BBVA response to the EBA Discussion Paper on Simple Standard and Transparent Securitisations

General Remarks

BBVA welcomes the opportunity to participate in the current effort to promote a robust and well-functioning securitisation market in Europe. We have worked in close cooperation with the European Banking Federation, analysing the Discussion Paper issued and elaborating a response. We, therefore, broadly support the main ideas sent by the aforementioned association. Nevertheless, we do not want to miss the opportunity to make individual comments on this significant issue.

We fully **agree with the European Commission's approach of differentiating high-quality securitisations (HQS) and reviewing their regulatory treatment in order to accommodate it to their characteristics**. We consider that elimination of regulatory hurdles that affect both supply and demand is entirely necessary to establish the correct environment for the revival of a robust and sustainable securitisation market in the EU.

We consider that **it would be positive for the European economy to benefit from the renewal of the market for less complex products in Europe**. Ultimately, this could support greater funding diversification, help to freeing up capital to grant more credit and provide insurance companies and other institutional investors with investment assets with maturities and returns that match their liability profiles. It could produce clear benefits to the real economy, complementing other long-term funding channels.

We agree with the **need for coordinating, as much as possible, with related global initiatives** but without endangering the urgency of the task of restoring this funding channel for the European economy.

We welcome **EBA's call for a comprehensive cross-sector revision of the current regulatory framework for HQS,** in order to improve consistency and mitigate any undue penalisation of these instruments in comparison with alternative financial instruments (e.g. covered bonds) or with the treatment of the underlying loan portfolios. It should be wide in scope, in order to provide the right incentives to both originate and invest in HQS.

We consider that the EBA **Discussion Paper is a very valuable contribution with regard to the definition of HQS.** We fully agree with the **approach taken to qualify entire deals**, rather than single tranches, following criteria consistent to a large extent with those anticipated in the ECB/BoE Discussion Paper. Similarly, we welcome the exclusion of external rating requirements from the definition, consistent with the political aim of reducing over-reliance on rating agencies.

The proposed **staged approach** to the definition seems to have clear advantages. As a first stage, a set of criteria to define **SST (Simple, Standard and Transparent) securitisations, intended to be the core definition common to all regulations.** As a second stage, additional sets of criteria to qualify for preferential treatment in different rules may be required if proven to be necessary to fulfil the objectives of those rules. This would **allow SST to be the common standard** for the revival of a robust securitisation market in Europe, and for the restoration of confidence in this market.

But consideration should be given to the total number of labels, since the creation of **too many labels could provoke an excessive fragmentation and complexity** and play against standardisation. A mechanical multiplication of labels along all regulations (SST qualifying/non-qualifying for banking capital, SST qualifying/non-qualifying for LCR, SST qualifying/non-qualifying for Solvency II, etc.) could provoke undesired effects associated with excessive fragmentation and complexity.

In this regard, **we have some doubts on the necessity of creating, as the EBA proposes, a duplication of the SST label in order to differentiate those securitisations qualifying for a preferential banking capital treatment from those that do not qualify**, depending on their compliance with the EBA's proposed criteria addressing credit risk. On the one hand, SST already includes some criteria related to credit risk (the retention rule to align incentives and favour robust origination practices, exclusion of impaired assets at issuance, underwriting criteria), that could be reinforced, if considered necessary, to strengthen the definition of SST and mitigate the risk of inclusion of subprime loans. On the other hand, current and forthcoming banking solvency rules are already credit risk sensitive and assign in general requirements consistent with credit risk both for internal models and for standardised approaches. Then, if the securitisation framework is sensitive enough to the credit risk of the underlying portfolio, it could make it unnecessary to add minimum credit risk requirements to the SST definition.

