

EBA/OP/2014/14

22 December 2014

Opinion of the European Banking Authority on the securitisation retention, due diligence and disclosure requirements

Introduction and legal basis

The EBA competence to deliver this Opinion to the European Commission is based on Article 34(1) of Regulation (EU) No 1093/2010¹.

Article 512 of Regulation (EU) No 575/2013 ('CRR') mandates the European Commission to report to the European Parliament and the Council in relation to the application and effectiveness of the provisions of Part Five of the CRR in the light of international developments. As a result, the Commission issued a call for advice to the EBA in December 2013 related to the application of the above-mentioned provisions.

The EBA subsequently received a further call for advice from the Commission² specifying the above mentioned mandates and requesting the EBA to provide advice also on the appropriateness and effectiveness of CRR requirements for investor, sponsor and originator institutions in relation to exposures to transferred credit risk in the light of international market developments.

In accordance with Article 14(5) of the Rules of Procedure of the Board of Supervisors³, the Board of Supervisors has adopted this opinion.

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 (OJ L 331, 15.12.2010, p. 12).

² The EBA received the call for advice in January 2014

³ Decision adopting the Rules of Procedure of the European Banking Authority Board of Supervisors of 11 December 2013 (Decision EBA DC 001 (Rev3)).

General Proposals

This Opinion constitutes the advice of the EBA on several aspects related to the securitisation retention, due diligence and disclosure requirements (CRR Articles 405-409).

The 'EBA Report on Securitisation retention, due diligence and disclosure requirements' (the Report), annexed to this Opinion, develops the analysis which was carried out to support the different recommendations.

The advice takes the form of:

- Nine recommendations No 1-9) on the overall appropriateness of requirements related to exposures to transferred credit risk as specified in CRR Articles 405-409;
- One recommendation on the convergence of the retention rules regulatory frameworks

Recommendation 1: Indirect approach with the direct approach to be used as complementary

Taking into account the positive impact of the current framework on EU markets, the EBA recommends keeping the indirect approach for now and implementing a complementary direct approach: in addition originators/sponsors/original lenders should be obliged to publicly disclose on the detailed retention form using a standardised format to create more transparency and certainty for the investors and to thereby facilitate the investors' due diligence.

Rationale

The 'indirect' approach places the onus on the investors and consequently encourages investors to only buy securitisation exposures following proper due diligence and once they fully understand the risk they are taking on. Therefore, placing the requirement on the investors rather than on the originator has the potential of serving as an additional tool to enhance the level of sophistication of investors over time. Furthermore the 'indirect' approach has the merit of increasing the ability of NCAs to enforce risk retention provisions effectively.

On the other hand, the 'direct' approach, which places the retention requirement obligation directly on originators, sponsors and original lenders instead of the investor institutions, could, while causing potential additional costs for originators, original lenders and sponsors, reduce compliance costs and improve legal certainty for investors, thereby encouraging new securitisation investors to invest. Moreover, the EBA believes that the enforcement of disclosure requirements must be possible.

Given the approach adopted in some major jurisdictions, a move towards the direct approach could also bring some benefits in terms of cross-border consistency.

Recommendation 2: Forms of retentions

The EBA believes that, other than the five forms of risk retention already available, no other form should be considered at this time and recommends further assessment of the effectiveness of the five forms already in place.

Rationale

The options provided in Article 405 of the CRR are well established and, according to feedback received by stakeholders and national supervisors, seem to work well and are deemed sufficient.

The EBA stresses that greater choice with additional forms of retention may have some drawbacks: because originators, original lenders and sponsors are given a greater choice with regard to how to retain risk, their chosen form may not be as effective in aligning interests and mitigating risks for investors as the options provided for in the CRR. Furthermore, the special features of an additional “L-shape” retention option would add to the complexity of measuring the net economic interest.

Recommendation 3: Alternative mechanisms to achieve the alignment of interests

The EBA believes that alternative mechanisms for aligning interests other than risk retention should not be considered as a substitute for risk retention requirements.

Rationale

While the alternative mechanisms specified above are considered helpful as a complement to risk retention requirements, the EBA does not believe that there is sufficient evidence supporting the use of these alternative mechanisms as a substitute or demonstrating that they are equivalent to the current retention options in place regardless of the asset class or securitisation structure.

Recommendation 4: Retention on a consolidated basis

The EBA believes that it is essential that consolidation be accomplished with regard to the scope of supervision on a consolidated basis (Article 405(2) of the CRR) and believes that the scope of consolidation should not be expanded.

Rationale

The EBA believes that it must be possible to enforce disclosure requirements. Therefore, the retaining entity needs to be included in the scope of supervision on a consolidated basis. Furthermore, retention within the scope of supervision on a consolidated basis will ensure

transparency on retainers and the possible use of regulatory arbitrage relating to the retention position. This approach is also consistent with the EBA's observations and findings outlined in its Final Report to the European Commission on the perimeter of credit institutions established in the EU Member States.

Recommendation 5: Exemptions and exceptions to Article 405 of the CRR

The EBA believes that there are sufficient ways of complying with the retention rule; therefore, the EBA does not recommend allowing for any further exemptions and/or exceptions to Article 405(3) and Article 405(4) of the CRR at this time.

