29 September 2011

Q&A on

Guidelines to Article 122a of the Capital Requirements Directive

Background and introduction

1. On 31 December 2010, the Committee of European Banking Supervisors (CEBS) published the 'Guidelines to Article 122a of the Capital Requirements Directive'. The guidelines seek to provide some general considerations on the application of Article 122a and to provide clarity on specific aspects of the detailed requirements.

2. The objective of the guidelines are to: 1) achieve a common understanding among competent authorities across the EU on the implementation and application of Article 122a; and 2) create more transparency for market participants in order to assist compliance by credit institutions with the relevant requirements of the Directive.

3. Following the publication of the guidelines the EBA has received a substantial number of questions, from competent authorities and market participants, requesting clarification on the guidelines and/or further guidance on Article 122a.

4. This Q&A document provides answers to technical and interpretive questions raised by competent authorities and market participants after the publication of the 'Guidelines to Article 122a of the Capital Requirements Directive' on 31 December 2010.

5. The EBA believes the publication of the Q&A paper on the guidelines on Article 122a will further encourage market participants to create a more transparent and uniform securitisation market going forward and will enable more convergence of supervisory practices across Europe with regards to this Article.

Remarks

6. The questions received have been categorized into three Sections:

- Section I: Opinion on the Capital Requirements Directive (CRD) / Specific paragraphs of Article 122a
- Section II: Clarifications and/or questions on sector-specific issues which are better treated thematically.
  - II.A: Asset-backed commercial paper (ABCP) conduits
  - II.B: Correlation trading
  - II.C: Managed collateralised loan obligations (CLOs)
- Section III: Clarification and/or questions on specific clauses/paragraphs of the guidelines.
  - III.G: Clauses/paragraphs related to general considerations on paragraphs 1-7 of Article 122a.
  - III.X: Clauses/paragraphs related to paragraph X of Article 122a.

Index

Nº	Title	Section	Date of submission of question	Date of response
Q13	**Due diligence** requirements for **correlation trading portfolios** – no need to include confirmation of retention.	II.B	H1 2011	09 2011
Q14	Relationship between **paragraphs 25, 26 and 29 of the guidelines**	II.C	H1 2011	09 2011
Q15	Clarification of the coverage/scope of **paragraphs 25 and 26 of the Guidelines.**	II.C	H1 2011	09 2011
Q16	More clarity on **"definable originator" in paragraph 25** – particular example of a case of multiple originators.	II.C	H1 2011	09 2011
Q17	**Disclosure requirements** for originators/sponsors **when paragraph 25 applies.**	II.C	H1 2011	09 2011
Q18	Clarification of the possibility under paragraph 26 of the guidelines of meeting the retention requirement by **an entity that does not meet the definition of sponsor nor originator – 'originator SPV'**.	II.C	H1 2011	TBD
Q19	**Level of involvement of an equity retention holder** in the ramp-up and reinvestment phase of a CLO.	II.C	H1 2011	09 2011
Q20	Characteristics that **a fund** should have in a managed CLO to be **an eligible equity investor**.	II.C	H1 2011	09 2011
Q21	**Retention by group affiliates of the collateral manager** – consideration of investment firm consolidation waivers under the CRD.	II.C	H1 2011	09 2011
Q22	**Restriction on retention by a fund managed by the CLO manager** – does it only apply if the fund has not been formally involved in the CLO transation?	II.C	H1 2011	09 2011
Q23	**Measurement of retention** – nominal value vs. market value.	II.C	H1 2011	09 2011
Q24	**Grandfathering for CLOs** which are out of their reinvestment period in 2014 but which invest the proceeds of credit impaired obligations and unscheduled principal	II.C	H1 2011	09 2011

Nº	Title	Section	Date of submission of question	Date of response
	proceeds in replacement obligations			
Q25	**Retention by holders who can be removed by investors or have the ability to resign:** can the party replacing such retention holder take the retention?	II.C	H1 2011	09 2011
Q26	**Application of Art122a at consolidated level**: application of Art122a to non-credit non-subsidiary affiliates that invest in a securitisation; application of due diligence requirements.	III.G	H1 2011	09 2011
Q27	Clarification on **whether an investor can disregard Art122a if he transfers the economic risk of a purchase** to a non-regulated entity outside the consolidated group via a total return swap or a credit default swap.	III.G	H1 2011	09 2011
Q28	**Application of requirements in Art122a (§6) and (§7) to consolidated affiliates.**	III.G	H1 2011	09 2011
Q29	Clarification of why the **flexibility of paragraph 9 of the guidelines** regarding the application of Art122a at consolidated level for certain positions in the **trading book** cannot be extended to certain positions in the **banking book.**	III.G	H1 2011	09 2011
Q30	Exemptions from Art122a for **non-eligible liquidity facilities.**	III.G	H1 2011	09 2011
Q31	Clarification of the meaning of assuming credit risk with respect to a securitisation in **multiple capacities.**	III.G	H1 2011	09 2011
Q32	Identification of **originator** and **application of the exemption from retention described in paragraph 22 of the guidelines** to **real estate financing transactions** where tranched obligations are issued by a **propco** (i.e. property company).	III.1	H1 2011	09 2011
Q33	Definition of **'net economic interest'**: distinction between **nominal exposure** and **notional exposure.**	III.1	H1 2011	09 2011
Q34	**Retention option (d)**: possibility of **retaining only part of the first loss tranche.**	III.1	H1 2011	09 2011

