FEDERATION
BANCAIRE
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Banking supervision
And Accounting issues Unit

The Director

Paris, October 1st 2010

FBF comments on the CEBS Consultative Paper 40 on guidelines to Article 122a of the Capital Requirements Directive

Dear Sir,

The French Banking Federation (FBF) is the professional body representing over 430 commercial, cooperative and mutual banks operating in France. It includes both French and foreign-based organizations.

The FBF is pleased to take this opportunity to comment on the proposal on the implementation of the provisions of Article 122a of the CRD. The FBF welcomes the initiative of the CEBS to guarantee a better alignment of interests of originators, sponsors and investors for securitization transactions.

The FBF agrees on both the purpose of CP 40 and the principles exposed in the document, but wishes to present its main concerns related to the different impacts for both the primary and the secondary markets for securitization.

Consequently, in the first part of our detailed comments, the FBF underlines the following key points:

- The due diligence requirements
- The additional risk weights
- The correlation trading
- The impact on ABCP transactions
- Consolidations issues
- Hedging of the retained position

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The second part presents the French Banking Federation's responses to the consultation questions.

The French Banking Federation wants to see the instigation of healthy competitive conditions and believes the only way to do is to establish appropriate regulations. The FBF remains at your disposal for any further discussion on these matters.

Yours sincerely,

Jean-Paul CAUDAL

French Banking Federation Position note

CEBS Consultation Paper 40 on guidelines to Article 122a of the Capital Requirements Directive

The Committee of European Banking Supervisors published its proposal of the implementation guidelines on the Article 122a of the CRD. These guidelines will have to be transposed into Member States' national law by 31 October 2010 and will be applied from 31 December 2010.

French Banking Federation welcomes this document which contains a number of helpful clarifications on the implementation of the provisions of Article 122a of the CRD. The aim of these provisions is to guarantee a better alignment of interests of originators or sponsors and investors for the securitisation transactions.

French Banking Federation appreciates the opportunity to respond to these guidelines which represent a complement to the provisions of the CRD on topics where guidance appears necessary.

Before answering to the consultation questions we would like to present hereunder our main concerns arising from the proposal which will significantly affect both the primary and the secondary markets for securitisation. This outcome would be contrary to the public authority's efforts to restore the securitisation market which plays an essential role for the financing of the economy.

Key points

1. The due diligence requirements will have very severe consequences for liquidity of the securitisation market

The consultative paper's proposal in its current form will materially affect the secondary trading activity, investors or dealers would be reluctant to invest in securitization positions, which could dry up the liquidity of the securitisation market.

We would like to underscore that the secondary market plays an essential role by underpinning the functioning of the primary market (the primary market would significantly shrink without a proper functioning secondary market).

We welcome the principle of "intensity of the due diligence" put forward by the CP40 we plead for further clarification on this issue with regard to trading book positions. Paragraph 63 of the CP40 suggests that trading book in contrast to non-trading book have to additionally adjust due-diligence efforts to secondary market circumstances.

With regard to due diligence requirements we consider that consultative paper puts relative higher constraints on trading book compared to non-trading book (the trading book will suffer additional risk weights at least as high as those applied to non-trading books).

2. The additional risk weights' framework represents a major concern from an investor standpoint

Art 122a states that penalties should be a "*proportionate additional risk weight ...*" and shall progressively increase the risk weight with "*subsequent infringement*" of the due diligence.
In contrast, CP40 sets out escalating risk-weights which are much more severe than the CRD 2 requirements where even initial breaches may lead multiple penalties ending up to to full deduction from capital.

The due diligence for the trading book represents a single process that should be assessed as a whole. The additive feature of the penalties' framework leads very rapidly to full deduction which will discourage the investors. We consider that the additive penalties applied simultaneously are not justified and we understand the application of increasing penalties for subsequent infringements or failure to remediate existing infringements (which means infringements that take place after first infringement or infringements that had not been remediated, at distinct moments of time).

In addition, considering that the investors are highly dependent on the originator/ servicer for avoiding penalties, clarification on the penalties framework (how this will work in practice) is paramount for any credit institution willing to invest in securitization positions. Moreover, too heavy and non-risk based penalties would discourage investors and would inhibit the revival the securitisation which plays a highly important role in financing the economy.

3. Correlation trading

The intention behind article 122a is to ensure alignment of interests between those who originate and distribute risk and the investors who buy it in order to remedy the information asymmetry arising on specific risk transfer.

Retention requirement

The exemption formalised under paragraph 3 and related to "transactions based on a clear, transparent and accessible index" was intended to permit correlation trading not be submitted to the application of retention requirement. We consider that correlation trading activities should not be submitted to the retention requirement formulated under the article 122a. However, it might be interpreted from the consultative paper that trades on bespoke baskets of reference obligations should be submitted to retention requirement.

