regulation (EU) No xxxx/201y in relation to residential mortgage exposures. Institutions shall identify appropriate and comparable metrics for analysing the risk characteristics of other asset classes.
 3. The structural features of the securitisation referred to in Article 395(1)(g) of Regulation (EU) No xxxx/2013 shall, in addition include swaps, guarantees and sponsor support mechanisms.

Article 18 - Stress Tests

1. The stress tests that institutions must undertake, in accordance with Article 395(1) of Regulation (EU) No xxxx/2013, shall include all relevant securitisation positions. The stress tests shall be incorporated into broader stress testing that the institutions undertake, in accordance the Internal Capital Adequacy Process specified in Article 72 of Regulation (EU) No xxxx/2013.

Question:

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 of CRD IV, or should it, where applicable, be in accordance with Article 173 of the CRR and follow the credit stress testing requirements for IRB banks?

2. Institutions may make use of comparable financial models developed by third parties, in addition to those developed by ECAIs, provided that they take due care, prior to

investing to validate the relevant assumptions in, and structuring of, the models and to understand the methodology, assumptions and results of such models.

Article 19 - Exposures in the trading book and non-trading book

1. The holding of a securitisation position in the trading or non-trading book respectively shall not represent a sufficient justification in itself for the application of different policies and procedures or a different intensity of review to fulfill the due diligence obligations in Article 395 of Regulation (EU) No xxxx/2013. In determining whether different policies and procedures or a different intensity of review shall be applied, all relevant factors materially impacting the risk profile of each of the books and of the relevant securitisation positions shall be considered, such as the size of the positions, the impact on the institution's capital base during a period of stress, and the concentration of risk in one specific transaction, issuer, or asset class.

Explanatory Box

A specific example related to the above provision would be the following: the trading desk of an institution could, as part of its market-making activities, be requested by clients to bid on baskets of securitisation positions as a whole, where the precise requirements of each of clauses (a) to (g) of Article 395(1) of Regulation (EU) No xxxx/201y cannot be met on a discrete basis for each specific position in such basket, for instance, due to a short timeframe, unavoidable operational delays in acquiring such information, or the existence of non-remediable gaps or inconsistencies in information availability. However, should such exceptions not be material in the aggregate context of such basket, or in the context of the overall risk profile of the trading book, this should not necessarily impede such institution from providing a secondary market in such positions, provided that such institution has a suitable framework via formal policies and procedures for ensuring control around such exceptions, follows prudent process for analysing and recording such exceptions, and has a process for ensuring that such exceptions are commensurate to the risk profile of its trading book.

2. Institutions shall ensure that any material change to the risk profile of their trading book is appropriately reflected with a commensurate change in their due diligence procedures as regards the securitisation positions in their trading book. In this regard, institutions shall identify in their formal trading book policies and procedures the circumstances which would trigger a review of the due diligence obligations.

Article 20 - Positions in the correlation trading portfolio

1. Where securitisation positions are held in the correlation trading portfolio and are reference instruments as referred to in Article 327(1b)(ii) of the Regulation (EU) No xxxx/201y or are eligible for inclusion in the correlation trading portfolio but have not been assigned thereto for risk management or similar reasons, the requirements under Article 395 of Regulation (EU) No xxxx/201y shall be deemed to be met if an

institution fulfils the relevant requirements under Section 5 Chapter 5 of Title IV of Part Three of the Regulation (EU) No xxxx/201y for calculating the own funds requirements of these securitisation positions provided that an institution's approach to calculating the own funds requirements of its correlation trading portfolio results in a comprehensive and thorough understanding of the risk profile of its investment in the securitisation positions. An institution shall take appropriate additional measures to ensure the relevant obligations under Article 395 of Regulation (EU) No xxxx/201y are satisfied if this institution does not achieve a comprehensive and thorough understanding of the risk profile of the investment in the securitisation positions by fulfilling the own funds requirements for the correlation trading portfolio.

Questions:

Q12: Is the qualification "...securitisation positions ... held in the correlation trading portfolio...as referred to in Article 327(1b)(ii) of Regulation (EU) No xxxx/201y" introduced in Article 20 correct/necessary? Should this qualification be removed? If not, why?

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?

CHAPTER V

REQUIREMENTS FOR ORIGINATORS, SPONSORS AND ORIGINAL LENDERS

Article 21 - Uniform policies for credit granting

1. The obligation in Article 397 of Regulation (EU) No xxxx/2013 to apply the same sound and well-defined criteria for credit-granting to exposures to be securitised as to exposures to be held in institutions' own books shall not imply that the actual borrower types or loan products must be the same for securitised and non-securitised exposures or prohibit modification of aspects of the underwriting process for specific loan types in order to meet the conditions for sale of such loans to the securitisation.
2. Where they have not undertaken the original credit-granting of the exposures to be securitised themselves, or are not active in credit-granting the specific types of exposures that are being securitised, sponsors and originators shall ensure that they obtain all the necessary information to assess whether the criteria applied in the credit-granting for such exposures are as sound and well-defined as the criteria applied to non-securitised exposures.