Nº	Title	Section	Date of submission of question	Date of response
Q35	**Retention** in securitisations where the underlying assets are **purchased receivables** sold with a discount that is refundable.	III.1	H1 2011	09 2011
Q36	Clarification on the **measurement of the retention requirement** when the exposures securitised consist of, or include, an **undrawn, unrealised, contingent or future component.**	III.1	H1 2011	09 2011
Q37	**Exemptions** from retention requirement under Art122a (§3): **transactions based on widely traded indices.**	III.3	H1 2011	09 2011
Q38	Obligation to **disclose information under Art122a (§7),** even if the obliged parties do not have the right to receive the information.	III.7	H1 2011	09 2011

Section I: Opinion on CRD / Specific Paragraphs of Art 122a

<table>
<tr><th colspan="2">Q1: Consideration of partial guarantees in the context of exemptions to Art122a (1)
(Ref: Art 122a.3)</th></tr>
<tr><td>Q: Paragraph 3 of 122a states that the retention requirements do not apply where the securitised exposures are claims or contingent claims on or fully, unconditionally and irrevocably guaranteed by amongst others, central banks and central governments. The question is how this should be interpreted in the case of items that benefit for a partial guarantee.

As example, FFELP student loans are 97% guaranteed by the US government. In theory two legally distinct pools can be synthetically created - one containing the US government guaranteed cash flows, whilst the second pool contains the non guaranteed cash flows. In such an instance the required retention would be 0.15% (i.e. 3% * 5%) as the exemption would apply to the 97%. However, if the synthetic distinction of the pools is not made, a literal read of the rule would result in a 5% retention requirement for the same underlying risk. We would argue that an appropriate interpretation would therefore be to exempt from retention all cash flows which benefit from a guarantee of the kind listed in paragraph 3.</td><td>A: The securitized exposure should be fully guaranteed in order to meet the exemption requirement referred to in paragraph 3.

Student loans that are 97% guaranteed do not meet the requirement for exemption.</td></tr>
<tr><th colspan="2">Q2: A/B loan structures in commercial real estate transactions: are they subject to Art122a? could a “B loan” retained by the originator be treated as a first loss tranche?</th></tr>
<tr><td>Q: Please confirm whether A/B loan structures in commercial real estate transactions should be excluded from the definition of “securitisation” set out in Directive 2006/48/EC and therefore not be subject to Article 122a. We note

Paragraph (24) of the preamble to Directive 2009/111/EC refers to “the misalignment between the interest of firms that ‘re-package’ loans into tradable securities and other financial instruments (originators or sponsors) and firms that invest in these securities or instruments (investors)”. This is not relevant for A/B real estate loans as they do not represent a repackaging of loans;

It would seem to go beyond the intended scope of securitisation regulation if all tranching/subordination of indebtedness, e.g. the issuance of subordinated debt by banks and corporates, resulted in such indebtedness being subject to Article 122a and yet treating A/B loans as securitisations would seem to be a move in</td><td>A: As transactions can be structured in many different ways, a firm should look to the economic substance of a transaction to determine whether it is a securitisation as defined in the CRD.

With regard to the application of the Art. 122a retention requirements to A/B loan structures, retention of the B loan can only be considered an eligible form of retention in circumstances where the B loan is considered to be a first loss tranche in a securitisation. Should this be the case, the B loan should also be treated under the CRD securitisation framework for regulatory capital purposes.</td></tr>
</table>

that direction; If A/B loan transactions are treated as securitisations, this would result in CMBS securitisations of such loans being treated as "re-securitisations" for the purposes of Directive 2010/76/EU with the consequence that holdings of such CMBS securities by applicable institutions (e.g. credit institutions) will be subject to punitive capital treatment. The definition of "securitisation" in Directive 2006/48/EC requires that exposures are tranched and that "the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme". The tranching applied pursuant to typical A/B real estate loan structures does not include the distribution of losses during the ongoing life of a transaction. In such structures, losses are not distributed until enforcement of the relevant loans and both A and B loans constitute full recourse corporate obligations of the relevant borrower. Can a "B loan" which is retained by the originator be treated as a first loss tranche for the purposes of method (d) as paragraph 56, which refers to a first loss being "achieved by comparable but not identical means?"	
Q3: Change of the form of retention during the life of the securitisation (Ref: Guidelines § 32)	
Q: "The form of retention (i.e. which of options (a) through (d) is used) cannot change during the life of the securitisation, without such change impacting the fulfilment of the requirements of Paragraph 1, except under exceptional circumstances (for example, when re-structuring of a transaction is necessary), provided that such change is explicable and has good reason, and provided that such change is disclosed in a transparent manner to investors (on which, see guidance to Paragraph 7 below, and, in particular, clause 123). Credit institutions should be sensitive to potential abuse by originators, sponsors or original lenders of such ability to change the form of retention." This paragraph seems to be more prescriptive than the provision included in art. 122a of the CRD which does not specify that the form of retention cannot change during the life of the securitisation (and therefore could be contested by an institution). Please confirm if our understanding is correct?	**A**: The retention of 'the net economic interest is measured at the origination and shall be maintained on an ongoing basis'. Maintaining the initial net economic interest implies maintaining the applied measure and thus the form of retention. As stated in paragraph 32, the change of form of retention may be allowed only under exceptional circumstances. This is in order to avoid an opportunistic behaviour by originator, sponsor or original lender and to make the disclosure to investors easier. Furthermore the form of retention may have helped determine an investor's decision to invest in a specific in securitisation transaction. Moreover, a change in the methodology could lead in practice to implicit support situations (for example, by shifting retention in a senior position for retention in a mezzanine position).
Q4: Follow-through to the assessment of the benefits of allowing combination of retention options (Ref: Guidelines § 36)	