Given the different nature of the correlation trading activities as a whole (both index tranches and bespoke tranches) from the "re-packaging of loans into tradable securities" (which is the scope of application of art. 122a) we consider there should be an exemption from retention for correlation trading which would be consistent with the CRM carve-out for specific risk in CRD 3. The correlation trading exemption is based on the following reasons:

- Both index and bespoke correlation trading operate on the sole basis of publicly available information where where there is no asymmetry of information,

- The correlation trading activity does not transfer to investors default risk existing in the correlation trading books. Instead, the correlation trading desk's client bank selects the (two way liquid CDS) corporate entities which comprise the reference portfolio on which it wishes to take a single tranche exposure, and with respect to default risk, the correlation trading book will actively hedge these exposures with single name CDS.

Therefore we consider that the consultative paper wording on this issue should be reviewed to avoid any inconsistencies between the scope of the correlation trading activities and the exemption from the retention requirement.

In our response to question 4 we propose a clear definition for correlation trading activities.

Due diligence requirements

With respect to due diligence requirements, it important to note that correlation trading firms are already undertaking extensive due diligence within the scope of the trading activity, which we request to be maintained as is, and consisting in checking such eligibility criteria as:

- the liquidity of the underlying reference entities, along the lines of the CRD 3 definition,
- the pertinent parameters of the operation in interaction with the rest of the trading portfolio, including issuer risk and credit spread sensitivity,
- the documentation of the operation, in particular through a comparison with standard interdealer confirmations.

Furthermore, correlation trading desk will be subject to extensive due diligence requirement under the highly specified CRM approach implemented by CRD 3 which will come into force on December 31, 2011, at the latest.

On this basis, in our response to the question 14 we propose a new paragraph for due diligence requirements applicable to correlation trading activities.

4. Impact on ABCP transactions

There is no carve-out for ABCP transactions in 122a, even though these deals are structured very differently from "term" securitisation deals. Yet these conduits essentially play a unique role in the short term financing of corporates activities. As a consequence, we recommend CEBS applies a practical and flexible interpretation of the text of 122a to make it work for ABCP transactions in the absence of such a carve-out.

In ABCP transactions the credit risk of the underlying assets is covered (totally or partially) by the bank administering the programme which is referred to as the "sponsor". This may be in the form of a programme-wide or transaction-specific standby letter of credit. The sponsor therefore would be exposed to the credit risk of a securitisation position to the extent of the letter of credit (which will often cover more than 5% of the economic risk of the transaction)1. It seems to us to be unnecessary that the sponsor in these circumstances should also retain an economic interest on the basis of one of options (a) to (d) or paragraph 1 in order to satisfy the retention requirement vis-a-vis the commercial paper's investors whose risk the sponsor is already supporting.

In addition, the scope of the due diligence and disclosure requirements as currently expressed in the CP40 are not workable especially for underlying assets such as trade receivables, "utilities receivables" or any other receivables originated by corporates (by way of example, telecoms bills on individuals may include several millions receivables). **Clearly, the CP's guidelines are primarily geared to term RMBS/ ABS transactions and are not suitable to standard ABCP transactions**.

We note that considerable amount of work for improved ABCP disclosure is already under way in other jurisdictions (U.S.) and proposals put forward by the ASF and supported by the investors' community, should serve as the best template in terms of due diligence and disclosure requirements.

Therefore, we urge CEBS to review and to complete these guidelines or at a further stage in order to address retention and due diligence requirement with regard the ABCP transactions.

5. Consolidation issues

Contrary to the legal framework of art 122a, the CEBS proposal indicates that the art 122a falls under the application of the art. 71 of the CRD. Therefore, a non-EU subsidiary of an EU credit institution will be submitted to the retention and due-diligence requirements (thus would be permitted to invest only on positions which comply with the 5% retention rule) whilst its local broker-dealer competitors would not be subject to these rules. This creates an uneven playing field between investors and would unduly prevent the local broker-dealer of a non-EU credit institution to curtail certain activities, not subject to the retention requirement in their local jurisdiction. As a result, EU actors will be pushed aside from several non-EU markets.

1 Note that for conduits where the sponsor provides a fully supporting 100% liquidity line covering all credit losses of the portfolio, we consider that those transactions fall outside the scope of Art 122a as there is no tranching of risk. (investors are only exposed to the bank providing the liquidity facility)

6. Hedging of the retained position

The flexibility to hedge retained positions with respect to a series of risk, provided that specific risk is not fully neutralised is important, as is the flexibility to fund such retained positions. We appreciate the positive views of the CP on some of these challenges which would nevertheless require further clarifications.

French Banking Federation's responses to the consultation questions

The FBF understands the need for an improved qualitative monitoring of the securitization framework, which will come in addition to the increased quantitative and qualitative monitoring that will be treated in the CRD3 directive.
However we take great care in our response of the quantitative requirement at EU level in order that EU regulation stays in line with regulatory developments at international level, without distortions, in order that European banks compete with peers on a level playing field.

