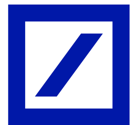
Deutsche Bank



EU Transparency Register ID Number 271912611231-56

Deutsche Bank AG
Winchester House
1 Great Winchester Street
London EC2N 2DB

Tel +44 20 75458000
Direct Tel +44 20 75451903

19 December 2017

DB response to the European Banking Authority (EBA) discussion paper on Significant Risk Transfer (SRT) in securitisations

Dear Mr Farkas,

Deutsche Bank (DB) welcomes the opportunity to comment on the discussion paper on Significant Risk Transfer in securitisations. We are supportive of overall objective of more harmonised treatment and supervisory assessment of securitisation transactions and generally agree with the direction taken in the paper. Nevertheless, there are some areas where we have concerns:

- **Supervisory feedback on SRT to the originator:** the proposal for mandatory feedback is unlikely to be practical for supervisors given the high volumes of notified SRT transactions. This proposed approach should be reviewed.

- **Credit Events Synthetic Securitizations:** proposing to use the Restructuring definition as stated in the Capital Requirements Regulation (CRR) as a Credit Event in order to achieve SRT in synthetic securitizations is incorrect. The overarching purpose of SRT is to protect the originator in cases where actual losses are suffered, not the likelihood of a loss. We would therefore recommend this definition is revised.

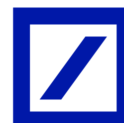
- **Time calls:** installing an ex ante limit on time calls for synthetic deals will not work in practice and therefore we would propose a more flexible approach showing that suitable safeguards are already in place.

- **Definition of overcollateralization:** the discussion paper only focuses on the use of this definition in with regards to Non-Performing Loan securitisations. We believe however that this approach might also spill over to performing loans, which requires further assessment.

- **Cost of credit protection:** we believe that if the premiums are non-contingent, this should not prevent fulfilment of SRT. Instead, these premium payments are taken into account when calculating the present value of the premia and compare them with the losses of the protected exposures.

Chairman of the Supervisory Board: Paul Achleitner.
Management Board: John Cryan (Chairman), Kimberly Hammonds, Stuart Lewis, Sylvie Matherat, Nicolas Moreau, Garth Ritchie, Karl von Rohr, Marcus Schenck, Christian Sewing, Werner Steinmüller, Jeffrey Urwin.

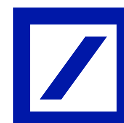
Deutsche Bank Aktiengesellschaft domiciled in Frankfurt am Main;
Local Court of Frankfurt am Main, HRB No 30 000; VAT ID No DE114103379;
www.db.com



These points are set out in more detail in the attached response. Please do not hesitate to contact us if you have questions or wish to discuss further.

Yours sincerely,

Matt Holmes
Head of Regulatory Policy



Annex I Response to the questions

In this annex we only provided responses to the questions where the discussion paper could benefit from additional feedback.

Question 3: What are your views on the proposals on the assessment process set out above? Are any other changes necessary to further improve the process?

With regards to the supervisory feedback on SRT to the originator, we are concerned that it may not be practical to introduce a mandatory feedback requirement competent authorities for each notified SRT transaction, since the volume of notified SRT transactions on industry level is significant. A mandatory requirement on supervisors might risk creating additional uncertainty within the process if responses were to be delayed. Especially if the ECB has to provide this feedback for all Eurozone banks. This uncertainty could be addressed through clearer definition of 'reasonable timeframe', for response by the Competent Authority (CP) e.g. one month of after the submission of final information by the bank. In addition it should be made explicit that for cases where no permission is required and the bank-internal assessment comes to the conclusion that SRT is fulfilled, SRT should be assumed until such time as the CA provides feedback.

With regards to the so-called full deduction option, it is not clear why the originator should notify the competent authority since the exercise of this option does not fall under the term 'significant risk transfer assessment'. This is confirmed by the EBA feedback on page 13 of the corresponding final EBA Guidelines on SRT:

"As, according to Articles 243 (1) (b) and 244 (1) (b) of the CRR, SRT recognition is not required for securitisations where an originator institution applies a risk weight of 1,250% to all retained securitisation positions or where these retained securitisation positions are deducted from Common Equity Tier 1 items in accordance with Article 36 (1) (k) of the CRR, these securitisations do not fall within the scope of application of these Guidelines." [1]

In addition, the requirements for effective risk transfer (see Articles 243(5) and 244(5) current CRR and Articles 244 (4) and 245 (4) CRR amendment) are still assessed by the banks and must be fulfilled in order to exclude the securitised exposures from the RWA calculation of the originator.

Question 7: Do you agree with the assessment of the SRT implications of all the identified structural features? Are any material aspects missing from this representation?

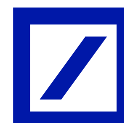
The proposed requirement that synthetic securitizations include three credit events (including restructuring) in order to achieve credit risk mitigation, and applying the credit event definitions under Article 178, is incorrect and would run contrary to CRR Articles 213, 215 and 216. Article 178 (3) (d) refers to the "likelihood of a loss being suffered", whereby the overarching purpose of SRT is to protect originators against actual losses by ensuring losses on the underlying portfolio are absorbed by the transaction, and sufficiently transferred to a third party. CRR Articles 215 and 216 specifically indicate an actual loss must occur, contradicting Article 178 (3) (d).