Article 22 - Disclosure of the level of the commitment to maintain a net economic interest

1. The retainer shall, pursuant to Article 398 of Regulation (EU) No xxxx/2013, disclose to investors at least the following information on the level of its retention commitment:
 - a. confirmation of the retainer's identity and of whether it retains as originator, sponsor or original lender;
 - b. the option from (a) to (e) under Article 394 of Regulation (EU) No xxxx/2013 that has been applied to retain a net economic interest;
 - c. any change to such retention option in accordance with Article 10(1)(d) of this Regulation;
 - d. confirmation of the level of retention at origination and of the commitment to retain on an on-going basis, which shall relate only to the continuation of fulfilment of the original obligation and shall not require data on the current nominal or market value, or on any impairments or write-downs on the retained interest;

In the case of transactions falling within the scope of the exemptions set out in paragraphs 3 and 4 of Article 394 of Regulation (EU) No xxxx/2013 institutions acting as originator, sponsor or original lender shall disclose a confirmation of the exemption applied including the reasons for applying the exemption.

2. The disclosure shall be:
 - e. appropriately documented and made publicly available, except in bi-lateral or private transactions where private disclosure is considered by the parties to be sufficient. The inclusion of a statement on the retention commitment in the prospectus for the securities issued under the securitisation programme shall be considered an appropriate means of fulfilling the requirement;
 - f. confirmed after origination with the same regularity as the reporting frequency of the transaction, at least annually and in any event when a breach of the retention commitment under Article 394(1) of Regulation (EU) No xxxx/2013 occurs or when the performance of the securitisation position, risk characteristics of the securitisation or underlying exposures materially change or following a breach of transaction documentation.

Article 23 - Disclosure of materially relevant data

1. Originators, sponsors and original lenders shall ensure that access to materially relevant data under Article 398 of Regulation (EU) No xxxx/2013 is not overly prohibitive in terms of search, accessibility, cost and other factors that might impede access, such that it is overly burdensome for investors to fulfil their due diligence requirements. Materially relevant data shall be determined and disclosed at the date of the securitisation and on at least an annual basis thereafter, and more frequently, where appropriate, taking into account any material change to the performance of the securitisation position, risk characteristics of the securitisation position, underlying exposures or breach of transaction documentation.
2. Materially relevant data on the individual underlying exposures shall, in general, require data to be provided on a loan-by-loan basis, however there are instances when the data may be provided on an aggregate basis. In assessing whether aggregate information is sufficient, factors to be taken into account shall include the granularity of the underlying pool and whether the management of the exposures in such pool is based on the pool itself or on a loan-by-loan basis.

Explanatory Box

It may not be appropriate to provide information at loan level in the case of a securitisation with a large volume of exposures that constitute a highly granular pool.

Question:

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 of the Regulation (EU) No xxxx/201y? What kind of information is required in those cases? Please specify by type of underlying asset.

3. Templates generally accepted by market participants may be considered to be an appropriate format to satisfy the disclosure obligations set out in Article 398 of Regulation (EU) No xxxx/201y, assuming that such templates contain the necessary information to enable investors to comply with their due diligence requirements under Article 395 of the Regulation (EU) No xxxx/201y.

Questions:

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 and Article 398 of the Regulation (EU) No xxxx/201y, respectively? Please differentiate in your response in terms of the types of underlying assets, if applicable.

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?

CHAPTER VI

FINAL PROVISIONS

Article 24 - Entry into force

This Regulation shall enter into force on the day following that of its publication in the Official Journal of the European Union.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the Commission
The President*

*[For the Commission
On behalf of the President*

[Position]

COMMISSION DELEGATED REGULATION (EU) No .../2013

laying down implementing technical standards for facilitating the convergence of supervisory practices with regard to the implementation of additional risk weights according to European Parliament and Council Regulation (EU) No xxxx/2013

of dd mmmm 2013

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No xx/2013 of the European Parliament and of the Council of dd mmmm 2013 on⁵, and in particular 399(3) thereof,

Whereas:

1. Experience to date of the application of the retention, due diligence and disclosure requirements for securitisation positions imposed by Union law has demonstrated that uniform conditions for the implementation of these requirements are needed to ensure a common and consistent application in all Member States. In this context, the development of implementing technical standards on additional risk weights in the case of non-compliance with the requirements should facilitate the convergence of supervisory practices.
2. This Regulation lays down implementing technical standards to achieve a common understanding amongst competent authorities on the application of a uniform approach towards the assessment of an institution's compliance with the requirements and the application of additional risk weights in the case of material non-compliance therewith by reason of negligence or omission.
3. In order to facilitate the convergence of supervisory practices when applying additional risk weights an appropriate formula should be defined. The formula should impose a proportionate additional risk weight of no less than 250% which progressively increases with subsequent infringements. An appropriate factor should be introduced in the formula to allow for a lower additional risk weight to apply in the cases of exposures exempted under Article 394(3) of Regulation (EU) No xx/2013.
4. This Regulation is based on the draft regulatory technical standards submitted by the European Supervisory Authority (European Banking Authority) to the Commission.
5. The European Supervisory Authority (European Banking Authority) has conducted open public consultations on the draft implementing technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the

⁵ OJ...

opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093x/2010.

HAS ADOPTED THIS REGULATION:

CHAPTER I

Additional risk weight

Article 1 - General considerations

1. Competent authorities shall ensure that any additional risk weight imposed under Article 396 of Regulation No xxxx/2013 shall be applied to all relevant securitisation positions held by an institution which are affected by the material infringement.
2. If a securitisation position to which an additional risk weight applies matures or is sold, the risk weight shall cease to apply.
3. Where an institution rectifies its infringement of the requirements, the additional risk weight shall cease to apply.
4. When assessing whether to apply an additional risk weight, competent authorities shall consider both the materiality of the breach and its relevance to the risk analysis of the securitisation position. Materiality shall be considered in both quantitative and qualitative terms and, where applicable, at both entity and consolidated level. In assessing materiality, competent authorities should consider, among other factors, the duration of the breach, the size of the affected positions and the whether the institution has attempted to proactively rectify the breach.
5. In considering whether an institution has failed, by reason of its negligence or omission, to meet the retention requirement of not assuming exposure to a securitisation position unless the originator, sponsor or original lender explicitly discloses that it will retain as specified in Article 394 of Regulation (EU) No xxxx/2013 competent authorities shall not be influenced by breaches by the retainer of its commitment to retain, so long as the institution can demonstrate that it has taken appropriate account of prior failures of the retainer to satisfy its retention commitment in respect of earlier securitisations of the same retainer.
6. Competent authorities shall apply an additional risk weight for infringement of the disclosure requirement in Article 398 of Regulation (EU) No xxxx/2013 to the originator's, sponsor's or original lender's retained positions in, or other exposure to the relevant securitisation.

Article 2 - Calculation of additional risk weight

1. Competent authorities shall apply the following formula to determine the total risk weight ('Total RW') in accordance with the approach specified in Articles 240(6) and

326(3) of Regulation (EU) No xxxx/2013 to be applied where an institution does not meet the relevant requirements in any material respect:

$$\text{Total RW} = \text{Min}[12.5 ; \text{Original RW} * (1 + (2.5 + 2.5 * \text{InfringementDuration}_{\text{years}}) * (1 - \text{Article394Exemption}_{\text{Pct}}))]$$

Where:

12.5 is a factor representing the maximum value that the total risk weight can reach;

Original RW is the risk weight that would apply to the securitisation positions if no additional risk weight was imposed;

2.5 is the minimum factor applying to the original risk weight in order to calculate the additional risk weight;

$\text{InfringementDuration}_{\text{years}}$ is the duration of the infringement, expressed in years, rounded down to the nearest 12-month period. This variable is equal to “0” for an infringement of less than 12 months, equal to “1” for an infringement of more than 12 months but less than 24 months, equal to “2” for an infringement of more than 24 months but less than 36 months, etc. The duration shall generally be measured from the start of the infringement, although competent authorities, taking account of the specificities of the transaction, may impose other starting points. ‘Infringement’ shall mean the breach of one or more of the requirements capable of triggering an additional risk weight. The infringement shall turn into a ‘subsequent infringement’ when time passes without rectifying the infringement, leading to a progressive increase of the additional risk weight.

$\text{Article394Exemption}_{\text{Pct}}$ is a variable equal to 0.5 if Article 394(3) of Regulation (EU) No xxxx/201y applies to the securitisation positions to which the additional risk weight is calculated, and equal to 0 if such exemption does not apply.

Questions:

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

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 $\text{Article394Exemption}_{\text{Pct}}$ equal to 0.5 if the exemption in Article 394(3) applies is reasonable?