Consideration should also be given to a feasible, rapid and reliable way to assess compliance with SST. We favour a label for EEA SST, with a certification mechanism that ensures a unique and transparent interpretation of the criteria included in the definition of SST and that would help rebuilding trust. A credible independent certification, that provides an accurate assessment in an efficient way and in a short period of time, and that is freely available in a single location, would undoubtedly promote the operability and liquidity of these transactions. An equivalence procedure could be introduced for SSTs originated outside Europe, to produce a **non-EEA equivalent SST label**.

The EBA Discussion Paper leaves for a later stage, once the definition of SST has been finalised, the design and calibration of **the preferential treatment in banking capital requirements for qualifying SST.** Although this approach looks prudent, we consider it to be a pity that there is no inclusion of any proposal in this regard, apart from the one related to the floors, albeit a provisional one, in order to start discussions and **favour a more timely completion of the task**.

Anyway, we appreciate the **valuable contribution of the Discussion Paper in analysing what went wrong during the financial crisis and highlighting the differentiated behaviour** of many securitisations in Europe, which showed a strong performance. Also valuable is the review of the steps already taken in Europe to address several revealed shortcomings.

We also welcome the recognition, supported by the analysis conducted of capital charges based on external ratings in the post-crisis period, **of the penalising capital charges** for many European securitisation transactions, which suffer from an excessive and volatile non-neutrality charge in comparison to the capital charges associated with the underlying portfolios, even if they are transactions that have shown very low losses. We consider that this issue should be addressed without undue delay.

We are of the opinion that a **differentiated regulatory capital treatment should consider the lower risks (e.g. model risk, legal risk and agency risk) that characterise SST securitisations**. Setting commensurate and more controlled non-neutrality charges, on top of the capital requirements of the underlying portfolios, should be the way forward and thus approaches based on a supervisory formula would be appropriate. On the contrary, the use of approaches based on external ratings looks quite challenging in this respect.

Response to the questions raised in the Discussion Paper

Question 1: Do you agree with identified impediments to the securitisation market?

We largely agree with the analysis carried out by EBA, and consider that regulatory burden and uncertainty, particularly in relation to capital requirements, are key factors. Evidence suggests that the current prudential framework implies capital for all tranches that is a large multiple of the capital required for holding the underlying assets. The multiplying factor is more than 2 in all EU countries and it scales up to 4 or 5 in some countries. This is clearly reflected, for instance, in the EBA analysis of SME retail portfolios (EBA Discussion Paper, figures 20 and 21, page 76). Given this evidence, this issue should be addressed without much delay.

Question 2: Should synthetic securitisations be excluded from the framework for simple standard and transparent securitisations? If not, under which conditions/criteria could they be considered simple, standard and transparent?

No securitisation should be excluded merely for being synthetic. On the contrary, we consider that synthetic securitisations can be perfectly designed in a simple and transparent manner, and that it would be feasible to define a set of tailored criteria for them to be included as simple, standard and transparent securitisations. This type of securitisation can be a key instrument for capital management and risk transference, and consequently can favour the granting of additional credit to SMEs and other sectors of the real economy. Furthermore, since there are a number of European initiatives (EIB/EIF) that use simple synthetic structures with the goal of re-activating the European economy, not including these structures could be counterproductive.

Question 3: Do you believe the default definition proposed under Criterion 5 (ii) above is appropriate? Would the default definition as per Article 178 of the CRR be more appropriate?

We support the exclusion, at the time of issuance, of non-performing loans, but we consider that it should be understood in the sense that underlying loans and receivables should not be in default, as defined in the prudential regulation, in order to achieve consistency and promote harmonised implementation. This approach of relating non-performing loans with prudential definition of default has already been taken by EIOPA for its recommendations for type A securitisations under Solvency II.

European prudential regulation, Article 178 of Regulation (EU) No 575/2013 (CRR), considers a loan being in default when the institution concludes that the obligor is unlikely to pay its credit obligations, or when the obligor is more than 90 days past due on any material credit obligation. The regulation additionally provides discretion to national competent authorities to replace the 90 days, with 180 days for some asset classes – residential or SME commercial real estate - and we consider that this discretion should be disregarded for the SST definition to favour harmonisation.