Q: The footnote to Paragraph 36 gives scope for the EBA to recommend combinations of retention options – will the EBA be following this through?	**A**: The EBA will follow up on this point with the Commission and provide advice to the Commission
Q5: Measurement of materiality of infringement at consolidated and subsidiary level (Ref: Art122a.5)	
Q: The purpose of consolidation, should materiality be measured in relation to the credit institution on a consolidated basis or only in relation to the subsidiary's activities? E.g. if a credit institution's subsidiary were to be non-compliant in respect of 10% of its ABS trades but this amounted to only 0.001% of the credit institution's consolidated activity then would not pose material risk.	**A**: Materiality does not refer only to the relation of the affected securitisation positions to the aggregate activity of the credit institution but also to the kind of the infringement. Therefore, even non-compliant activities of a subsidiary that seem insignificant on a consolidated basis may be classified as material breaches at subsidiary level. Materiality of an infringement of Art. 122a has to be assessed at both subsidiary and consolidated level.

Section II.A: ABCP Conduits

Q6: Retention by sponsors via 'second loss' programme wide credit enhancement (Ref: Guidelines § 57 and footnote 13)	
Q: *Situation* The seller/originator has retained 4% of the programme via a discount when selling the assets. This discount can be perceived as a 'first loss'. The sponsor retains then 7% via PWCE. The PWCE is in this construction a 'second loss'. The question is whether the retention requirement can be fulfilled by the sponsor in this case given he is technically retaining a 'second loss'. The 'first loss' is in this case fully retained by the seller/originator. In this way the 'second loss' is the most junior tranche with regards to the tranches placed by investors. The question is whether the retention by the sponsor in this way is allowed.	**A**: A Letter of credit, guarantee or similar form of credit support may be a permissible form of retention under option (d) as stated in paragraph 57of the guidelines. The EBA recognised that in certain circumstances (for instance, ABCP conduits) such a form of retention may constitute a second-loss exposure at the securitisation program-wide level, as a first-loss exposure at the transaction-specific level underlying this programme-wide level is assumed by the originators or original lenders of the underlying exposures (see footnote 13).
Q7: Due diligence and disclosure requirements in ABCP transactions	
Q: Please clarify how you would expect the investor due diligence requirement and corresponding sponsor disclosure requirements to be implemented at the level of the conduit and ABCP investors.	**A**: The EBA is aware that sellers often use ABCP for the purposes of anonymity and that according to the guidelines, confidential arrangements do not need to be disclosed. However, a balance must be reached between transparency and confidentiality, as the financial crisis highlighted a lack of awareness in respect of the composition of conduits. It is therefore primarily the decision of investors as to what due diligence requirements and level of granularity of the disclosure they consider as most appropriate for each asset class. It is not the EBA's intention to prescribe these requirements.
Q8: Exemption from the need to disclose loan-by-loan level data for highly granular portfolios (Ref: Guidelines § 128)	

Q: The obligation to provide "loan-level" data to investors may not apply in situations deemed to be "not appropriate", for instance in case of "securitisations with a large volume of exposures that are highly granular." Can we get more explicit guidelines or clarification on what asset classes may fall under this category? We understand for instance that trade receivables or credit card securitisations clearly fall under this exemption; what about Auto Loans ABS? Can the EBA please give further guidance on the exemption from the need to disclose loan-by-loan level data for highly granular portfolios ? What type of assets are envisaged as being within the exemption?	**A**: The EBA does not intend to provide additional guidance. As set out in the guidelines, whilst the granularity of the asset pool may be a consideration in determining whether loan level data is required, the key determinant should be whether loan level information is a necessity for due diligence and therefore whether it would be required by investors.

Section II.B: Correlation Trading

Q9: Application of the exemption from retention for correlation trading activity (Ref: Guidelines § 73)	
Q: The Guidelines provide an exemption from retention for correlation trading activity providing the positions form part of the CRD III correlation trading portfolio. How will this be applied in practice given CRD III is not live until the end of this 2011? Firms will still be in discussions with their respective regulators in terms of the models, requirements and positions that constitute the correlation trading portfolio.	**A**: Once the definition of correlation trading in the Directive has been met and the firm has identified its correlation trading portfolio to the competent authority, the firm can consider such positions as being exempt from retention. Before that, firms are expected to operate in a prudent manner with regard to the positions under discussion.
Q10: Application of the exemption from retention for correlation trading activity – identification of the trading portfolio via QIS exercises. (Ref: Guidelines § 73)	
Q: Where a bank has identified its correlation trading portfolio to the Regulator either via the model approval process/discussions or QIS exercises, will positions included in this portfolio going forward be exempt from retention?	**A**: Once the definition of correlation trading in the Directive has been met and the firm has identified its correlation trading portfolio to the competent authority, the firm can consider such positions as being exempt from retention. QIS exercises are NOT a recognised method of determining the correlation trading portfolio.
Q11: Positions no longer eligible for the correlation trading portfolio – application of ARW (Ref: Guidelines § 73)	
Q: If on finalising the model, it is deemed that certain positions are no longer eligible for the correlation trading portfolio would these positions be subject to a penalty charge as the rules were applied in good faith and disclosed to the regulator?	**A**: Positions incorrectly assigned to the correlation trading portfolio would not be exempted from Art. 122a. If the retention requirements have not previously been met for a position, we would expect them to be met as soon as the issue is identified as the position will no longer be carved out. In any event, when considering additional risk weights reference should be made to the criteria stated in Art. 122a ('the requirement … are not met .. by reason of the negligence or omission')
Q12: Due diligence requirements for correlation trading portfolios while CRD3 is not into force (Ref: Guidelines § 81)	
Q: The Guidelines state that due diligence requirements for correlation trading portfolios will satisfy article 122a if they meet the Annex V requirements in 2006/49/EC as amended by CRD3. However as CRD3 is not yet in force, a	**A**: In the interim period, firms should comply with due diligence requirements in a manner that they feel is appropriate to the specific circumstances. As stated in the guidelines, the fact that a position is in the