***Question 1**: Do you agree with this differentiation between the requirements of credit institutions when "investing" (leading to the applicability of Paragraphs 1, 4, and both sub-paragraphs of 5) as opposed to the lesser requirements when assuming "exposure" but not "investing" (leading to applicability of Paragraph 1 and sub-paragraph 2 of Paragraph 5)?*

We fully agree with the differentiation between the requirements applicable to credit institutions when "investing" as opposed to the lesser requirements when assuming "exposure" but not investing. However we consider that would be useful to accurately define what is meant by "investing". Whilst the questions 2 and 3 (and the related paragraphs) provide straightforward guidelines on what is meant by "assuming exposure to credit" no similar guidelines are formalised for "investing" (for instance we question whether the provision of credit enhancement through a subordinated note would be seen as "investing" or "assuming exposure").

We also agree that the table on page 10 sets out the differentiation between the two types of requirements clearly. However, in the light of further paragraphs of the CP40 we consider that the framework of the additional risk weights application raises the following questions.

First, we seek clarification on how the additional risk weights will apply in case of breach of Para 7's requirements to the interest retained by the sponsor or originator as paragraphs 77 to 90 are not clear on how this risk weights should be measured for originators or sponsors.

Secondly, we seek confirmation on Para 5 with regard to who bears the additional risk weights for the breach of Para 7's requirements. Para 5 applies to "*Credit institutions, other than when acting as originators or sponsors or original lenders [...]*" and therefore we consider that it applies only to credit institutions as investors or assuming exposure to a securitisation. Moreover, Para 5 states that the additional risk weights apply "*Where the requirements in paragraphs 4, 7 and in this paragraph are not met in any material respect by reason of the negligence or omission of the <u>credit institution</u> [...]*" without make clear what is meant here by credit institution (originator, sponsor or investor). We consider that if the originator does not provide the investor with the Para 7 information as a result of the investor's own negligence or omission then the additional risk weights will apply to the investor and if the negligence or omission is caused by the originator, the investor is not subject to additional risk weights. We ask CEBS to confirm our view on this issue.

Question 2*: Do you agree with this differentiation in the role of a credit institution as liquidity facility provider (based on the provisions of CRD Annex IX, part 4, paragraph 2.4.1, point 13)?*

We support the differentiation between credit institutions acting as hedge/derivative counterparty which are exposed to the risk arising from principal losses on the securitised exposures or securitisation position(s) and similar credit institutions which are not exposed to credit risk. Therefore we consider that art. 122a (1) should apply only to credit risk institutions which assume exposure to credit risk.

Whilst we agree that eligible liquidity facilities (i.e. liquidity facilities which comply with the provisions of CRD Annex IX, part 4, paragraph 2.4.1, point 13) should not be subject to the specific requirements of the article 122a (1) we request CEBS to consider that other liquidity facility should also be exempted from the application of the article 122 a (1). We consider that liquidity facilities provided in term ABS transactions that not assume credit risk should not fall within the scope of article 122a (1).

We support the approach allowing credit institution to determine on a case by base basis should the article 122 a (1) is enforceable depending on the extent to which a derivative/hedge counterparty to a securitisation assumes credit risk.

Therefore we ask CEBS to broaden the scope of liquidity facilities which could be exempted from the application of the article 122 (1) and to amend accordingly the wording of paragraph 7 of the CP in order to allow a credit institution which is a liquidity provider to a securitisation to determine whether or not is exposed to credit risk.

Question 3*: Do you agree with this differentiation in the role of a credit institution as hedge counterparty, and what issues might arise when credit institutions seek to determine whether their role as hedge counterparty results in the assumption of credit risk or not?*

For credit institutions acting as hedge/ derivative counterparties we agree that a differentiation should be made across institutions depending whether the derivative/hedge counterparty assumes "risks arising from principal losses". Therefore, we understand that hedge/ derivatives counterparties which do not assume credit risk arising from principal losses of the securitised exposures are not subject to the requirements of article 122a.

We consider that legal documents supporting the terms and conditions for hedging/derivatives transactions should be the cornerstone for determining the exposure to credit risk.

***Question 4**: Does this guidance adequately address means of fulfilling the retention requirement in the case of securitisations of exposures from multiple originators, sponsors, or original lenders? And if not, what suggestions do you have for additional clarity?*

In reference to paragraph 20, we believe that the multiple retention requirements for multiple sellers within a same corporate group should be considered met if one seller within the group is fulfilling the consolidated requirement across the group.

We also seek further clarification on how the guidance on multiple retention requirements would apply to exposures to ABCP conduits.

a) For the ABCP Conduit Sponsor which assumes credit risk exposure through either one of the following:
    - (i) at least 5% of the liquidity line covering each underlying transaction,
    - (ii) a programme-wide standby letter of credit covering at least 5% of the conduit's notional exposure, or
    - (iii) the retention by originators (including in the situation above described for multiple sellers within a same group) is one way of meeting the article 122a retention requirements. We note however this approach might not work in Germany, where the national regulation seems to require the originator to be a bank or a regulated financial institution in order to be able to fulfill the retention requirement (therefore not covering the situation of a corporate originator of trade receivables or other types of receivables).

b) For the ABCP investor, the retention requirement (if it applies) should be considered as automatically met if the programme's sponsor confirms that it has effectively retained a 5% net economic transaction through one of the above-mentioned method.