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

CHAPTER II

FINAL PROVISIONS

Article 3 - Entry into force

This Regulation shall enter into force on the day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the Commission
The President*

*[For the Commission
On behalf of the President*

[Position]

5. Accompanying documents

5.1 Examples regarding the application of additional risk weights

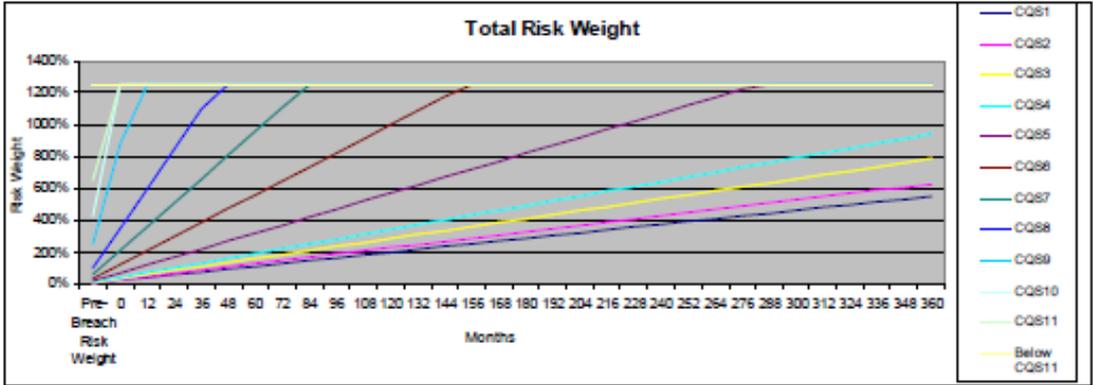
Example 1: a 6 year infringement on a securitisation position with an original risk weight of 60% and not subject to any of the exemptions in Article 394 of Regulation (EU) No xxxx/201y.

$$\text{Total RW} = \text{Min} [12.5; 0.60 * (1 + (2.5 + 2.5 * 6) * (1 - 0))] = 1,110\%$$

The following table shows the total risk weights that would apply to securitisation positions not subject to any of the exemptions in Article 394 of Regulation (EU) No xxxx/201y, depending on the respective original risk weight for any of the credit quality steps (CQS) and on the duration of the infringement, up to 8 years of infringement and assuming that the infringement is not rectified.

CQS	RW	Years in Breach									
		0	1	2	3	4	5	6	7	8	
CQS1	7%	25%	42%	60%	77%	95%	112%	130%	147%	165%	
CQS2	8%	28%	48%	68%	88%	108%	128%	148%	168%	188%	
CQS3	10%	35%	60%	85%	110%	135%	160%	185%	210%	235%	
CQS4	12%	42%	72%	102%	132%	162%	192%	222%	252%	282%	
CQS5	20%	70%	120%	170%	220%	270%	320%	370%	420%	470%	
CQS6	35%	123%	210%	298%	385%	473%	560%	648%	735%	823%	
CQS7	60%	210%	360%	510%	660%	810%	960%	1110%	1250%	1250%	
CQS8	100%	350%	600%	850%	1100%	1250%	1250%	1250%	1250%	1250%	
CQS9	250%	875%	1250%	1250%	1250%	1250%	1250%	1250%	1250%	1250%	
CQS10	425%	1250%	1250%	1250%	1250%	1250%	1250%	1250%	1250%	1250%	
CQS11	650%	1250%	1250%	1250%	1250%	1250%	1250%	1250%	1250%	1250%	
Below CQS11	1250%	1250%	1250%	1250%	1250%	1250%	1250%	1250%	1250%	1250%	

The following graph illustrates the same, but up to 30 years.



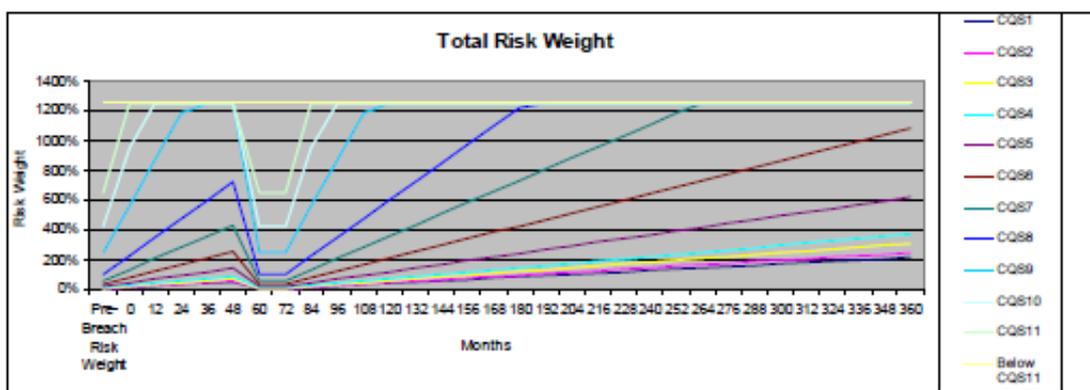
Example 2: a 4 year infringement on a securitisation position with an original risk weight of 250% and subject to an exemptions in Article 394(3) of Regulation (EU) No xxxx/201y. The infringement is remediated during years 5 and 6, but starts again in year 7.

