EBA Discussion Paper on the Significant Risk Transfer in Securitisation

This document provides the response of the Dutch Securitisation Association ("DSA") on the EBA Discussion Paper dated 19 September 2017.
We welcome the opportunity to commend on this Discussion Paper.

DSA Background

The Dutch Securitisation Association was established in 2012 as representative body of the Dutch securitisation industry. Our membership includes issuers of securitisations both from the insurance and banking industry, and we are operating in close cooperation with the Dutch investor community.
Our purpose is to create a healthy and well-functioning Dutch securitisation market. We try to achieve this i.a. by providing a standard for documentation and reporting of Dutch RMBS and Consumer ABS transactions, promoting (in close cooperation with PCS) further standardisation and improvements in transparency, and active involvement in consultations about future regulation of the securitisation market.
Against this background, we would like to commend, on behalf of all Dutch issuers joined in the DSA, on the EBA Discussion Paper on the SRT in Securitisation (individual DSA members may also provide their own comments).

Our comments

Question 1: Does the data on synthetic and traditional SRT securitisation transaction correspond with your assessment of SRT market activity in the EU? Do you have any observations on these data?
Since a considerable share of SRT transactions is not public, it is very difficult to get a feeling of the actual size and distribution over asset classes etc. Nevertheless, based on our knowledge of the Dutch market, the data provided do not seem to be unrealistic in the context of the current shape of the European securitisation market in general.

Question 2: Are you aware of any material supervisory practices that have not been covered in the EBA analysis?
Given the (inevitably) undisclosed nature of practices around SRT discussions with supervisors, there are not many sources outside the EBA questionnaire that could reveal these practices. We are however aware of the fact that some of our members are subject to far more detailed information requirements from their competent authorities than customary for SRT applications at other competent authorities. We are not against detailed information being shared, but the burden of information should be a function of the complexity of the transaction and not of the location of the competent authority.

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 ?
Standardisation of securitisation processes is one of the key objectives of the Dutch Securitisation Association and against that background we welcome the proposals of EBA on the SRT assessment process. We do however note that the provision of informal early feedback by supervisors, as strongly desired by originators (as per section 70), unfortunately did not make it to your recommendations.

We support the proposal of several other market participants to require competent authorities to react within 30 days when notified, but would like to link the notification to (30 days before) actually achieving SRT (f.i. by selling the relevant notes in a traditional securitisation) rather than the closing of the transaction.

Question 4: Could you provide suggestions as to whether and how the template for SRT notification by the competent authority to EBA provided in Annex I of the EBA Guidelines should be amended to reflect the new EU securitisation framework and the STS securitisation product?
Apart from the obvious ones (new CRR articles, new (homogeneous) types of collateral, additional inputs for new tests) we envisage no further template changes.

Question 5: Should a standardised SRT notification template be developed, for submission by originators to competent authorities, in order to facilitate the SRT assessment process? If yes, should this template be different for traditional and synthetic securitisation? (Please provide examples of templates, as appropriate).
Again, we are strongly supporting standardisation. However, given the diverse nature of SRT transactions, a template should not be overly prescriptive. In that respect we refer to the ECB template of 24 March 2016, that seems to strike the right balance between detail and flexibility. Given the different characteristics of true sale and synthetic transactions, different templates for the two mechanisms would be appropriate.
The notification template should provide some kind of level playing field, where currently competent authorities in different jurisdictions have widely diverging requirements w.r.t. the information to be provided as part of the notification, as also indicated in our answer on Question 2.

Question 6: Could you provide suggestions as to how a template for monitoring SRT compliance should look like (e.g. by potential amendments of the current COREP framework)?
Frequent monitoring is important but should not be overly burdensome and should not lead to re-assessment of the SRT status but just confirm that no material structural changes to the transaction have been made.
So we would suggest to limit the reporting to material/relevant deviations from the original application; any relevant quantitative tests will have to be met at inception of the transaction only and do not have to be monitored during the life of a transaction. The fact that losses materialise does not mean that that risk was never initially transferred and that SRT treatment should be revisited by recalculating the quantitative tests.