As mentioned in the introductory part, we propose hereunder an amended version of the paragraph 55 of CP40:

"55. CDX and iTraxx provide examples of clear, transparent and accessible indices to which the provisions of Paragraph 1 would not apply. The nature of such indices that allows the exemption from the provisions of Paragraph 1 should be that they are based on liquid instruments for which an investor has sufficient available market information and for which the notion of tradability can be applied to both derivatives and the ultimate underlying exposures.

Likewise, the bespoke credit correlation trading activity, i.e. transactions based on a customized portfolio of reference entities, shall be exempt from the provisions of Paragraph 1 provided that:
- *such reference entities are part of a clear, transparent and accessible index as mentioned above; or*
- *there exists a liquid two-way market in respect of each of such reference entities, so that the above notion of tradability can be applied."*

We consider that the last paragraph has to be deleted because it is contrary to the idea of bespoke/customized portfolio. The requirement for liquid two-way market ensures that no party can exercise an undue control on the composition of the customized portfolio in order to avoid the application of the retention requirement.

> ***Question 5**: Do you agree that the form of retention should not be able to be change during the life of the transaction, except under exceptional circumstances only, or alternatively should some additional flexibility be granted? Please provide evidence of exceptional circumstances which would justify a change in the form of retention.*

First, we consider that the wording of the article 122a does not imply that the form of retention should not change during the life of the transaction (assuming compliance of the form of retention with the article 122a and its disclosure to investors). Furthermore, we think that flexibility should be granted for changing the form of retention during the life of the transaction. Changing the form of the retention can be contemplated in several cases such as for accounting, regulatory reasons (if there is no uniform solution to the conflicts between different sets of rules in different jurisdictions) or reorganisation of roles between the sponsor's credit enhancement and originator retained interests.

> ***Question 6**: Should the definition of "net economic interest" in terms of "nominal" exposure be interpreted to mean that both excess spread tranches (i.e. where only residual interest cashflows are sold) and interest-only tranches (i.e. where all interest cashflows are sold) be excluded from the various means of fulfilling the retention requirement (as both have notional rather than nominal values), or should either be a valid means of fulfilling the retention requirement? If the retention requirement were allowed to be fulfilled by retention of a tranche with no principal component (for instance, an excess spread tranche or an interest-only tranche), how would the retention percentage be computed – with reference to the notional value, market value, or otherwise?*

We do not see the "economic rationale" explaining why an excess-spread tranche or interest-only tranche shall be excluded from the various means of fulfilling the retention requirements, especially as long as these are in a subordinated position in the transaction's capital structure and rank below any reserve fund.

Whilst the computation of the value of such tranches depends upon certain assumptions made in terms of performance of the underlying assets (delinquency, default, loss, and prepayment rates), these tranches represent a real economic interest in the transaction, which can be assessed at its inception. So long as the computation methodology is agreed-upon and disclose to the investor (with the ability for the investor to conduct its own sensitivity analysis on those underlying performance assumptions) and although these tranches do not include a principal component, the retention of this economic interest in the transaction shall be accepted as a way to fulfil the retention requirements.

Question 7: *Where Paragraph 1 indicates that a credit institution must ensure that retention has been "explicitly disclosed", is the guidance above sufficient? In particular, will the market evolve such that credit institutions would expect such disclosure by market participants to be of a binding nature, and therefore provide some means of enforcement or redress to them, or should such a requirement be part of the CEBS guidance? Feedback is welcome on the most effective means to assure that the commitment of the originator, sponsor or original lender is enforceable by credit institutions that invest. This is an area which CEBS is likely to pay particular attention to in as part of keeping these guidelines up to date and in annual reviews of compliance.*

Considering the differences in law regimes which exist between EU jurisdictions it appears that is not feasible to provide a comprehensive list of the means to make enforceable the retention requirement against originator, sponsor or original lender.

Given that the additional risk weights scheme for disclosure breaches will affect the liquidity of the investment instruments, we consider that the investors will pay close attention to ensuring that originators and sponsors fulfil the obligations related to the retention requirements. We assume that market practice will develop over time in order to protect investors from the loss of liquidity in their instruments, mainly through the legal documents supporting the transactions.

However, due consideration should be given to the existing transactions that are not grandfathered under paragraph 8 as it will be very difficult to modify legal documentation for incorporating enforcement provisions on the retention requirements.

***Question 8**: Does this guidance address properly the subject of hedging of retained exposures? What specific types of hedge should be permitted? CEBS would welcome evidence and examples from respondents.*

We welcome the CEBS guidance on the permitted type of hedging of the retained exposures. We agree that the aim of the article 122 a) is not to forbid prudent risk management which can be attained by hedging but instead the rationale is to prevent the originator to transfer the risks associated with the portfolio of securitised assets underlying the retained position. Therefore we consider that the restriction on hedging should be limited exclusively to direct hedges of the retained positions. Failure to agree with this term will lead to negative, unintended consequences for banks' risk-management activity and to specific bank activities (correlation trading desk).