bank would look to perform a less intense trading book due diligence as allowed for under the guidelines until such time that the CRD3 requirements are in force.	trading book is not in itself sufficient justification for lower due diligence standards; any distinction must be appropriate and justified.
Q13: Due diligence requirements for correlation trading portfolios – no need to include confirmation of retention (Ref: Guidelines § 81)	
Q: Some banking book investors in correlation trades have been asking trading desks to confirm that the required due diligence under 122a would not need to include confirmation of retention	**A**: Provided transactions are based on a "clear, transparent and accessible index", the due diligence requirements need not feature retention. This is because Art122a (3) does not make a banking book/ trading book distinction, so such positions are carved out of the retention requirement, irrespective of where they are held.

Section II.C: Managed CLOs

Q14: Relationship between paragraphs 25, 26 and 29 of the Guidelines (Ref: Guidelines § 25, 26, 29)	
Q: What is the relationship between paragraphs 25, 26 and 29 of the Guidelines? Are managed CLOs meant to fall exclusively within paragraph 26 and are the 2 paragraphs mutually exclusive or could a transaction potentially fall within either?	**A**: Paragraph 29 sets out ways of meeting retention requirements where there are multiple originators/original lenders more generally, whilst paragraphs 25 and 26 relate to circumstances where it is not possible to identify an originator/sponsor/original lender or where such a party can be identified but a different party could best align incentives with those of investors. Paragraph 25 is not intended to lead into paragraph 26; the two paragraphs are distinct from one another.
Q15: Clarification of the coverage/scope of paragraphs 25 and 26 of the Guidelines (Ref: Guidelines § 25, 26)	
Q: Can the EBA offer any more clarity on what paragraph 25 covers if CLOs are exclusively within paragraph 26? The corollary of this is the question what does paragraph 26 add if CLOs fall within paragraph 25?	**A**: Paragraph 25 and 26 are included in the guidelines to provide flexibility for transactions, in certain limited circumstances, to meet the retention requirements. The EBA is aware of certain transactions, in various asset classes, which can meet the retention requirement under either paragraph 25 or paragraph 26.
Q16: More clarity on 'definable originator' in paragraph 25 – particular example of a case of multiple originators (Ref: Guidelines § 25)	
Q: Can the EBA offer any more clarity on "definable originator" in paragraph 25 *Example:* The originator/sponsor does not fit within any of the defined roles with respect to the 20 per cent portion of the portfolio. The 20 per cent portion will be created by means of the purchase of loans from various market sellers by the Investment Manager on behalf of the Issuer. With respect to the 20 per cent portion, there is no "definable originator" which is involved in the CLO in any capacity other than the respective sellers of those loans. The originator/sponsor will have "transferred a proportion of the risks and rewards of the underlying exposures or positions to investors" through its sale of 80 per cent of the portfolio to the Issuer. The intent is therefore to align the	**A**: In cases of multiple originators or original lenders, in general, paragraph 29 of the guidelines applies. An originator/sponsor in a transaction can be appointed as the appropriate party to retain the 5 per cent exposure to the whole transaction as long as this originator/sponsor has provided the majority of the portfolio in the securitisation transaction and is involved in structuring the transaction, selecting the initial portfolio and defining the eligibility criteria and tests. On an on-going basis the originator/sponsor is expected to comply with all aspects of the guidelines and to be involved in material changes to the deal including for example changes to eligibility criteria, tests or the appointment of new a collateral manager. Furthermore the interests of the originator/sponsor should be aligned with the interests of the investors.

interests of the originator/sponsor with the interests of investors by the originator/sponsor constituting the Appropriate Party for the purposes of the 5 per cent retention. The Originator/Sponsor believes that it is the appropriate party for the purposes of retaining a 5 per cent exposure to the transaction. Could EBA please confirm if the originator/sponsor could be the appointed as the appropriate party to retain the 5 per cent exposure to the transaction.	
Q17: Disclosure requirements for originators/sponsors when paragraph 25 applies (Ref: Guidelines § 25)	
Q: On the basis that clause 25 does apply, the originator/sponsor is unsure as to the level of disclosure required to ensure that it has "explicitly disclosed" that it will fulfil its retention obligation for the purposes of paragraph 30 of the CEBS Guidance	**A**: The originator/sponsor should make the disclosure in accordance with paragraph 37 and taking into account paragraph 123 and 124.
Q18: Clarification of the possibility under paragraph 26 of the guidelines of meeting the retention requirement by an entity that does not meet the definition of sponsor nor originator – 'originator SPV' (Ref: Guidelines § 26)	
Q: Under paragraph 26 of the Guidelines, an entity that neither meets the definition of sponsor nor originator, but whose interests are most optimally aligned with those of investors, can fulfil the retention requirement. In that case, does it mean that no originator is needed in the transaction or do we still need an originator such as an originator SPV? In order to qualify as originator SPV (if one is required) does the originator SPV need to purchase the assets and then transfer them to the CLO? Or can the originator SPV sell a protection to the CLO on the assets it holds?	**A**: Pending (work in progress)
Q19: Level of involvement of an equity retention holder in the ramp-up and reinvestment phase of a CLO (Ref: Guidelines § 26)	
Q: What level of involvement does the equity retention holder have to have in the ramp-up and reinvestment phase of a CLO? Would the deal be CRD compliant if the most subordinated investor is only involved in selecting the initial portfolio and in defining the eligibility criteria and tests? Or does it also need to have an on-going right to influence the portfolio?	**A**: A third party equity investor in a CLO could hold the retention if it is involved in structuring the transaction and selecting the exposures and be CRD compliant it is involved in selecting the initial portfolio and defining the eligibility criteria and tests. On an on-going basis the equity investor is expected to comply with all aspects of the guidelines and be involved in material changes to the deal including for example changes to eligibility criteria, tests or the appointment of new collateral manager.