However, the EBA would recommend further assessing the possibility of introducing an 'exceptional circumstances' provision whereby under certain circumstances (such as the insolvency of the retainer), the retainer could be changed during the life of a securitisation transaction to ensure that the retainer is always the most appropriate entity to whom the interests of the investors should be aligned.

Rationale

The EBA believes that providing further exceptions could lead to abuse of the rules and that securitisation transactions could specifically be structured to meet the possible exemptions. Furthermore, as mentioned before, the EBA does not believe that any alternative mechanisms can be used as a substitute or are equivalent to the current retention options in place regardless of the asset class or securitisation structure.

Recommendation 6: Potential loopholes

The EBA believes that, for the purposes of the retention requirements, the 'originator' definition in CRR Article 4(13) should be narrowed down and defined in further detail to reduce the potential misuse of the retention requirements via legal definition loopholes and to ensure real alignment of interests between the originator and investors.

Rationale

As a result of the wide scope of the definition of 'originator' in Article 4(1)(13) of the CRR, it is possible to structure securitisation transactions so as to meet the legal requirements of the regulation without following the 'spirit' of the regulation and which, in fact, do not always align the interests of the most appropriate party to retain (originator, original lender or sponsor) with the interests of the investors.

The EBA believes that the entity claiming to be the 'originator' should in principle be of real

substance and should always hold some actual economic capital on its assets for a minimum period of time.

If necessary, the EBA could do further work on narrowing down the scope of the originator definition.

Recommendation 7: Disclosure requirements

Overall, the EBA considers the disclosure requirements in the current framework (CRR Article 409) in conjunction with the corresponding RTS (Article 22 and Article 23) to be appropriate and fit for purpose to ensure investor protection and financial stability. Therefore, the EBA does not recommend any changes.

Rationale

Originators and sponsors of securitisations should ensure that investors have access to all material information that is needed to perform a comprehensive and well-informed analysis of the risks arising in relation to the securitisation, where this analysis also takes the form of stress tests on the cash flows and collateral values supporting the underlying exposures. In principle, disclosure should include information on the credit quality and performance of the underlying assets on a loan-by-loan level. However, there are instances where 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 that pool is based on the pool itself or on a loan-by-loan basis. In this regard, the EBA considers the current requirements as sufficiently comprehensive and flexible to ensure that securitisation investors receive all material information on various types of transactions.

The EBA notes that the implementation of CRA3 provisions and other initiatives led by national authorities on the development of data templates for public and private transactions as well as established collateral frameworks of central banks have the potential to further improving the effectiveness of the framework, and to enhance consistency and transparency across the EU. The EBA consequently supports the current measures, and does not see any further need for additional measures beyond those already undertaken. However, the EBA considers the alignment of the different EU requirements to be helpful.

Recommendation 8: Due diligence requirements

The EBA considers the due diligence requirements in the current framework (CRR Article 406 and Articles 15 and 16 of the corresponding RTS) to be sufficient and appropriate to enable investors to conduct appropriate due diligence.

Rationale

The due diligence requirements ensure a high level of safety for that current investors, and new investors consequently buy securitisations with a full understanding of the risk they are taking on and without a sole reliance on external ratings. Even though the requirements far exceed the requirements for comparable investment products, they are deemed appropriate because of the additional level of complexity inherent to securitisation positions compared to other investment products.

Recommendation 9: Adequacy of the level of additional risk weights and administrative penalties/measures

The EBA believes that the current sanctions in terms of additional risk weights and administrative penalties/measures are adequate.

Rationale

Given the low number of non-compliant cases (as highlighted in the compliance studies conducted by the EBA), the EBA believes that the sanctions in terms of additional risk weights imposed on an institution failing to meet the requirements provided in Article 405 (retention requirements), Article 406 (due diligence requirements) or in Article 409 (disclosure requirements) of the CRR and calculated by applying the formula in accordance with the approach specified in Article 245(6) and Article 337(3) of Regulation (EU) No 575/2013 serve as an adequate deterrent to violating risk retention, due diligence and disclosure requirements.

The EBA also believes that the administrative penalties and administrative measures that can be applied under CRD IV Article 67, where an institution is exposed to the credit risk of a securitisation position without satisfying the retention requirements in CRR Article 405, are adequate.

Recommendation 10: Convergence of the retention rules regulatory frameworks

The EBA supports the development of more alignment and consistency between regimes and supports the IOSCO peer review which was launched in spring 2014 to assess the implementation of the G20 commitments at a global level, and to encourage further convergence between regimes.

Rationale

The EU regime and the foreign legislation, if not harmonised, may drive a real wedge in the global securitisation markets and may further reduce EU issuers' ability to benefit from the global investor base and EU investors' ability to benefit from global securitisation investments; therefore reducing the competitiveness of the EU financial industry and its ability to be engaged in the global securitisation market.

Specific proposals and supporting analysis

The Report annexes to this Opinion develops the analysis which was carried out to substantiate the different recommendations to the European Commission and presents, within the relevant sections, a more detailed illustration of the rationale behind each recommendation.

This opinion and the supporting report will be published on the EBA's website.

Done at London, 22 December 2014

[signed]

Andrea Enria

Chairperson

For the Board of Supervisors