***Question 9**: Should retention of 5% of each securitised exposure fulfil the requirements of Paragraph 1 under option (a)?*

We agree that this option (retention of 5% of each securitised exposure) fulfils the 5% retention requirement formalised under Paragraph 1, option (a).

***Question 10**: Should option (b) be applicable equally to both securitisations of revolving exposures and revolving securitisations of non-revolving exposures4 (or revolving securitisations with a combination of revolving and non-revolving exposures) in fulfilling the requirements of Paragraph 1?*

We agree that option (b) should apply equally to both securitisations of revolving exposures and revolving securitisations of non-revolving exposures (or to a combination of both).

***Question 11**: Do you agree with this interpretation of the phrase "there shall be no multiple applications of the retention requirement" to mean that there shall be no requirement for multiple application either by individual parties or at the level of individual SPVs, but that there may be multiple application at the overall transaction level (for instance, where a transaction is the resecuritisation of existing securitisations), and does the above lead to an effective and proportionate alignment of interest for resecuritisations?*

The Directive 2009/111/EC, recital 25, specifically states the following: "*where securitisation transactions contain other securitisations as an underlying, the retention requirement should be applied only to the securitisation which is subject to the investment*".

From the standpoint of the investor in a resecuritisation, the securitisation which is subject to the investment is the resecuritisation and only at this level the retention requirement should be applied. Assuming that the originator of resecuritisation had formally committed to retain at the outset and as long as the securitised assets are performing, it would be unduly burdensome and contrary to the Directive's provisions to request investor into a resecuritisation to check on an ongoing basis that the retention requirement is fulfilled both at the resecuritisation level (which is expected to monitor) and at the level of the underlying securitisations.

On this basis, we ask CEBS to review guidance on the "multiple applications of the retention requirements".

***Question 12**: Does this interpretation of the phrase "net economic interest shall be determined by the notional value for off-balance sheet items" raise any potential issues with respect to application of the retention requirement?*

For credit card transactions, all references to notional value of the transaction shall be based on the amount of receivables generated, and not on available balance.

***Question 13**: Given that Paragraph 1 specifies that "retained positions, interest or exposures are not hedged or sold", to what extent will it be possible for an originator, sponsor or original lender to use such retained interest for secured funding purposes without having "sold" such retained interest, for instance in cases where such funding is sought under a TBMA/ISMA Global Master Repurchase Agreement (GMRA) or alternatively under a bespoke repo agreement?*

We agree with paragraph 51 of the guidance that the retained positions should be available to be used as collateral for secured funding purposes. We would urge that this is replicated in national regulations to ensure that there is not considered to be a breach of the retention requirement should originators do this.

With respect to repo agreements in which the repo takes the legal form of a title transfer, these agreements are legally structured with an outright spot sale of the securities and an unconditional forward buy back of such securities concluded simultaneously. Hence, the transferor of the securities -lending out the securities and borrowing the repo cash amount - retains throughout the repo transaction the economic risk associated with the securities. Effectively, if any such security defaults, the transferor has to replace it immediately with a performing security at no cost to the counterparty. This confirms that the retention requirement is effectively satisfied where the exposures are repoed out to a third party under a TBMA/ISMA Global Master repurchase agreement or similar bespoke repo agreement. Whilst the third party -borrowing the securities and lending the repo cash amount - may indeed default and fail to transfer back equivalent securities at the end of the term of the repo, the assumption of this counterparty risk by the transferor is mitigated by regular collateral calls, and is not inconsistent with retaining the originator's interest in the securitised exposures, as in the normal course of events the counterparty will transfer back the securities. Any exposure retained without being repoed would also be subject to counterparty credit risk yet this does not impair the nature of the retention.

Furthermore the prudential treatment of a repo transaction fully supports our view above. In a repo transaction, the transferor has to calculate RWA on the transferred security (to account for the unconditional forward buy back agreement) and in addition will have to calculate a counterparty risk charge which will be a function of the repo haircut, and will cover only the marginal risk of the difference between the market value of the securities transferred and the value of the cash and any collateral posted in return. The Financial Collateral Directive also treats repo agreements the same way – i.e. as secured lending transactions and not outright transfers.

In the same way, full economic risk to the retained exposures is maintained where the originator or sponsor sells outright the exposures and simultaneously takes the economic risk back via a credit derivative transaction (CDS or total return swap as the case may be). Interests are aligned when the economic risk is retained – just as it would not be permissible to buy protection on the retained exposures using an exactly matching CDS, so it should be possible to sell them and re-purchase the economic risk with a matching CDS. Furthermore, we are of the view that originators should have the flexibility to retain synthetically. It should be possible for the Originator or Sponsor to retain risk of the vertical slice or first loss portions of the assets or tranches sold on an unfunded basis, as the economic risk held will be the same. We believe that paragraph 33 of the guidance should be deleted and that holding the retained exposures on an unfunded basis should be allowed.

Hence we believe that the extent a party is retaining a net economic interest (whether it be sponsor, originator, original lender, asset manager), that party should have the discretion to secure the most efficient funding that is possible so as not to constrain the availability of credit to the market. This should include pledging positions under secured loans, as well as repo / GMSLA type lending arrangements.