On the other hand, we consider that the additional requirements included in Criterion 5, (i) and (iii), could be redundant or unnecessary, as CRR's default definition is comprehensive enough and already includes the assessment of those events that could make the obligor unlikely to pay its credit obligations.

Question 4: Do you believe that, for the purposes of standardisation, there should be limits imposed on the type of jurisdiction (such as EEA only, EEA and non-EEA G10 countries, etc.): i) the underlying assets are originated, and/or ii) governing the acquisition process of the SSPE of the underlying assets is regulated, and/or iii) where the originator or intermediary (if applicable) is established, and/or iv) where the issuer/sponsor is established?

We favour a label for "EEA SST", with a certification mechanism that ensures a unique and transparent interpretation of the criteria included in the definition of SST transactions, which would help to rebuild trust. An equivalence procedure could be set for SSTs originated outside Europe that comply with "equivalent criteria" for them to qualify as "non-EEA equivalent SST".

Question 5: Does the distribution of voting rights to the most senior tranches in the securitisation conflict with any national provision? Would this distribution deter investors in non-senior tranches and obstacle the structuring of transactions?

We are not aware of any conflict between the distribution of voting rights to the most senior tranches in the securitisation and national law provisions.

Nevertheless, we consider that not all voting rights should be allocated to the most senior tranches, and that junior tranches should preserve some influence, at least to take part in the decisions that concern to them more than to senior tranches. Otherwise, it would lead to reduced demand for junior tranches, resulting in larger spreads for those tranches that could hinder the economics of the structure.

Question 6: Do you believe that, for the purposes of transparency, a specific timing of the disclosure of underlying transaction documentation should be required? Should this documentation be disclosed prior to issuance?

We consider that it is not possible to finalise all transaction documents with sufficient time before issuance and that some flexibility should be allowed. Accordingly, we would have no objection to the disclosure of the transaction documents within a reasonable time after issuance.

Question 7: Do you agree that granularity is a relevant factor determining the credit risk of the underlying? Does the threshold value proposed under Criterion B pose an obstacle to the structuring of securitisation transactions in any specific asset class? Would another threshold value be more appropriate?

We agree that granularity of the underlying portfolio could be a factor to be taken into account when assessing the risk of the underlying portfolio and, consequently, when assessing the risk of the securitisation exposures, but it is not obvious that high granularity is linked with low credit risk. Nevertheless, we consider that if this factor is already included in regulatory approaches to calculate regulatory capital charges[1], it could be redundant to include it as a strict minimum requirement. See answer to Question 8.

Anyway, if inclusion is decided on, we would like to point out the convenience of adopting a more flexible approach not to hamper the securitisation of certain asset classes. The 1% threshold proposed could pose an issue for certain SME securitisations, and it could be raised to 2-3%.

1: For Rating Based Approaches, ratings already includes granularity, according to the Basel Committee assessment. For regulatory approaches based on Supervisory Formulas, granularity is already being considered among the relevant risk factors.

Question 8: Do you agree with the proposed criteria defining simple standard and transparent securitisations? Do you agree with the proposed credit risk criteria? Should any other criteria be considered?

We consider that the EBA Discussion Paper is a very valuable contribution with regard to the definition of HQS. We fully agree with the approach taken to qualify entire deals, rather than single tranches, following criteria consistent, to a large extent, with those anticipated in the ECB/BoE Discussion Paper. Similarly, we welcome the exclusion of external rating requirements from the definition, consistent with the political aim of reducing the excessive dependency on CRAs.

The proposed staged approach to the definition seems to have clear advantages. A first stage comprising a set of criteria to define SST (Simple, Standard and Transparent) securitisations, intended to be the core definition common to all regulations. A second stage comprising the design of additional sets of criteria required to qualify for a preferential treatment under different rules, if proven necessary to fulfil the objectives of those rules. This would allow SST to be the common standard for the revival of a robust securitisation market in Europe and for the restoration of confidence in this market.