Q20: Characteristics that a fund should have in a managed CLO to be an eligible equity investor (Ref: Guidelines § 25, 26)	
Q: In line with the guidelines, where there is no entity which satisfies the definition of originator or sponsor, the retention may be held by an alternative entity. We understand that an equity investor can be a fund provided it is not a fund manager or advised by the CLO manager, and that fund is managed or advised by a firm which is independent of the CLO manager (the "second set of eyes"). We also understand that the identity of the investors in the equity investor fund may change over time, provided that the manager of the fund is independent (as stated above). Does the EBA agree with this? Will it be possible for such equity investor to be a fund which has been established specifically to invest in retention positions provided it has a "second set of eyes" unrelated to the CLO manager providing advice to the fund? What additional characteristic would the EBA require such fund to possess in order to be an eligible equity investor?	**A**: The originator SPV can be an entity which is a fund (but "not a fund which is controlled or managed by the investment manager"), with a role in the structuring of the CLO or the asset selection for the CLO (such as a subadvisor or portfolio selection advisor). As stated in paragraph 26, where the retained interest of such an 'originator SPV' is sold to third-party investors with no involvement in the relevant securitisation, this does not ensure alignment of interest. While it is not possible to cover all potential circumstances, this provides broad guidance for viewing such arrangements that meet the definition of 'originator' via the potential use of an SPV, but which must, nonetheless, ultimately ensure alignment of interest. The equity investors in a fund that acts as originator SPV may change over time.
Q21: Retention by group affiliates of the collateral manager – consideration of investment firm consolidation waivers under the CRD (Ref: Guidelines § 25, 26)	
Q: Paragraphs 25 and 26 - Can group affiliates (including parent and subsidiary undertakings) of the collateral manager hold the retention? In this context, would the affiliate be required to be included in a consolidation under Art 71 of the CRD, or would its inclusion in an accounting consolidation be sufficient? It should be noted in this regard that many EEA assets managers have obtained the "investment firm consolidation waiver" under the CRD.	**A**: As long as the parent/affiliate of the collateral manager is consolidated at group level the retention requirement can be met by the parent/affiliate. The parent/affiliate should respect the disclosure requirement as set out in Art. 122a. The guidelines are not intended to determine which entities of a group are captured on the basis of the legal relationship between the group entities. Rather, it was intended that Art. 122a would apply to the whole group, because an EU credit institution could be exposed to credit risk from securitisation by virtue of the activities of any other entities within the group.
Q22: Restriction on retention by a fund managed by the CLO manager – does it only apply if the fund has not been formally involved in the CLO transation? (Ref: Guidelines § 26)	
Q: Paragraph 26 states that if the retaining party is a fund it cannot be managed by the asset	**A**: As mentioned in the feedback paper 'a fund which is controlled or managed by the

manager but must be managed by a third party. Some CLOs are issued to provide leverage to loan portfolios, where the fund holding the loan portfolio is controlled by the asset manager of the CLO. The CLO will issue the senior notes into the market, but the fund retains the entire equity risk in the portfolio. In these circumstances the fund should be able to be the retaining party even though it is managed by the asset manager as it is the party which is most aligned with the interests of the CLO investors Can the EBA confirm that the restriction on the retention being held by a fund managed by the CLO asset manager only applies if the retaining fund has not been formally involved in the CLO transaction?	investment manager' cannot meet the retention requirement as it is the least likely to create alignment of interest with the investor, as the supposedly 'retained' exposure could essentially be resold to another of the investment manager's funds or CLOs, without any retention by the investment manager or any entity involved in structuring the CLO.
Q23: Measurement of retention – nominal value vs. market value (Ref: Guidelines § 43)	
Q: What is the correct amount of retention that a CLO manager is required to keep in an actively-managed pool? Consider the following example: At origination 100m nominal loans are put into a CLO , trading at 90% of nominal value. To comply with retention, the asset manager retains 5m equity in the transaction. After a year the loans are trading at 105% - hence are worth 105m. The CLO manager sells the existing loans and buys 105m worth of other loans trading at 85%, i.e. the nominal value of these new loans is 123.5m. The guidance says "To take account of these different circumstances, where the nominal value of exposures in a securitisation may increase or decrease over time, the retained net economic interest would typically be expected to increase should the nominal value of exposures increase." Also note that the retention requirement, as applied under option (a), references the tranches" of the securitisation; the retention requirement, as applied under options (b), (c) and (d), references the "securitised exposures" (or potentially securitised exposures). It is recognized that under certain circumstances this could lead to different outcomes between the different options when measuring the retention requirement; for instance, if the securitisation benefits from overcollateralization (i.e. the nominal value of securitised exposures is higher than the nominal value of tranches issued under such 24 securitisation). Hence does the 5m of retention of the nominal equity notes still count as complying with the 5% retention rule when the nominal value of the loans is now 123.5m? The 23.5m increase in nominal securitised exposures is merely due to trading gains not due to additional capital.	**A**: The EBA considers that the underlying text is clear that the retained amount is expressed by the nominal value rather than the market value/acquisition cost of the asset pool. Consequently, in the example provided, the minimum retention would be 5% of the new, higher, nominal value. This is explained in footnote 8 on page 21 of the guidelines.