***Question 14**: Is further clarification needed on the ability to differentiate between the trading book and the non-trading book?*

The article 122a formalised the obligation for firms before investing to implement policies and procedures "appropriate to their trading book and non-trading book"

We welcome the CEBS's guidelines for Para 4 requirements applicable to trading book, and particularly the concept of intensity of due diligence that "*may vary according to the specificities of the trading book versus the non-trading book*". However, we consider that for trading book CEBS formalizes more stringent requirements than the article 122a by imposing a "*minimum threshold due diligence requirements*". Furthermore, this statement seems to be contradictory with the paragraph 60: *"Trading book requirements must not be considered to be a subset of non-trading book requirements; rather, they can be different to non-trading book requirements if the risk profile is truly different."*

Concerning trading book positions, paragraph 63 states that "*In performing its analysis a credit institution may also distinguish between the risk profile of its investments in securitisation positions. [...]*" to conclude that "*[...] if circumstances change [...],then any such change in risk profile should be matched with a commensurate change in due diligence requirements.*" Indeed, the depth of due diligence should be in line with the risk profile of the position. While we agree with this principle for trading book we consider that it should be extended for the trading book versus banking book positions. We can not reasonably expect from a credit institution to implement for positions those time horizon and/ or materiality are completely different from non-trading book the same checks which apply for non-trading book positions. Given that a trading desk may trade large numbers of bonds every day, the level of due diligence that is possible differs from non-trading book due to time constraints and the typology of the holding. The due diligence requirements need to be carefully calibrated in order to ensure that the market liquidity is not undermined. Indeed, the additional risk weights for due diligence breaches will deter investors if they consider that the requirements are disconnected from the nature of the holding and its time horizon.

For due diligence requirements which apply to correlation trading activities we propose to add in the consultative paper a new paragraph 63a after existing paragraph 63:

"63a. In the particular case of the credit correlation trading activity, the scope and intensity of due diligence as prescribed by Paragraph 4 can be satisfied where the correlation trading desk already performs extensive due diligence within the context of an actively managed book (i) prior trading a new position, and (ii) an on ongoing basis as relevant provided such extensive due diligence includes the following three key areas;

(a) the eligibility of the proposed transaction for the correlation trading book ensuring that the reference portfolio comprises only 2 way liquid corporate credit default swaps;

(b) extensive review of risk parameters and the impact of including the proposed transaction in the existing credit correlation book; and

(c) the review of the related structure and its legal documentation."

In the end, we ask CEBS for further guidance on how to differentiate between what is appropriate for trading book and the non-trading book in terms of scope of Para 4 requirements and on the intensity of due diligence for trading book. We also request CEBS to put forward materiality thresholds for due diligence for trading book position.

Question 15*: Is the general guidance on securitisation stress testing in the document linked above sufficient, or is further guidance needed on how stress testing should be undertaken for the specific requirements of Article 122a, and if so what topics should such further guidance cover?*

We consider that the CP 32 guidance on stress testing already formulates comprehensive and demanding requirements. The guidance states that *"institutions should include in their stress tests all relevant information related to the underlying asset pools - their dependence on market conditions - dependence of the securitisation positions on market conditions, complicated contractual arrangements and effects related to the subordination level of the specific tranches."* While we agree with this principle we consider that flexibility should be granted to credit institution with regard to the "relevant information related to the underlying asset pool" provision in order to be allowed to gather all relevant information provided that this information is also available (and assuming that credit institution made its best effort in order to obtain all necessary information).

Question 16*: Do you agree with this method of calculating the additional risk weight?*

We believe that clarification is needed in paragraphs 80 and 81, as well as in the Table 1 that the maximum risk weight applied to a securitisation, inclusive of punitive additional risk weights in case of certain breaches, should not result in situations in which the capital required to be held against a securitisation exceeds the exposure value of that position.

This means that

(i) under current 8% capital charge applied to risk weights, the maximum 1250% risk weight should be applied on an aggregate basis (original + addition) and not only to the additional risk weight, and

(ii) an adjustment mechanism should be introduced to automatically take into consideration new (higher than 8%) capital charge applied to risks weight as it is the case under the new standards developed by the Basel Committee on Banking Supervision. Absent such adjustment, the effect of the very punitive additional risk weights percentage will result in a capital charge higher than the nominal value of the securitisation position.

We will therefore welcome a revised Table 1 which shows the maximum capital charge that can be <u>effectively applied</u> to a securitisation position, after consideration of the amount capped at the nominal value of the position.

***Question 17**: Do you have any comments on this approach to achieving consistent implementation of application of the additional risk weights by competent authorities, including both the level and duration for which additional risk weights are applied? Do you agree that, notwithstanding the textual provisions of Paragraph 5, the cumulative result of applying such additional risk weights should not result in the capital required to be held against a securitisation position exceeding the exposure value of such securitisation position?*

This provision does not seem to be fully coordinated with International regulatory developments at the Basel Committee and we have strong concerns with regards to the uneven level playing field it could create.