$$\text{Total RW} = \text{Min} [12.5 ; 2.5 * (1 + (2.5 + 2.5*4) * (1 - 0.5))] = 1,250\%$$

The following table shows the total risk weights that would apply to securitisation positions subject to the exemption in Article 394(3) of Regulation (EU) No xxxx/201y, depending on the respective original risk weight for any of the credit quality steps (CQS) and on the duration of the infringement, up to 8 years of infringement and assuming that the infringement is remediated during years 5 and 6, but that it starts again in year 7.

CQS	RW	Years in Breach									
		0	1	2	3	4	5	6	7	8	
CQS1	7%	16%	25%	33%	42%	51%	7%	7%	16%	25%	
CQS2	8%	18%	28%	38%	48%	58%	8%	8%	18%	28%	
CQS3	10%	23%	35%	48%	60%	73%	10%	10%	23%	35%	
CQS4	12%	27%	42%	57%	72%	87%	12%	12%	27%	42%	
CQS5	20%	45%	70%	95%	120%	145%	20%	20%	45%	70%	
CQS6	35%	79%	123%	166%	210%	254%	35%	35%	79%	123%	
CQS7	60%	135%	210%	285%	360%	435%	60%	60%	135%	210%	
CQS8	100%	225%	350%	475%	600%	725%	100%	100%	225%	350%	
CQS9	250%	563%	875%	1188%	1250%	1250%	250%	250%	563%	875%	
CQS10	425%	956%	1250%	1250%	1250%	1250%	425%	425%	956%	1250%	
CQS11	650%	1250%	1250%	1250%	1250%	1250%	650%	650%	1250%	1250%	
Below CQS11	1250%	1250%	1250%	1250%	1250%	1250%	1250%	1250%	1250%	1250%	

The following graph illustrates the same, up to 30 years.



All numbers in the tables and graphs should be treated only as illustrative of potential outcomes of the calculations. These tables and graphs should not be read as a fixed scale of total risk weights that result from various infringement scenarios, and neither should the relationship between credit quality steps and risk weights provided in such tables and graphs be interpreted in isolation from the sources of the definitive relationship between credit quality steps and risk weights provided elsewhere in Regulation (EU) No xxxx/201y.

5.2 Draft Cost- Benefit Analysis / Impact Assessment

Problem identification (Market failure and/or Regulatory failure)

1. Articles 394-398 of the CRR establish requirements on both investor institutions and sponsor or originator institutions engaging in securitisation transactions. An institution becoming exposed to the credit risk of a securitisation shall ensure that the originator, sponsor or original lender retains a material net economic interest in the securitisation transaction, according to specific criteria, and shall apply due diligence before entering the transaction and thereafter. Sponsor and originator institutions shall apply the same sound credit-granting criteria to the loans they intend to securitise as they do to loans not to be securitised and shall disclose to investors all relevant information on the retention of net economic interest in the transaction as well as on the risk characteristics of the securitised exposures. Additional risk-weights are established for those institutions assuming exposure to a securitisation that do not comply with the mentioned requirements and for originators, sponsors or original lenders that do not comply with their disclosure requirements.
2. The provisions address the fundamental problem of the possible misalignment of interests and incentives in securitisation transactions between the investors, on the one hand, and the originator, sponsor or original lender on the other hand. Diverging interests among the parties of a financial contract can lead to moral hazard behaviour when certain information on relevant features of the contract is only available and accessible to one party but not to other parties (i.e. the contract is characterized by an asymmetry of information). Moral hazard behaviour occurs when the party that has more or better information takes on excessive risk knowing that the other party in the transaction will bear the costs of those risks without being equally informed about those risks.
3. The recent financial crisis has shown that in securitisation transactions the following problems can materialise:
 - a. Originators, sponsors or original lenders may have little incentives to adequately screen the credit risk characteristics of the exposures they intend to securitise, given that the credit risk of the securitised exposures is transferred to securitisation investors and credit enhancement providers.
 - b. Some securitisation transactions proved to be particularly opaque as relates to the information on the credit risk features of the securitised exposures. Such information was not sufficiently available and accessible to investors.
4. Misaligned incentives and the lack of information and transparency in some securitisation transactions contributed to excessive risk-taking in parts of the securitisation industry and to a broad lack of confidence in securitisation transactions. These outcomes not only led to losses and to the drying up of liquidity and funding in the securitisation markets, but also contributed to the overall freezing of the interbank markets.