Members have suggested that retention should be measured in terms of the value of the liabilities of the securitisation, rather than the value of the underlying assets. Page 20 of the feedback document which accompanied the Guidelines refers to CLOs on the left and states that measurement is "at origination", i.e. when the exposures were first securitised. This is deemed to be sufficiently clear in the guidance already. However, further text has been added to clarify that retention is measured with respect to the nominal value of the exposures at the time of securitisation, and is independent of the acquisition price of such exposures.	
Q24: Grandfathering for CLOs out of their reinvestment period in 2014 which invest the proceeds of credit impaired obligations and unscheduled principal proceeds in replacement obligations (Ref: Guidelines § 134)	
Q: Will grandfathering continue for CLOs which are out of their reinvestment period in 2014 but which invest the proceeds of credit impaired obligations and unscheduled principal proceeds in replacement obligations.	**A**: For securitisation that came into existence prior to 1 January 2011, the proceeds of credit impaired obligations and unscheduled principal proceeds can be used for substitute obligations in accordance with paragraph 134, if this is specifically pre-defined in the contractual terms of the transaction.
Q25: Retention by holders that can be removed by the investors or that have the ability to resign: can the party replacing such retention holder take the retention? (Ref: Guidelines § 26)	
Q: What is the EBA's position in regards to a retention holder who has an ongoing role in a transaction which includes a right of removal by the investor or the ability to resign? Can the party replacing such retention holder take the retention (i.e. the retention is linked to the role)? For instance, if the retention is initially held by the CLO manager must it continue to be held by the entity acting as CLO manager from time to time (i.e. if a CLO manager retention holder resigns or is removed the retention should be transferred to the replacement CLO manager)?	**A**: Since a CLO manager's ability to resign substantially reduces alignment with investors, CLO managers having this ability should only be allowed to hold and transfer retention if despite these problems they are still regarded as most appropriate party to align investors' interest with. If a transaction includes a right of removal by the investors any replacement of the CLO manager is initiated at the investors' discretion and does therefore not create any material problems regarding the alignment of interest with those investors.

Section III.G: Clauses related to general considerations on § 1-7 of Art 122a.

Q26: Application of Art122a at consolidated level: application of Art122a to non-credit non-subsidiary affiliates that invest in a securitisation; application of due diligence requirements (Ref: Guidelines § 8)	
Q: Is it correct that, where the consolidated group contains a credit institution, but if it is a non-credit institution, non-subsidiary affiliate that invests in a securitisation, the requirements of Art122a do not apply to the non-credit institution? Does this include both the retention requirements and the due diligence requirements for investors? Both European and non-European credit institutions are keen to understand the implications for EU credit institutions and their non-EU affiliates subject to consolidated supervision (such as a US bank or broker-dealer subsidiary of an EU bank or bank holding company) of securitisation investments made or exposures assumed by the affiliates, whether in the trading book or the non-trading book. Could an affiliate enter into some structured finance investment activity without triggering Art 122a's detailed due diligence requirements? Is it correct that, as the credit institution itself is not "investing" but only indirectly "assuming exposure", at most only part of the due diligence requirements would apply?	**A**: The guidelines are not intended to determine which entities of a group are captured on the basis of the legal relationship between the group entities. Rather, it was intended that Art. 122a would apply to the whole group, given that an EU credit institution could be exposed to credit risk from securitisation by virtue of the activities of any other entities within the group. The EBA does not agree that only part of the due diligence requirements would apply if the credit institution itself is not investing directly and refers to the table on page 10 of the guidelines which explains the circumstances/role under which a credit institution would be considered to be assuming 'exposure' to credit risk.
Q27: Clarification on whether an investor can disregard Art122a if he transfers the economic risk of a purchase to a non-regulated entity outside the consolidated group via a total return swap or a credit default swap (Ref: Guidelines § 8)	
Q: Can a credit institution investor disregard Art 122a if the economic risk of a purchase is transferred to another, non-regulated entity outside the consolidated group via a contract such as a total return swap or credit default swap?	**A**: A credit institution should not disregard Art 122a if the economic risk of a purchase is transferred to another non-regulated entity outside the consolidated group via a contract such as a total return swap or credit default swap. This would be viewed as an avoidance mechanism.
Q28: Application of requirements in §6 and §7 to consolidated affiliates (Ref: Guidelines § 8)	
Q: Does the EBA agree that the originator requirements (consistent origination standards under Article 122a(6) and disclosure under Article 122a(7)) do not apply to consolidated affiliates? This is on the basis that consolidated supervision relates to the consolidation of risk positions in a consolidated group; it does not mean that an	**A**: The originator requirements under paragraphs 6 and 7 of the Art. 122a would typically only apply to the relevant EU credit institution rather than to the broader group.