We are very concerned that such severe and overlapping penalties will deter many investors from being (re)-involved in the European ABS market. This is surely not the intent of the directive and may dry out liquidity in the markets and ultimately prove detrimental to the overall real economy.

Whilst we obviously agree that the maximum capital charge should in no circumstance exceed the exposure value of a securitization position, we believe that the proposed fixed-scale method of calculating the additional risk weight is overly punitive and goes beyond the requirements set out in Article 122a, not leaving the possibility to national regulators to adopt a more measured and proportional approach.

Leaving more discretion to national regulators in applying additional risk weights could be used for instance to allow grace periods for compliance and to remove the fixed scale. Thus regulators could impose higher additional risk weights for substantial breaches or negligence by investors and less onerous risk weights for inadvertent or lesser breaches.

By way of example, a more flexible approach should be adopted in case of several breaches related to the same transaction as the application of additional charges of 250% each for cumulative breaches related to one exposure on the same date (it is likely that if any one of the elements of the due diligence requirements is breached, other elements will also be breached) will result in an overly punitive and not "proportional" charge as reflected in the table below.

Figure 8: Maximum penalties Rating	Initial RW	Max. RW	Min. No. of Penalties	Escalation Factor
AAA (senior, granular)	7%	95%	5	13.5
AA	15%	203%	5	13.5
A+	18%	243%	5	13.5
A	20%	270%	5	13.5
A-	35%	473%	5	13.5
BBB+	50%	675%	5	13.5
BBB	75%	1013%	5	13.5
BBB-	100%	1250%	5	12.5
BB+	250%	1250%	2	5.0
BB	425%	1250%	1	2.9
BB-	650%	1250%	1	1.9
<BB-, NR	1250%	1250%	0	1.0

Source: BIS, CEBS, Barclays Capital ABS Research

The penalties applied for "subsequent" breaches should therefore be related to the same breach occurring in "subsequent" transactions and reflecting a more fundamental and recurrent issue with compliance of the Article 122a requirements.

We are further concerned as to the effect of an originator's failure to retain the 5% economic risk on an investor's ability to sell its securitisation positions in the secondary market. Whilst an investor may comply with all requirements of paragraph 4 and 5 of 122a, and therefore as stated in paragraph 87 of the guidance no additional risk weights will apply to it, it will still be effectively and potentially quite extensively penalised by the market (i.e. by valuation declines) if the originator fails to retain its portion of risk, even though the underlying assets are robust. This effective market penalty may also extend to all other securitisations issued by that same originator (even if it has not specifically breached its obligations in respect of any other transaction) owing to the risk faced by all investors of having exposure to any transaction undertaken by an originator that has, in one instance, breached.

Impact on the market

We are firmly of the view that the disproportionate application of penal additional risk weights will deter bank investors from the securitisation market, especially with respect to the senior tranches which contribute most to the funding of securitisations, since the impact on the respective size of the position will produce massive relative capital requirement increases even for inadvertent breaches. Likewise, since we understand provisions similar to article 122a are intended to be introduced into other directives such as the Solvency II and AIFM Directives, such a punitive approach will seriously impact the entire investor base for European securitisations. Even if such similar provisions are not introduced in other directives, the punitive nature of the Committee's approach might also deter non-bank investors from investing in the first place owing to the potentially reduced liquidity in the secondary market.

Furthermore, we understand the strong concern with regards to the quality of external rating for structured products and we encourage the CEBS to put more emphasis on internal ratings and internal capital measures such as the K(irb) in order to assess the capital adequacy for securitization products.

Penalties to be applied to the originating bank when such bank retains a piece in a securitisation.

It seems that some uncertainty is still present in the CP 40 text as to know:

(i) whether the provisions of paragraph 5 apply to an originating institution which retains an interest in the securitisation for inadvertent breach of the provisions of paragraph 7 and, if it does,

(ii) (ii) whether the additional weights are multiples to be applied to the RWA pre-additional weight or are incremental weights applicable to the nominal of the retained position, and

(iii) (iii) whether the resulting RWA, after application of the additional weight, can go above the RWA of the Pool absent the securitisation. As a quick numeric example, when a bank securitizes a Pool with a nominal of 100 attracting a capital "Kirb" of 4, by buying protection on the first loss position of 0 to 5 (then retaining the senior tranche with a nominal of 95), in case the 1250% penalty would apply to the retained tranche, the bank would end up with a capital charge of 95 versus 4 pre-securitization i.e. circa 24 times higher! Clearly, the possibility of facing such extreme punitive weight would strongly deter any bank from entering into a hedging transaction. Yet, the weights are deemed to be non-punitive, as evidenced by the latest sentence in paragraph 6 of the 122a where the cap to Kirb is explicitly referred to.