Question 7: Do you agree with the assessment of the SRT implications on all the identified structural features? Are any material aspects missing from this representation?
For our (dis)agreement with the assessments we refer to our answers on questions 8-16.
W.r.t. 3.2.7 Credit Events, which is not covered in the follow up questions, we and many others in the industry, note the discrepancies between CRR art. 178 as incorporated in your proposal, and the market standard of CRR art. 215/216.
To the best of our knowledge the list of structural features with SRT relevance is close to exhaustive. One missing element to be further elaborated on, is the maturity to be matched by the credit protection, especially for "until further notice" exposures (like overdrafts).

Question 8: Do you agree with the proposed safeguards related to the use of pro-rata amortisation?
We agree with the proposal to include clearly specified contractual triggers as a condition for including (elements of / potential) pro-rata amortisation in SRT transactions and we also agree with the suggestion to have the trigger values reviewed by the competent authorities. However, we would prefer to have also the actual definitions of triggers reviewed by the competent authorities rather than being determined by the 4 tests defined a as minimum in the EBA proposal. The 4 tests are not all equally valid or not always properly worded to cover all kinds of potential SRT transactions (f.i. the granularity test is not always required, depending on the nature of the assets).

In this respect it could also be considered to reduce the number of tests, f.i. by combining trigger I and II by including non-matured defaults in the definition of cumulative losses in I. Furthermore we would appreciate to receive confirmation that the proposal also allows for a choice of pro-rata or sequential amortization per tranche (again subject to review by the competent authorities) in order to meet specific preferences of investors in this respect.

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 do understand the proposed safeguards against the possible scenario that an originator institution can use a time call to reassume credit risk that is still equal (or higher) than the risk transferred at the start of a transaction. However, in a situation where the credit risk is considerably lower than originally anticipated, it should be possible to call the transaction well before the end of the WAL of the securitised exposures.
Obviously, when exercising the call, compliance with regard to Implicit Support and Step-in Risk guidelines should be demonstrated to the competent authorities.
Also we would suggest that the exercise of the time call should follow the WAL of the securitised portfolio, in line with current practice, and not to add the replenishment period to the non-call period, which would seriously limit the flexibility of SRT transactions.
Furthermore we still fail to see why the regime for true sale transactions in this respect should be different from synthetic transactions, at least in a situation as described above (reduced credit risk, no implicit support).

Question 10: Do you agree with the proposed safeguards on the use of excess spread in traditional securitisation?
We do agree with the proposed safeguards (not guaranteed or fixed, clearly defined also in terms of place in the waterfall).
In more general terms, we do question the way the proposal treats future/unearned excess spread, and in that respect we refer to our answer on Question 12 (below) on the use of excess spread in synthetic securitisation.

Question 11: Do you agree with the proposed safeguards constraining the use of excess spread in synthetic securitisation? In particular, do you agree with:
a. The proposal of only allowing a contractually fixed (pre-determined) excess spread commitment in synthetic transactions?
b. The proposal to only allow a 'trap' excess spread allocation mechanism in synthetic transactions?
a. We do agree with a pre-determined calculation method for excess spread in synthetic transactions, but not with a pre-determined fixed amount or percentage.
b. We miss the rationale for not allowing the use-it-or lose-it mechanism, where according to section 221 "the trapped allocation mechanism effectively counteracts SRT to a larger extent than the use-it-or-lose-it allocation mechanism".

Question 12: Do you agree with the proposed way to treat the excess spread commitment in synthetic securitisation transactions for the purposes of the quantitative assessment of SRT and commensurate risk transfer?
We do not agree with the way the excess spread commitment is treated in the quantitative assessments of SRT.
In line with the CRR, we agree that realized/earned excess spread (one year EL in a synthetic transaction) should be regarded as a securitisation position. Future/unearned excess spread should however not be a securitisation position. The EBA proposal:
-conflicts with the treatment of future excess spread for loan portfolios on bank's books.
-leads to double counting of risk and consequently excessive capital requirements.
As regards the "Commensurate test", please see our comments on Questions 23 and 24.