CRR Articles 213 and 215 do not require the credit event 'restructuring' to be included for guarantees. Therefore, we do not see a reason why different credit risk mitigation requirements should be introduced for securitization and non-securitization exposures.

This proposed change would force originators in certain jurisdictions to mark-to-market the retained tranches of their issued synthetic securitizations, and could have significant consequences to the risk profile of these transactions, leaving originators exposed to complex risks such as correlation, gamma, etc. This is clearly not the intention of bank balance sheet synthetic securitization originators.

---

[1] https://www.eba.europa.eu/documents/10180/749215/EBA-GL-2014-05+Guidelines+on+Significant+Risk+Transfer.pdf



We foresee the implementation of the requirement of three credit events to achieve SRT as having a very substantial impact on the market, and could reduce market-wide issuance significantly, as banks (and possibly others) will be highly impacted, as future bank issuances would be curtailed under the proposed rules.

In light of this, we believe CRR Articles CRR 123, 215 and 216 should continue to be applied and used while assessing SRT in synthetic securitizations.

Question 8: Do you agree with the proposed safeguards related to the use of pro-rata amortisation?

In our view any triggers used to determine the switch from pro-rata to sequential amortization should be forward looking and not look on the past performance of the portfolio. A CLO being “pro-rata” amortized should be viewed in the same way as a brand new CLO issued with the same economics. This because the only relevant aspect should focus on the riskiness of the tranche given the outstanding pool, irrespective of what happened beforehand. Therefore, backward looking triggers I and II are not relevant.

Question 9: Do you agree with the proposed safeguards related to the use of time calls? Do you agree with the different approach to time calls in traditional vs. synthetic transactions?

We understand why a different approach for time calls in traditional and synthetic securitisations is proposed, but we do not agree with the proposed imposition of a limit on time calls for synthetic deals.

With regards to time calls in synthetic securitisations, it is important to focus on how the time call will work in practice. A time call which includes the following features does not endanger SRT in a synthetic securitisation:

- Under this time call, the bank has the option to terminate the bought protection on the underlying exposures (i.e. terminate the synthetic securitisation) on or after a certain point in time, and only incurred losses until that call date are compensated by the protection provider. Further the bank will also no longer pay any premia in the future beyond the call exercise date.
- In addition, the bank should not be obliged to pay a termination fee that is above the usual market handling costs and there are no other compensation payments at the respective call date.
  In any event, the exercise of the call option should be in line with the bank’s risk and portfolio management practices.

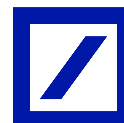
If a time call as described above exists, Articles 250 and 238 of the current CRR are sufficient to reflect the potential maturity mismatch, i.e. if the protection buyer has the option to terminate, the only question is whether there is an incentive to exercise the option or not. If yes, the earliest date at which the protection can be terminated is used for determining maturity mismatches. Therefore, the retained RWA for the protection buyer will be higher due to the maturity mismatch, which is then reflected in the SRT assessment. A time call as described above does not endanger SRT.

Given the above factors, we believe that the proposed approach in 102 (c) of the discussion paper is unnecessary as suitable safeguards are already in place.

Question 30: Do you agree with the proposed way of implementing the SEC-IRBA and SEC-SA approaches for the calculation of securitisation tranche capital in the presence of a non-refundable purchase price discount? Do you envisage other ways to implement the mentioned approaches in the presence of a non-refundable purchase price discount?

The EBA discussion paper only addresses the topic of non-refundable purchase price discount with regards to NPL securitisations. However, since the definition of ‘overcollateralisation’ is not restricted to NPL portfolios, consideration must also be given to what the EBA view would mean for securitisations of performing loan which are bought at a price which is lower than the nominal value.

The EBA view might lead to a situation where all types of purchase price discounts (i.e. refundable and non-refundable for NPL and performing assets) must be treated as a separate tranche. Following this EBA view, the investor in a traditional securitisation applying the SEC-SA would need to know the original



gross book value of the underlying assets on the balance sheet of the originator bank who sells the assets to the SSPE.

The CRR already explicitly prescribes a certain treatment of refundable and non-refundable purchase price discounts which are both options for the purchaser of the receivables, i.e. no obligations how to treat purchase price discounts:

1. Article 153 (7) / 154 (6) new CRR: “For purchased receivables, refundable purchase price discounts, collateral or partial guarantees that provide first loss protection for default losses, dilution losses, or both, may be treated as a first loss protection by the purchaser of the receivables (...).The seller providing the refundable purchase price discount and the provider of collateral or partial guarantees shall treat those as an exposure to a first loss position (...).

2. Article 248 (1) (d) new CRR: “An originator institution may deduct from the exposure value of a securitisation position which is assigned 1 250 % risk weight (..) the amount of the specific credit adjustments on the underlying exposures in accordance with Article 110, and any non-refundable purchase price discounts connected with such underlying exposures to the extent they have reduced own funds.