obligation placed on a credit institution to carry out a specific task (e.g. disclose information) is also placed on all consolidated affiliates of that credit institution.	
Q29: Clarification of why the flexibility of paragraph 9 of the guidelines regarding the application of Art122a at consolidated level for certain positions in the trading book cannot be extended to certain positions in the banking book (Ref: Guidelines § 9)	
Q: Paragraph 9 offers an "exemption" to retention for immaterial trading activity taking place in trading books of subsidiaries. Could it be clarified why this is restricted to trading activity and why it could not be extended to immaterial investments held in banking books of subsidiaries? This is a particular concern where a subsidiary operates in other jurisdictions outside the EU, but it cannot hold securitisation positions in its banking book as the local market has no equivalent retention requirements.	**A**: The exemption was introduced to enable institutions to conduct market-making activities in the secondary market. Taking into account the nature and the intent of this activity (positions held intentionally for very short-term resale and not for funding or longer-term investment), it seems questionable whether there are similar reasons for granting an exemption for the non-trading activity.
Q30: Exemptions from Art122a for non-eligible liquidity facilities (Ref: Guidelines § 12)	
Q: Paragraph 12 states that in certain “exceptional circumstances”, non eligible liquidity facilities may be exempt from Article 122a if they do not assume credit risk on the underlying exposures. Can further guidance be provided as to what these circumstances are? If liquidity facilities are not assuming credit risk on the underlying exposures surely they are not caught by article 122a anyway? If the EBA disagrees with the above would it be sufficient to demonstrate and provide evidence that a facility is structured to meet the intention of the requirements for eligible liquidity facilities where instances such as local market practices / local legal requirements result in the precise eligible liquidity requirements not being met ?	**A**: Liquidity facilities that meet the CRD preferential treatment set out in Annex IX, part4, paragraph 2.4.1 point 13 are eligible liquidity facilities Exemption for non eligible liquidity facilities will be assessed on a case by case basis and on the basis of the guidelines, taking into account local market practices and local legal requirements.
Q31: Clarification of the meaning of assuming credit risk with respect of a securitisation in multiple capacities (Ref: Guidelines § 16, 61)	
Q: “In circumstances where a credit institution is assuming credit risk with respect to a securitisation in multiple capacities (i.e. more than one of investor, liquidity facility provider, hedge counterparty, etc), such credit institution should ensure that it is meeting whatever provisions apply to each relevant role (as outlined above). In circumstances where a credit	**A**: The table on page 10 of the guidelines offers a summary of the different roles in a securitisation and the requirements that would apply to each of them. Where a credit institution assumes more than one role in the transaction, it must ensure that it is meeting whatever provision apply to each relevant role it assumes. The retention requirements

institution is both assuming credit risk with respect to a securitisation (for instance, as investor, liquidity facility provider, hedge counterparty, etc), but is also sponsor or originator of such securitisation (and hence involved in securitising the relevant exposures), once again, it must ensure that it is meeting whatever provisions apply to each relevant role that it assumes.” Would you please clarify how this provision applies in practice, and particularly define more precisely the terms “multiple capacities”?	only apply to the original lender, originator or sponsor of the transaction. Para 61 is clear: only one of the originator, sponsor or original lender is subject to the retention requirement. Multiple application of the retention requirement by different parties to the transaction is not required by the Directive. Therefore, if one credit institution acts as more than one of the roles of original lender, originator and sponsor, there should not be multiple application of the retention requirement either.

Section III.1: Clauses related to § 1 of Art 122a

Q32: Identification of originator and application of the exemption from retention described in paragraph 22 of the Guidelines to real estate financing transactions where tranched obligations are issued by a propco (i.e. property company) (Ref: Guidelines § 22, 25, 26)	
Q: The Guidelines to Article 122a of the Capital Requirements Directive published by CEBS (the Guidelines) refer to circumstances where there is either no sponsor, original lender or originator in a "securitisation" transaction (see paragraph 25) or where there are entities that do meet the definition of originator or sponsor, or fulfil the role of original lender in such a transaction but it is more appropriate for another entity to fulfil the retention requirement of Article 122a (see paragraph 26). In addition, paragraph 22 of the Guidelines refers to circumstances where the tranching of credit risk is made on the liabilities issued by an originator (where such liabilities do not transfer the credit risk of third parties) and states that the retention requirements of Article 122a will be met automatically by the originator in these circumstances. In the context of a real estate financing transaction where tranched obligations are issued by a propco (i.e. a property company), (to the extent that such a transaction is a "securitisation") can you confirm that (a) the propco will constitute the originator and (b) the automatic retention referred to in paragraph 22 of the Guidelines will apply, and it will not therefore be necessary to take any further steps to retain risk to meet the requirements of Article 122a? Further to the above, we note that in certain jurisdictions it may be a regulatory requirement for the relevant loan to the propco to be advanced by a licensed banking institution before it can be refinanced through a securitisation (pursuant to which the propco is the obligor). In such circumstances i.e. where a loan to a propco is advanced by a bank and refinanced more or less immediately via a securitisation (where the propco is the obligor), will the automatic retention described above still apply?	**A**: Paragraph 22 of the guidelines refers to circumstances where there is tranching of the credit risk of an originator's own liabilities without the transfer of the credit risk of third parties. In such cases, the credit risk remains with the originator given that the originator is the final debtor to the investor. It is therefore accepted that alignment of interests, and also retention, is automatically met. The specific example of covered bonds is given in this clause and in footnote 4 of the Guidelines. Significantly, in the case of covered bonds, there is full recourse to both the assets in the covered bond asset pool and also to the full balance sheet of the issuer of the covered bonds (i.e. the originator of the securitisation). This can be contrasted with the example of a real estate financing transaction where the tranched obligations issued by a property company are its own liabilities. In such a case, there is recourse to the assets in the securitisation SPV only and not to the full balance sheet of the property company. A distinction can therefore be made between securitisations of own liabilities with full recourse to the balance sheet of the originator and to those with limited recourse to the assets of the SPV. We consider that automatic retention should not apply in scenarios where there is only limited recourse and therefore should not apply to the propco example.
Q33: Definition of "net economic interest": distinction between nominal exposure and notional exposure (Ref: Guidelines § 35)	
Q: The Directive defines "net economic interest" as a nominal exposure, and not a notional exposure. Therefore, securitisation positions which have no principal component (for example, an excess spread tranche) do not qualify as part of the retention requirement). What is the distinction between nominal and notional	**A**: In the context of the guidelines, generally, the term "Nominal" is used as reference for on-balance sheet items, whereas "notional" is a term used as reference for off-balance sheet items. Excess spread cannot qualify as part of the