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5. By ensuring more aligned interests (through the retention requirements, the criteria for credit-granting) and by increasing transparency and availability of information (disclosure and due diligence requirements) Articles 394-398 of the CRR aim at restoring the confidence in securitisation markets and contribute to the realisation of the general regulatory objective of enhanced financial stability.

Problem definition and objectives of the RTS and ITS

6. The proposed RTS and ITS aim at clarifying aspects related to the requirements imposed on institutions becoming exposed to the (credit) risk of a securitisation or acting as originators, sponsor or original lender by Articles 394-398 of the CRR as well as establishing elements of convergence in supervisory practices within the Single Market related to those requirements.
7. The harmonisation of requirements and supervisory practices related to Articles 394-398 of the CRR, realized at the level of technical standards, contributes to achieving the following specific regulatory objectives:
 - a. Preventing regulatory arbitrage opportunities within and across EU jurisdictions
 - b. Enhancing legal clarity
 - c. Achieving a level playing field within the Single Market
 - d. Enhancing supervisory cooperation within the Single Market
 - e. Reducing the inefficient compliance burden that can result from conflicting implementations of the requirements on institutions operating cross-border within the Single Market.
8. Objectives (a) to (d) above, in turn, contribute to the realisation of the general objective of financial stability, underlying the CRR provisions on securitisation (see section 'Problem identification: Market Failure/Regulatory Failure').
9. Enhanced legal clarity and arbitrage prevention are particularly relevant given the drawbacks of the existing framework on incentive and risk retention in the area of securitisation. Article 122a, being part of an EU Directive, had been transposed into national legislation and hence had been subject to national legislators' discretion. The Guidelines, as a non-binding 'comply or explain' legal instrument, had found different levels of legally binding implementation in the different EU Member States. An additional layer of non-binding but clarifying provisions had been provided by the EBA Questions and Answers (Q & A) process.
10. Against the background of this diversified regulatory process, regarding in particular the topic of retention of net economic interest in securitisation transactions, the proposed standards have to ensure that:

-
- a. The extent of legal clarity reached with the combined text of the CRD, the Guidelines and the EBA Q&A, allowing market participants to structure current transactions in compliance with the requirements are, to the extent possible, transposed into directly binding legal regulations.
 - b. Potential instances of incomplete legal clarity, affecting securitisation transactions within a few specific segments of securitisation business, can be solved within the flexibility which is appropriate for directly applicable technical standards (see section 'Proposed approaches and impacts on markets and institutions' for a more detailed exposition).
11. Conditions (a) and (b) have to be achieved while taking into account the elements of novelty that the CRR introduces with respect to the CRD, particularly on the topic of 'sponsor' definition and allowed options and forms of retention of net economic interest.

Baseline: current market and regulatory practices

12. Article 122a of the Capital Requirements Directive (CRD, 2006/48/EC) had to be brought into force by 30 October 2010, for its application from 30 December 2010. The CEBS Guidelines to Article 122a of the CRD were to be applied by Member States by 1 January 2011.
13. The provisions in the proposed draft RTS and ITS will replace the content of the Guidelines and the related Q&A report published by the EBA in September 2011.
14. The EBA assessed Member States' compliance with the Guidelines through a questionnaire addressed to National Supervisory Authorities (NSAs).
15. Based on 27 responses it was assessed that, by 30 June 2012:
- a. 19 respondents⁶ had already implemented the Guidelines. Among these, 15 jurisdictions had implemented the Guidelines at least partly in a binding way⁷ while 4 jurisdictions had implemented them by means of national guidelines. The jurisdictions implementing the Guidelines through legally binding provisions supervise, according to 2010 available data, approximately 90% of EU banking assets. Among these jurisdictions, IT, NL, ES and UK account for 86% of 2011 new securitisation issuance in the EU.⁸
 - b. 13 respondents⁹ stated that they have conducted trainings to inform supervisors about the content of the Guidelines and/or included the topic in on-site examination handbooks and/or supervisory work programmes.

⁶ AT, BE, CY, CZ, DE, ES, FR, HU, IE, IT, LT, LU, MT, NL, PL, PT, SE, SL, UK.

⁷ A binding implementation is mostly associated with circulars, national laws or ordinances.

⁸ See IOSCO November 2012 Report *Global Developments in Securitisation Regulation*.

⁹ AT, BE, CY, CZ, DE, ES, FR, IE, IT, LU, NL, SL, UK.