Therefore, if all purchase price discounts fall under the term ‘overcollateralisation’, these optional rules would no longer apply. Keeping in mind that the definition of ‘overcollateralisation’ does not distinguish between NPL and performing portfolios, we think that the term ‘value’ for the underlying exposures refers to the gross book value of the underlying assets shown on the balance sheet of the SSPE before applying any specific credit risk adjustments. This means that the overcollateralisation is determined as the gross book value as defined shown on the balance sheet of the SSPE before applying any specific credit risk adjustments minus the book value of the tranches before applying any specific credit risk adjustments.

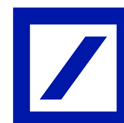
In line with Article 159 CRR, purchase price discounts for balance sheet exposures purchased when already in default, are already treated in the same manner as specific credit risk adjustments. Please note that this should, however,apply for CRSA and IRBA assets. In line with Article 166 (1) CRR, the purchase price discount is determined as the difference between the amount owed (i.e. the nominal amount) and the net book value on the purchase date (i.e. the accounting value remaining after specific credit risk adjustments recorded on the balance sheet of the SSPE on the purchase date). Normally, this net book value on the purchase date is the purchase price.

As a consequence, only purchase price discounts for assets purchased when already in default fall under the term ‘overcollateralisation’. This because for non-defaulted assets, the gross book value of the underlying assets shown on the SSPE’s balance sheet before applying any specific credit risk adjustments is always identical to the purchase price. Therefore, there is no difference between this gross book value as defined above minus the book value of the tranches before applying any specific credit risk adjustments if the amount of issued tranches equals the purchase price. We view that purchase price discounts are only relevant for traditional securitisations since only in these cases, a purchase of assets is performed.

In addition, for the purpose of determining the attachment and detachment point of the tranches, a distinction between refundable and non-refundable purchase price discounts is not required in the definition of ‘overcollateralisation’, i.e. it is not relevant. However, in practice, the purchase price discounts are usually non-refundable purchase price discounts for assets purchased when already in default.

The following example illustrates the treatment of purchase price discounts when determining the attachment and detachment points and distinguishes between (i) assets purchased when already in default and (ii) assets purchased when not in default:

<u>Case 1:</u>
In a traditional securitisation, the SSPE purchases a pool of defaulted loans with a nominal amount of EUR 100mn for EUR 20mn and issues two notes with a nominal of EUR 15mn (senior note) and EUR



5mn (junior note). The non-refundable purchase price discount is the difference between the nominal amount of the pool and the net book value on the purchase date which is identical to the purchase price, i.e. the discount is EUR 80mn.

Since the purchase price discount of EUR 80mn is treated as a specific credit risk adjustment, the gross book value of the underlying exposures before applying any specific credit risk adjustments is EUR 100mn. Therefore, there is an overcollateralisation of EUR 80mn and the following attachment and detachment points are determined:

Seniority	**Attachment point**	**Detachment point**
Senior note	85%	100%
Junior note	80%	85%
Non-Refundable purchase price discount	0%	80%

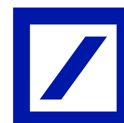
Case 2:
In a traditional securitisation, the SSPE purchases a pool of non-defaulted loans with a nominal amount of EUR 105mn for EUR 100mn and issues two notes with a nominal of 80 EUR mn (senior note) and EUR 20mn (junior note). The non-refundable purchase price discount is the difference between the nominal amount of the pool and the net book value on the purchase date which is identical to the purchase price, i.e. the discount is EUR 5mn.

However, since this discount for non-defaulted exposures are not treated as specific credit risk adjustments, the value of the underlying exposures is 100mn EUR. Therefore, there is no overcollateralisation and following attachment and detachment points are determined:

Seniority	**Attachment point**	**Detachment point**
Senior note	80%	100%
Junior note	0%	80%
Non-Refundable purchase price discount	-	-

In addition to the points above on overcollateralization, we would also note that First loss risk retention being done on a nominal / notional basis (i.e. option (d) of Art. 405(1)) for NPL securitisations may not allow for any downside risk exposure to the retention party where the purchase price discount is significant.

We think that application of the maximum risk weight for senior securitisation tranche of NPL securitisations should take into consideration the purchase price discount applied.



Annex II Additional comments

Additional comments on cost of credit protection (page 54 of the EBA discussion paper):
According to paragraph 7(4) of the EBA Guidelines, where premia are paid up-front, or not linked to losses in the asset pool being protected or otherwise guaranteed, competent authorities should consider if this reduces the extent of credit risk transfer. Therefore, the bank must already assess whether protection premiums are not proportional (non-contingent) to the exposures being protected.

This can occur, for example, when the premium payments are paid upfront or guaranteed over time without respect to write-downs, defaults or amortisation of the reference exposures, i.e. the premium payments are not a proportion of the amount that is still protected. However, we strongly believe that if the premiums are non-contingent, this should not be a knock-out criteria for fulfilling SRT. Instead, these premium payments are taken into account when calculating the present value of the premia and compare them with the losses of the protected exposures. Therefore, this serves as an input for another key criterion.