But consideration should be given to the total number of labels, since the creation of too many labels could provoke an excessive fragmentation and complexity and play against standardisation. A mechanical multiplication of labels along all regulations (SST qualifying/non-qualifying for banking capital, SST qualifying/non-qualifying for LCR, SST qualifying/non-qualifying for Solvency II, etc.) could provoke undesired effects associated with excessive fragmentation and complexity.

In this regard, we have some doubts on the necessity of creating, as the EBA proposes, a duplication of the SST label in order to differentiate those securitisations qualifying for a preferential banking capital treatment from those that do not qualify, depending on their compliance with the EBA's proposed criteria addressing credit risk. On the one hand, SST already includes some criteria related to credit risk (the retention rule to align incentives and favour robust origination practices, exclusion of impaired assets at issuance, underwriting criteria), that could be reinforced, if considered necessary, to strengthen the definition of SST and mitigate the risk of inclusion of subprime loans. On the other hand, current and forthcoming banking solvency rules are credit risk sensitive and assign in general requirements consistent with credit risk for both internal models and standardised approaches. Then, if the securitisation framework is sensitive enough to the credit risk of the underlying portfolios[2], it could make it unnecessary to add minimum credit risk requirements to the SST definition.

In relation to criteria considered, we largely support their convenience. However, we would like to comment on some of them. Refer to the Annex

Question 9: Do you envisage any potential adverse market consequences of introducing a qualifying securitisation framework for regulatory purposes?

We have a very favourable stance in relation to the proposal to introduce a qualifying securitisation framework for regulatory purposes. It has already been done for other financial instruments, as is the case of “eligible” covered bonds -or covered bonds that meet certain criteria- and that benefit from lower capital requirements.

2: It is so, and in an explicit manner, when supervisory formulas that rely on the capital requirements of the underlying portfolios are used. This is the case of the current SFA (Supervisory Formula Approach) and of the new SE-IRBA (Securitisation Internal Rated Based Approach) and SE-SA (Securitisation Standardised Approach), both based on the Simplified Supervisory Formula Approach and included in the new Basel Committee on Banking Supervision proposal for securitisation, “Revisions to the securitisation framework”, published on 11 December, 2014. In the case of Rating Based Approaches, as the one on the top of the hierarchy of European solvency regulation, Credit Rating Agencies take account of the credit quality of the underlying portfolios, among other factors, to assess the credit quality of a securitisation, and those ratings are the base for calculating minimum capital requirements.

Question 10: How should capital requirements reflect the partition between qualifying and non-qualifying?

Capital requirements should be lower for qualifying securitisation taking into account the lower risks involved (model risk, agency risk, servicing risk, etc.). That is, they should be commensurate to the lower risks involved and, consequently, they should seek to reduce the non-neutrality of the capital charges (i.e. the excess of the capital charges attracted by the total tranches of a securitisation in comparison to the capital requirements attracted by the underlying pool).

When supervisory formula approaches are used for capital requirements for securitisations, as for instance in the case of the current SFA or the new Basel proposals for the SE-IRBA and SE-SA, regulators could calibrate the level of departure from risk-neutrality and set a lower charge in the case of qualifying securitisations than for non-qualifying ones. That is much more difficult to achieve when external rating approaches are used, as is currently the case in CRR, due to the fact that the level of non-neutrality achieved ultimately depends on the changing methodologies and criteria applied by the rating agencies (as the EBA Discussion Paper shows, the application of the capital requirements currently in force to the structuring practices commonly used in Europe over the past few years has led to exceptional departures from the neutrality of capital requirements[3]).

Consequently, it could be sensible to delink the determination of minimum capital requirements from externally based methodologies and move to a formula-based approach to capital charges calculation with a specific calibration for "qualifying" securitisations. In this sense, we consider that the proposal for a **European SSFA**[4], outlined in a recent paper by a group of industry professionals, is a valuable contribution on the way forward to set a preferential treatment for robust securitisation in Europe in the short-term.