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- c. 8 respondents (representing approximately 5% of EU banking assets) had postponed the implementation of the Guidelines due to the lack of securitisation activities, at all or after 2010, within the markets they supervise.
16. The EBA also consulted representatives of market participants in order to assess the extent to which the provisions of Article 122a of the CRD and the associated Guidelines have been incorporated in current market practices.
17. The vast majority of market participants believe that Article 122a of the CRD and the associated Guidelines have been well received and are now well embedded in current market practices. The Q & A published by the EBA in September 2011, in relation to the Guidelines, contributed to clarifying several outstanding issues.

Proposed approaches and impacts on markets and institutions

18. The securitisation market in the EU is currently depressed. Available data show that, in 2011, 228 billion Euros of new securitisation products were issued, amounting to only 1/3 of new issuances in 2008 (i.e. pre-crisis levels). Approximately 86% of new issuances in 2011 were concentrated in four jurisdictions and more than half of them occurred within the Residential Mortgage Backed Securities (RMBS) segment. In addition, almost 80% of new issuances seem to be self-owned (i.e. retained).¹⁰
19. The transposition of provisions on credit risk transfer from the non-legally binding format of the CEBS Guidelines to Article 122a to the EU-wide legally binding and directly applicable format of the RTS and ITS is expected to result in higher levels of both harmonisation and compliance. Harmonised provisions are going to be in force even in those jurisdictions that had implemented the CEBS Guidelines by means of national guidelines or postponed their application altogether due to the lack of an active securitisation market.
20. Higher levels of harmonisation and compliance, in turn, are expected to impact the market by ensuring that benefits (a) to (e) listed above (see section 'Problem definition and objectives of the RTS and ITS') materialise. Those objectives should contribute to restoring investors' confidence in securitisation transactions.
21. The recovery of securitisation in the Single Market is expected to benefit the real economy by improving overall risk-sharing opportunities and increasing the availability of funding for both households and firms.
22. The proposed RTS and ITS are not expected to imply material costs onto supervisors and institutions, nor to have a material impact on transactions that are currently being structured/carried out within the most relevant segments of active securitisation markets, given the following considerations:

¹⁰ See IOSCO November 2012 Report *Global Developments in Securitisation Regulation*.

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- a. Most of the provisions proposed in the draft RTS and ITS have been already implemented (at least partly) as legally binding rules in all the EU jurisdictions where the securitisation market is currently active.
 - b. The vast majority of market participants have welcomed the provisions included in Article 122a of the CRD, the associated CEBS Guidelines and Q & A process. Market participants do not identify any relevant difference between Articles 393-399 of the CRR and Article 122a of the CRD.
23. However, consultation with market participants already at the stage of publication of the CEBS Guidelines had highlighted that, while being well-accepted and integrated into the vast majority of market securitisation practices, the retention requirements may represent a material challenge to the functioning of specific segments (classes) of securitisation transactions. As a consequence, the approach taken to transpose the provisions of the CEBS Guidelines on retention requirements into the draft RTS is likely to materially impact on the functioning of specific securitisation classes and on the compliance features of the (subdued) number of transactions currently being structured/carried out within those market segments.
24. The specific problems at stake, the approaches considered in the drafting of the RTS and the potential related impacts are described in the sections below.

Impact on specific classes of securitisations: Managed Collateralised Debt Obligation (Managed CLOs)

25. Implementation of risk retention rules for Managed CLOs has raised a legal issue in relation to the identification of the retainer within this specific class of securitisation transactions. The terms 'originator' or 'sponsor' as used in Article 122a of the CRD do not fit the roles played by any of the parties involved in a Managed CLOs transaction. As the entity structuring the CLO is not a credit institution in most cases, but rather an investment firm subject to MIFID provisions, it is not possible to legally identify the party that should retain the net economic interest within Managed CLOs as the 'sponsor' definition of the CRD is limited to credit institutions. The assets of a CLO are usually multiple syndicated loans purchased by a manager on the secondary market and not originated by any of the parties involved in the CLO. An individual credit institution may in some circumstances only play the role of structuring agent and does therefore not fall under the 'sponsor' definition.
26. Legal uncertainty over the identification of the retainer, according to market participants, materially affects investors' appetite for engaging in CLOs transactions, thus reducing the investor base available to EU CLOs and US CLOs looking for investors within the Single Market. Available data on the volumes of Managed CLOs business in the EU shows that, with the recent financial crisis, the supply of such class of securitisation products decreased materially. Between 2009 and 2011 only EUR 3 billion of CLO products were issued in Europe while in September 2007 (pre-crisis levels) outstanding CLO products amounted to EUR 130 billion. Only in 2012, US new issuances of CLOs amounted to approximately USD 22.5 billion. The EU CLOs market is also becoming increasingly 'static', as CLO vintages expire and managers are unable to refinance existing loans or to buy new loans. Standard and

Poor's estimate that EU CLOs outstanding capacity could reduce from above EUR 50 billion in 2011 to below EUR 10 billion by the end of 2014. The resulting funding gap could be material given that, during pre-crisis times, CLOs dealt with 40% to 60% of the leverage loans funding demand.