Question 13: In relation to the further considerations for stakeholders' consultation on the own funds treatment of excess spread:
a. Do you agree that the unrealised/unfunded component of the excess spread commitment should become subject to Pillar I own funds requirements?

b. What would be the impact on SRT transactions if Pillar I own funds requirements were recognised as suggested in Section 3.2?
a. We agree that future/unearned excess spread and future (back-loaded) losses are taken into account in the self-assessment. Additional regulatory capital penalties by making future/unearned excess spread subject to own funds requirements are undesirable (see our answer on Question 12) and not needed, and
b. Those regulatory capital penalties would seriously hurt the economics of SRT transactions and further reduce the number of such transactions

Question 14: Are there any other safeguards or alternative regulatory treatments to address risks retained through excess spread in traditional and synthetic securitisation?
Being part of the self-assessment should be a sufficient safeguard.

Question 15: Should there be a specific treatment in those transactions featuring excess spread in which the originator, instead of achieving SRT in accordance with one of the SRT tests specified in the CRR, chooses to deduct all retained securitisation positions from CET 1 or apply a risk weight of 1250% to all of such securitisation positions ('full deduction option'), in order to be allowed to exclude the securitised exposures from the calculation of risk-weighted exposure amounts?
Our comments (see answer on Question 12) whether (earned/unearned) excess spread qualifies as a securitisation position or not should be equally applicable to the full deduction option.

Question 16: What are your views on the use of originator's bankruptcy as an early termination clause? How does this clause interact with the resolution regime (i.e. the BBRD framework)? Should this clause be banned?
In our view, investors should at least have the option to demand this clause and it should not be banned, but we also welcome developments around the BRRD framework that ultimately may dis-apply the application of the clause.

Question 17: Do you agree with the proposed originator's self-assessment of risk transfer? Should such assessment be formulated differently?
Subject to our earlier comments on amortisation, excess spread and time calls, we agree with the principle of a self-assessment. Some further clarification (f.i. on how to develop scenario's for back-ended losses) would be welcome. Also we would welcome some more guidance on the use of EU-wide stress test results where the maturity of the SRT transactions will usually differ from the maturity applied in the stress test.

Question 18: Are you aware of circumstances where institutions have entered into a structured risk transfer transaction which is not captured by Articles 243 or 244 CRR? For example, where the accounting treatment has meant a transaction is not considered for SRT assessment, or where transactions economically similar to SRT transactions do not fall into the definition of a 'traditional securitisation' or 'synthetic securitisation'.
No, we are not aware of any of those transactions.

Question 19: Do you agree with the proposed specification of the minimum first loss tranche thickness for the purpose of the first loss test?
The test is overly robust. We expect that most transactions will (have to) rely on the mezzanine test. Furthermore we refer to the comments of AFME and the EBF on the technical flaws of / inconsistencies between the tests. A combined thickness test for protection tranches may be a way to get around these issues.

Question 20: Do you agree with the proposed requirement of the minimum first loss thickness for the transactions assessed under the mezzanine test (i.e. transactions including mezzanine securitisation positions)? Do you consider this requirement relevant for all the approaches for calculation of securitisation own funds requirements (including e.g. SEC-ERBA)?

In principle, we do agree with the first loss requirement for transactions subject to the mezzanine test. We would however prefer a requirement that allows more flexibility to sell some first loss also through the mezzanine tranche.

Question 21: Is a specification needed of the minimum thickness of tranches constituting mezzanine securitisation positions for the purpose of the mezzanine test?
No, the current mezzanine test in combination with the first loss requirement (but subject to our comment on flexibility in our answer on Question 20) should be sufficient.

Question 22: What impact do you expect the new CRR securitisation framework to have on tranches' minimum thickness?
To the extent we expect an impact on tranche thickness in transactions of Dutch originators, it should be a thickening of the sold tranches to compensate for the higher risk weights of the retained tranches.