When rating-based approaches are used for capital requirements, as is currently the case in Europe whereas in the USA approaches based on a supervisory formula are used, regulators face a difficulty in controlling departures from non-neutrality, and this can be highly penalising and volatile – as evidenced by the analysis undertaken by the EBA - depending to a large extent on the credit rating agencies' rating practices and induced tranching structures. Nevertheless, calibration could be attempted for qualifying securitisations, based on their historical behaviour for different rating levels. It would provide new tables with lower risk weights for qualifying securitisations. Requirements should be set based on ratings, but excluding the undue effect of certain ceilings included (refer also to answer to Question 12).

With regard to risk floors, we consider that they should also be calibrated specifically for qualifying securitisations, and would be lower than for non-qualifying transactions. In this sense, we consider that the 15% floor proposed could be too high, and is not supported by the historical behaviour of senior tranches of European securitisations. Moreover, attention should be paid to the capital treatment of alternative financial instruments, in order not to harm investment in securitisation bonds of high quality. For instance, it should be considered whether the current floor of 10% for covered bonds (standardised approach) is also appropriate for securitisations.

3: .EBA Discussion Paper, page 56, "…leads to material departure (by several multiples in many cases) from the capital requirement for the corresponding underlying portfolio". For instance, in the case of SME retail transactions evidence can be found in the EBA Discussion Paper (figure 20 in page 76) where the average factor over neutrality in SME securitisations is shown to be more than 100% (i.e. double the capital requirement of the underlying assets) in countries like Germany or UK, and more than 300% in Italy or Spain.

4: Duponcheele G., Linden A., Perraudin W. "How to Revive the European Securitisation Market", November 2014. Links to Executive Summary and Full Paper.

Question 11: What is a reasonable calibration across tranches and credit quality steps for qualifying securitisations? Would re-allocating across tranches the overall capital applicable to a given transaction by reducing the requirement for the more junior tranche and increasing it for the more senior tranches other than the most senior tranche be a feasible solution?

Refer to Question 10 for comments on methodology and calibration of capital charges. We do not consider that a feasible solution is to simply re-allocate capital across tranches, reducing the requirements for the more junior tranches and increasing it for the more senior ones, other than the most senior tranche. Capital allocation across tranches should be commensurate with the risk supported by them, reflecting both the relative risk of the tranches of a transaction and the overall risk of the transaction. The latter should largely take into consideration the risk of the underlying portfolio. Besides, consideration should be given to the fact that the reallocation would possible imply an increase of capital charges for mezzanine tranches, hindering the transfer of credit risk by banks and their ability to release capital and provide additional funding to the economy.

Question 12: Considering that rating ceilings affect securitisations from certain countries, how should the calibration of capital requirements on qualifying and non-qualifying securitisations be undertaken, while also addressing this issue?

If Rating Based Approaches are to be used, special attention should be given to the impact of the changing nature of credit rating agencies' methodology and applied criteria for assessing risk, and particularly the use of rating ceilings.

We consider it important that credit rating agencies are encouraged to publish additional information to complement heading ratings and help investors to assess the effect on securitisation ratings of sovereign and counterparty caps, included in the rating methodology of several agencies.

We understand that it is the agencies' prerogative to decide on the methodology to be used to assess risk. Likewise, it is the prerogative of the authorities to use those ratings in regulation or to introduce certain corrections to them to achieve their objectives. Deserving special attention are the mitigation of systemic risks and the consolidation of the banking union to help to alleviate the banking-sovereign risks feedback.

In the case of securitisation rating, we consider that certain practices followed by credit rating agencies are questionable and give rise to potential systemic risks. This would be the case of the practice of constraining ABS ratings by the rating of the corresponding sovereign, which could deter ABS issuance in stressed economies, preventing the viability of a complementary channel to finance real sectors when most needed. We consider that this practice may induce double-counting of risk, if country risk is already and adequately being captured in the credit risk assessment of the pool and third parties to an ABS transaction.