exposure?	retention because retention must be measured at origination and, at origination, excess spread is a contingent amount.
Q34: Retention option (d): possibility of retaining only part of the first loss tranche (Ref: Guidelines § 54)	
Q: When the retention is held in Subordinated Notes, must the retention under option (d) comprise the whole amount of the most junior tranche and no other equity tranche can rank pari passu? If this is the case, can the equity retention tranche be subject to notional subordination e.g. the subordination of the last €1,000.	**A**: It is not necessary to hold the full amount of the first loss tranche under retention option d). For example, it would be possible to hold a 50% vertical slice of a 10% first loss tranche in order to retain a 5% net economic interest. It is possible that the first loss tranche retained can rank pari passu with other tranches.
Q35: Retention in securitisations where the underlying assets are purchased receivables sold with a discount that is refundable (Ref: Guidelines § 59)	
Q: "Whereas both Recital 25 and Paragraph 3 outline the non-applicability of the provisions of Article 122a to purchased receivables (with Recital 25 explicitly specifying those purchased receivables that are "transferred at a discount"), should such exemptions not apply for any reason to transactions in which the receivables are sold with a refundable purchase discount, then such refundable purchase discount would qualify as a first loss tranche under option (d). See also clause 60 below for further clarification on meeting the retention requirement under option (d) by way of sale of exposures at a discount." Could you please explain this provision as we do not see how this paragraph applies in practice?	**A**: If there is a securitisation where the underlying assets are purchased receivables, and these receivables are sold by the original lender with a discount that is refundable, then, if the discount is greater or equal to 5%, the discount is valid to comply with retention under option (d). If the discount is lower than 5%, either the seller must retain via the first loss tranche of the securitisation until completing 5%, or other party must retain the whole 5% net economic interest.
Q36: Clarification on the measurement of the retention requirement when the exposures securitised consist of, or include, an undrawn, unrealised, contingent or future component (Ref: Guidelines § 65, 43)	
Q: Should the exposures, receivables or cashflows being securitised consist of, or include, an undrawn, unrealised, contingent or future component, then the retention requirement of 5% is dynamic in that it only applies to such undrawn, unrealised, contingent or future components at such future point in time when they are drawn, realised, crystallized or received, and not before such time). Please explain this?	**A**: The text in paragraph 43 is clear; the minimum requirement is 5% of the drawn exposures at origination and dynamically re-measured and re-adjusted throughout the life of the transaction.

Section III.3: Clauses related to §3 of Art 122a

Q37: Exemptions from retention requirement under Art122a(3): transactions based on widely traded indices (Ref: Guidelines § 73, 74)	
Q: A number of banks are market makers in a number of widely traded indices that reference securitisation positions such as PrimeX, CMBX, ABX, and the in the future possibly NCRMBX that Market is looking to develop. These Indices may contain names that reference new securitisation positions either due to construction or replacement of names in the existing Index series. Can the EBA confirm that all transactions based on widely traded indices are exempt from the retention requirement under paragraph 3 and not just those named as examples? Can the EBA also confirm that these indices can contain securitisation positions and as long as the transaction is based on the index it will be exempt from retention (i.e. the transaction does not need to be identified within the correlation trading portfolio model itself as long as it equates with the definition?)	**A**: The list given in paragraph 74 is indeed non-exhaustive and all transactions that are based on clear, transparent and accessible indices, where the underlying reference entities are identical to those that make up an index of entities that are widely traded will fall under the exemption. As long as the transactions are based on indices which fall under the exemption the indices can include securitisation positions. The transaction does not need to be identified within the correlation trading portfolio model itself as long as it equates with the definition.

Section III.7: Clauses related to §7 of Art 122a

Q38: Obligation to disclose information under §7 of Art122a, even if the obliged parties do not have the right to receive the information (Ref: Guidelines § 121 and footnote 24)	
Q: Is it correct to state that the wording of paragraph 7 of Article 122a imposes an obligation on parties to provide information to investors relating to underlying loans, even though those parties may no longer have any right to receive that information?	**A**: The EBA recognise that, in practice, the obligation of a credit institution as sponsor and originator to disclose the information outlined in Paragraph 7 may be an indirect obligation, as the information on the underlying loans may be held by a different entity, however this does not relieve a credit institution in its role as sponsor or originator of its duty to fulfil the requirements of Paragraph 7.