Question 23: Do you have any comments on the test of commensurate risk transfer proposed under Option 1?
We have a number of issues with the Option 1 test:
-our earlier comments on earned versus lifetime excess spread do apply again;
-additionally we wonder whether point-in time (ratio 1) and lifetime (ratio 2) can be compared in the way proposed;
-furthermore, we see an inconsistency in treating the lifetime EL as transferred in the commensurateness test for transactions that are designed to meet the mezzanine test (where the EL is retained as part of the first loss).
-and we wonder why (in the case studies of Annex 4) the UL of transferred positions is not calculated with the Supervisory Formula (with in the denominator also including the UL of all securitized positions rather than the underlying portfolio, to safeguard consistency).

Question 24: Do you have any comments on the test of SRT and commensurate risk transfer proposed under Option 2? In particular, is the 50% threshold for SRT therein needed and appropriate?
-the one year excess spread only materializes after one year, so should not be part of the point-in-time calculation of this test;
-UL should be further defined (as reg. UL);
-as regards the 50% threshold, we notice your statement (in section 231) that "the test is generally more severe compared to the existing quantitative tests". The 50% is justified in section 225 by the fact that this is in line with the policy objective for significant and commensurate. However in section 205, in the context of first loss tranche thickness, it is stated that 80% of UL has to be transferred. We would prefer to see the results of a quantitative impact study before commenting on the proper threshold.

Question 25: Should the SRT test be different depending on asset classes? Should it differ across STS and non-STS transactions?
No, we see no rationale for differentiating between asset classes.
As regards (non-)STS classification, we are strongly opposed to using the STS qualification for making any differentiation in regulatory treatment other than capital treatment.
The unjustified use of STS in the EMIR review has demonstrated the unfortunate consequences of this misconception.

Question 26: Could you provide, on the basis of SRT transactions that are part of your securitisation business, an assessment of the impact in terms of SRT achievement of the proposed requirements under both Option 1 and Option 2, taking into account the new CRR securitisation framework (Securitisation Regulation package)?
No, given the undisclosed nature of the mainly private transactions in our jurisdiction, for competition reasons originators do not want this information to be disclosed through the DSA, but they may be able to provide this information directly to you.

Question 27: Do you agree with the assessment of the market practice of NPL transfer? Are there material aspects that are not covered in this representation?
We generally agree with the market assessment and the material aspects mentioned. However the DSA members do not claim a deep knowledge of this market.

Question 28: What conditions/initiatives would, in your view, facilitate the well functioning of the NPL securitisation market?
We would like to emphasize transparency and availability of loan level data as a pre-condition for a well functioning (NPL) securitisation market.

Question 29: Which, in your view, are the core structural features that should be assessed within the SRT assessment of NPL securitisation transactions? Are the proposals on selected structural features of securitisation transactions proposed in this document (see Section 3.2.2) equally valid for NPL securitisation transactions?
Subject to our comments on the EBA proposals on selected structural features, they should generally be valid for NPL securitisation transactions as well.

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?
We do agree with the proposed way of implementing both methods in this specific case. It should also be extended to the use of non-refundable purchase price mechanisms in general (NPL or not).
On the adverse outcomes in case of the SEC-SA we subscribe to the detailed comments of AFME and EBF in their reactions on the proposals (not to be repeated here).

Question 31: Do the SRT quantitative tests provided for in the CRR currently in force (Articles 243 and 244 of the CRR) work properly for NPL securitisation transactions? If not, please provide an explanation to your answer.
To the extent the "first loss tranche" as per the new CRR covers the non-refundable purchase price discount, the tests should work.

Question 32: How should the alternative commensurate risk transfer proposed in this report be modified to address the specificities of NPL securitisation transactions?
Apart from our comments on this test (Question 23), the non-refundable purchase price discount should be properly reflected.

Question 33: How should the quantitative test proposed under Option 2 in this report (see Section 3.3.2) be modified to address the specificities of NPL securitisation transactions?
Apart from our comments on this test (Question 24), the non-refundable purchase price discount should be properly reflected.