Following this, we would recommend going beyond encouraging additional information, to **establish a mandatory disclosure, for credit rating agencies assessing ABS, of the rating in the absence of the sovereign ceiling.** Besides providing more transparency for investors, allowing them to filter out the sovereign cap if they wish to do so, it would **enable regulators to consider this rating as the reference in regulation instead of the currently considered heading ratings.** This would help to neutralise the negative effect of the raising of capital requirements of ABS with underlying assets located in stressed countries irrespective of their over-collateralisation, largely due to rating agencies' practices that translate the sovereign ratings' downgrades to ABS ratings. **Moreover, this would facilitate a move towards the overall objective of the global regulatory reform of reducing mechanistic reliance on credit rating agencies.**

Additional comments

On the convenience of certification and public sector involvement

We consider **that a certification mechanism should be considered, to ensure a unique and transparent interpretation of the criteria included in the definition of qualifying securitisation, and thus help to rebuild trust.** A credible independent certification, that provides an accurate assessment in an efficient way and in a short period of time, and that is freely available in a single location, would undoubtedly promote operability and liquidity of these transactions.

To achieve this goal, we are of the opinion that a **workable framework could be to delegate the daily work of certification, understood as solely assessing compliance with existing regulatory definitions, to a private sector entity,** but subject to public sector control. Using an experienced private sector company as a certification agency instead of public sector direct certification would entail some advantages, as it could adapt quickly and be operational in a reasonable time-frame, it could be easily scalable to adapt to changing market requirements and it could charge for the service offered to the market in an efficient and transparent way.

Nevertheless, public sector involvement is fully recommendable, as it has the last word when interpreting the regulatory definition, for instance, assisting the certification agency in any issue of interpretation or when an issuer/investor does not agree with the work of the certification agency. The convenience of the presence of public sector representatives in the decision-taking bodies of the certification agency and the surveillance of its governance arrangements should also be considered.

We think that PCS is in the best position to play this role of certification agency in Europe, due to its ample experience in labelling high-quality securitisations and its solid reputation. Besides, its corporate structure, internal code of conduct and the fact that it is a ‘not-for-profit’ entity ensure the absence of material conflicts of interest.

Annex: comments on criteria for SST definition and qualifying securitisations

- **Criterion A**: *Underlying exposures should be originated in accordance with sound and prudent credit granting criteria. Such criteria should include at least an assessment of the borrower's creditworthiness in accordance with paragraphs 1 to 4, 5(a) and 6 of Article 18 of Directive 2014/17/EU or Article 8 of Directive 2008/48/EC, as applicable.* **We consider that this criterion should be included as part of the general criteria for SST, to reinforce the Pillar I –Criterion 4 related to the underwriting standards in the origination of the underlying exposures.**

- **Criterion 15:** *The securitisation should meet the requirements of the Prospectus Directive*. **The application of this criterion would exclude most private placements, since they are not subject to compliance with this directive. This would be contrary to EU policy of encouraging private placements, and could be contrary to growth objectives. We consider that a high-quality private deal that meets all the other requirements should not be disregarded for not complying with the prospectus directive, as long as the investor has the required degree of transparency to assess the risk and rewards of the transaction.**

- Additional **clarification as to the intended scope** of some concepts would be helpful:
  - Pillar I **-** Criterion 3: *The securitisation should be characterised by legal true sale of the securitised assets, and should not include any severe insolvency clawback provisions*. **It would be convenient some additional clarification in relation to "severe".**
  - Pillar I **-** Criterion 4: *The securitisation should be backed by exposures that are homogeneous in terms of asset type, currency and legal system under which they are subject. In addition, the exposures should meet the following criteria:*
    - *They are consistently originated in the ordinary course of the original lender's business, pursuant to uniform and non-deteriorating underwriting standards.* **It would be convenient some additional clarification in relation to "*uniform and non-deteriorating underwriting standards*".**