27. The CEBS Guidelines had introduced elements of flexibility related to the identification of the retaining entity as the party in the transaction that best guarantees alignment of interest with investors, where neither the sponsor nor the originator can be identified, or where an originator or sponsor could be identified but the interests of an alternative entity were most optimally aligned with the interests of investors.
28. The wider definition of 'sponsor' proposed by the CRR, now including not only credit institutions but also investment firms, addresses the legal problem by clearly including CLOs asset managers that are investment firms into the scope of retention requirements.
29. It must be acknowledged that, taking into account the existing structure of the market, the identification of the retainer with the CLO asset manager may lead to a number of CLO managers facing capital constraints in fulfilling the 5% retention requirement. Feedback received from preliminary consultation of European market participants, as well as available evidence from consultation of US CLOs managers regarding similar retention requirements, indicates that most managers of CLOs are structured so as to operate with relatively small balance sheets and, therefore, are likely to struggle to provide the resources necessary to fulfil retention requirements.¹¹ This could potentially translate in the long term into a modification of the currently existing managed CLO model.

Impact on specific classes of securitisation - Commercial Mortgage Backed Securities (CMBS) class of securitisations

30. Available data shows that the CMBS class of securitisations in Europe only represents a very minor share of current new securitisation issuance in Europe, with only EUR 2.3 billion in 2011, amounting to 0.6% of total issuance, and EUR 3.1 billion in the first two quarters of 2012, amounting to 2.5% of total issuance during the period. The CMBS segment has been in a depressed state since 2008, with new issuance values always comprised between EUR 1 billion and EUR 3 billion during the period 2008-2011.
31. Consultation of market participants operating in the CMBS segment highlighted concerns regarding legal uncertainty over the identification of a retaining entity, in cases where sponsor originator or original lender cannot be legally identified or a party exists that better aligns

¹¹ The Loan Syndications and Trading Association (LSTA) polled US CLO managers about evidence on their expected capacity to retain interest in securitisation transactions, in view of the introduction of retention requirements in the Dodd-Frank Act that are similar to the ones considered in the draft RTS under consideration. Only 13% of consulted CLO managers report to be able to retain 5% risk in a vertical pro rata strip. 87% of consulted CLO managers could retain some form of equity/first loss position, but consider 5% too conservative a requirement. Only 22% could retain 4-5%, while 87% could retain 1% equity. The LSTA estimated that US CLO managers currently retain, on average, 1.7% - 2.7% equity.

interests with investors', as well as regarding the admitted forms of retaining economic interest.

32. Discussion has focused, in particular, on:

- a. single loan/single borrower CMBS transactions, the possibility that the borrower company, owner of the properties backing the CMBS bonds, might retain net economic interest via the real estate equity that they hold as underlying exposure to the securitisation transactions.
- b. the possibility that B-pieces, within A/B type of loans entering CMBS securitisations with their A component, be accepted as a form of retention of net economic interest.

33. The possibility for an entity that best aligns interests with investors of retaining economic interest via retention of B-pieces in an A/B structure entering the CMBS issuance, is expected to result in compliance with retention requirements, independently from the provisions proposed in the RTS, as a result of option (e) in Article 394 of the CRR, proposing retention of a first loss exposure not less than 5 % of every securitised exposure in the securitisation.

5.3 Overview of questions for Consultation

Questions relating to Draft RTS on the retention of net economic interest and other requirements related to exposures to transferred credit risk (Articles 394,395, 397 and 398) of Regulation (EU) No [xx/2013]

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 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 and the respective definitions of originator, sponsor or original lender.

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.

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) of the Regulation (EU) No xxxx/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?

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

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?

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?

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?

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

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

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?

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 of CRD IV, or should it, where applicable, be in accordance with Article 173 of the CRR and follow the credit stress testing requirements for IRB banks?

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

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?

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 of the Regulation (EU) No xxxx/201y? What kind of information is required in those cases? Please specify by type of underlying asset

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 and Article 398 of the Regulation (EU) No xxxx/201y, respectively? Please differentiate in your response in terms of the types of underlying assets, if applicable.

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?

Questions relating to Draft ITS Relating to the convergence of supervisory practices with regard to the implementation of additional risk weights (Article 396 of Regulation (EU) No [xx/2013]

Q1. Does the formula in Article 2 result in reasonable additional risk weights?

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) applies is reasonable?

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