<u>We propose the following clarification language</u>:

"*When an originating institution retains one or several tranches in the securitisation, the provisions of paragraph 5 will not result in a capital charge amount (after application of penalties) that will be greater than K(irb) that would have been assessed against the underlying exposures had they not been securitised.*"

***Question 18**: If a credit institution is involved as sponsor in the securitisation of exposures on behalf of third parties in an asset class or business line in which such sponsor is not itself active in extending credit, is the guidance provided above a sufficiently high standard to hold such sponsor to?*

We consider that guidelines are clear enough and we support the distinction which is made depending whether the sponsor originates assets which are similar to the securitised assets. Indeed, where a sponsor does not grant credit in the asset-types which are securitised, Para 6 should not apply. Furthermore, we support the view that in cases where securitised exposures consists of assets those credit-granting was initially made by an unconnected originator, sponsor or original lender (not the originator or sponsor itself) more limited scope of information would be used to analyse these exposures.

***Question 19**: Is this interpretation or the requirement with respect to "participations and underwritings in securitisation issues" clear and unambiguous, or are there alternative interpretations possible or clarifications necessary?*

In cases where credit institutions act as an investor, the intensity of the analysis will adapt for trading book positions comparing to the non-trading book positions.

We consider that a similar, consistent treatment should apply where credit institution is underwriting the transaction, i.e. the intensity of the analysis will need to adapt for trading book positions comparing to the non-trading book positions.

***Question 20**: Would disclosure templates that currently exist or are in the process of being prepared by trade associations, industry bodies, central banks, market participants or others fulfil these requirements on an adequate basis?*

Several standardising securitisation documentation initiatives are currently underway: for example, the project led by European Central Bank for standardised investor reports and loan-by –loan disclosure templates (exclusively for Euro-denominated issue). We assume that the recently amended EU regulation on Credit Rating Agencies will impact market practices as it sets out several disclosure requirements for externally rated structured credit products (including securitisation) which also apply to originators or sponsors.

Whilst we welcome these initiatives we underscore that their expectations are not similar with those of the Para 7. We consider that market practice will evolve and market standards will emerge with regard to the disclosure documentation.

***Question 21**: Would disclosure templates that currently exist or are in the process of being prepared by trade associations, industry bodies, central banks, market participants or others fulfil these requirements on an adequate basis?*

We agree that the sponsor or originator credit institution have to disclose on an on-going basis that it continues to fulfil the obligation that it initially undertook to maintain the economic interest in the securitisation. We support the view that this obligation does not imply for the sponsor or originator to provide further information on the current nominal value, current market value, or any impairments or writedowns on the retained interests.

The article 122a (see paragraph 7) can be interpreted as making an obligation to an originating bank in a securitisation to disclose data on the performance individual underlying exposures in the securitization.

In relation to ABCP conduit programmes

A specific approach is needed as a large portion of underlying assets include trade receivables and other categories such as utilities receivables portfolio comprising hundreds of thousands and sometimes millions of receivables. The specific short-term nature of the ABCP paper, the revolving nature of the underlying assets and the general protection provided by the conduit's sponsor are further characteristics which should be taken into consideration to differentiate reporting requirements for ABCP programmes from those related to term transactions.

We note that in both the US and European markets ABCP conduit sponsors, working with ABCP dealers and investors have developed standard reporting templates which have been found satisfactory by the investors' community. Such accepted templates should be considered as meeting the disclosure requirements mentioned in paragraph 7.

In relation to banks' balance sheet portfolio management

When an originating bank securitizes Corporate assets and the credit quality of the pool is assessed through the bank's internal ratings (which is more particularly the case for big but non public/non listed/non rated corporates) then we may face prohibitions to individual ratings disclosures. Indeed, these internal ratings may contain private banker's information. Disclosure prohibition can be the consequence of internal compliance policies, or from an internal legal analysis. Unfortunately, the disclaimer in the CEBS Consultative paper 40 allowing an originating bank to refrain from disclosing elements (see article 104, see also the article 68) provides comfort with respect to the above issue, but only to the extent some public legal or regulatory requirement would be breached. We would like the disclaimer to be extended to policies that are internal to the originating banks - or that consist in internal interpretations of public requirements.

We support the limitation on the scope of disclosure requirements set forth by paragraph 104 with regard to the provision of information that would breach other legal or regulatory requirements. We propose a slightly different wording in order to include compliance requirements (namely concerning confidentiality restrictions) which might not be directly supported by formal legal or regulatory requirements: *"The disclosure requirements of credit institutions when acting as sponsors or originators of securitisations, as outlined in Paragraph 7 above, need not extend to the provision of information that would breach* ***directly or indirectly*** *other legal or regulatory requirements (such as market abuse and confidentiality restrictions)".*

Question 22*: Would such implementation without a materiality threshold create complications or be overly burdensome?*

Many transactions provide for substitution of assets which become ineligible during the life of the transaction.

"Forced" substitution for breach of eligibility criteria should be exempt; otherwise, potentially most transactions existing in the market will be caught after 31st December 2014 if they substitute even one asset for this reason and it is very unlikely that existing transactions can be amended to remove this substitution provisions which effect is to improve the quality of the underlying portfolio.

We note that clarification is needed for the application of the requirement to credit cards master trust structures where the addition or substitution of assets should be in reference to the designation of new accounts and not to new receivables generated under the existing accounts.