20 April 2016

European Banking Authority
One Canada Square
London
E14 5AA

Submitted via website (www.eba.europa.eu)

Dear Sir

Response to the EBA Consultation Paper on Draft Guidelines on implicit support under Article 248(2) of Regulation (EU) No 575/2013

On behalf of the Association for Financial Markets in Europe ("**AFME**")[1] and its members, we welcome the opportunity to respond to the consultation paper (the "**CP**") on the draft guidelines (the "**Draft Guidelines**") on implicit support under Article 248(2) of Regulation (EU) 575/2013 (the "**CRR**") published by the European Banking Authority (the "**EBA**") on 20 January 2016.

Our response first raises two general comments prompted by our review of the CP and then goes on to answer the six questions posed by the CP.

A. Preliminary comments

1. *The EBA should make explicit that actions contemplated by the initial transaction documentation will not constitute implicit support.*

A number of AFME members have had conversations with their competent authorities, either in the context of this consultation or otherwise, where it became clear that certain competent authorities had some level of doubt in respect of this – a point AFME members consider beyond doubt. It would therefore be useful for the EBA to confirm in these Draft Guidelines that actions contemplated in the initial transaction documents and/or considered in the context of an initial SRT assessment will not constitute implicit support.

For example, it would be absurd for the sponsor of a fully-supported ABCP conduit to be prohibited under implicit support rules from providing support to the transaction it has sponsored. This is obviously a case of a bank supporting its transaction, but that support is contractually documented and appropriately reflected in the bank's capital, liquidity coverage and other accounting calculations. In other words, it is *explicit* support rather than implicit support, and for that reason it is unobjectionable.

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[1] AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.
AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.
AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

Similarly, if a time call, clean-up call or swap is contemplated by the documentation of a transaction from its inception and this is considered in the initial decision with respect to SRT, it would be a nonsense for it later to be deemed implicit support because e.g. pricing had changed in the interim.

Despite the fact that we consider it clear on the face of the CRR that none of these situations should be considered implicit support, each of them has been the subject of discussion between at least one member of AFME and its competent authority because the relevant competent authority was unsure of the correct interpretation of Article 248. It would therefore be useful for the market if the EBA could clarify the question in the final guidelines.

2. *Regulatory change since 2007 has largely addressed issues surrounding implicit support rules – these guidelines should therefore be limited to a narrow clarification required by Article 248(2) of the CRR*

We agree that implicit support risk was an issue in relation to certain securitisation vehicles including SIVs and securities arbitrage conduits prior to the 2007/2008 financial crisis. However, implicit support was not an issue for the vast majority of securitisation asset classes or other bank sponsored activities. There has never (to our knowledge) been a significant issue with banks offering implicit support for issuances in the far larger securitisation markets of RMBS, CMBS or CLOs. It is important to view implicit support risk through this lens – it was a fairly narrow problem that was not spread across a significant multitude of asset classes or activities.

Since the onset of the financial crisis many new regulations have been implemented and many market practices have changed. New regulations include risk retention requirements, enhanced regulatory due diligence and transparency requirements, regulatory capital changes, the introduction of the NSFR, the LCR, and ongoing banking reforms following the Liikanen Report and, in the UK, the Vickers Report. The framework provided by these new regulations must be borne in mind when seeking to further define the concept of implicit support set out in the CRR.

In that context, the objective of the guidelines required under Article 248(2) of the CRR should be relatively modest – a simple clarification of the requirements set out in Article 248(1) with some guidance about how they are to be applied. Subject to the comments below, we agree that this is broadly the thrust of the Draft Guidelines and we are supportive of this general approach.

B. Answers to specific questions

1. *Do you have any general comments on the draft guidelines on implicit support under Article 248(2) of Regulation (EU) No 575/2013?*

See our preliminary comments above. In the light of those comments, the evidentiary burden that is placed on originators and sponsors to essentially prove a negative (that transactions they enter into do not provide implicit support) is the source of some concern on the part of a number of our members. This burden is particularly onerous in the context of a requirement on institutions to notify their competent authorities regardless of whether they consider that the transaction provides support. Therefore, it would be extremely useful if the Guidelines could, to the extent feasible in the context of the CRR text, limit the scope of transactions that have to be notified to the competent authorities to those that present a real risk of providing implicit support.

Secondly, these guidelines are almost necessarily vague. They attempt to deal with a very wide range of asset classes and transaction structures each of which could be supported in a multitude of different ways, all in a single set of guidelines. This was always going to be challenging and is made the more so by the overlap with the SRT Guidelines. This situation gives rise to the continuing uncertainty described in our answers to questions 3 and 4.

One way the uncertainty described above might be ameliorated in some measure would be to provide a series of illustrative examples for each of the pieces of guidance in the Draft Guidelines similar to the approach of the authorities in the United States[2].

One such example is as follows:

> A bank securitises lines of credit ("**LCs**") to customers that are drawn as to 80% when they are transferred to the SSPE. SME term loans are securitised together with the LCs in the same portfolio. The SSPE then issues bonds equal to the drawn amount of the LCs and term loans. Call this amount 80, out of the 100 limit. If the customer draws the additional 20, the SPV will finance the drawing using amortisation payments from the SME term loan amortisation payments. If this is not sufficient to cover the draw requests, the SSPE will draw on a liquidity line provided by the bank and entered into at the time of establishment of the securitisation. The liquidity facility ranks *pari passu* with the Class A notes. Its other features are entered into on standard commercial terms.
>
> In our view, the guidelines should make clear that the liquidity line (including the sharing of any losses with the Class A noteholders) does not constitute implicit support. The liquidity line was entered into at the time of establishment of the securitisation in question and considered in the decision as to significant risk transfer.

By providing examples, institutions might understand better the limits of the implicit support rules and thereby achieve improved regulatory certainty. Examples would have the further benefit of helping to ensure that national competent authorities take similar approaches to the interpretation and enforcement of Article 248 and the implicit support guidelines.

Thirdly, in respect of the relationship between implicit support and significant risk transfer, paragraphs 16 and 17 of the Draft Guidelines seem inappropriate. More particularly, paragraphs 16 and 17 seem to add additional criteria for maintaining previously agreed significant risk transfer over and above the requirements of the CRR and the existing SRT guidelines (EBA/GL/2015/05). Without commenting one way or the other on the content of these paragraphs, they should be considered in the context of the SRT Guidelines and not in the context of a consultation on implicit support.

2. *Do you have any comments on the proposed definition of transactions not structured to provide support?*

In keeping with our submissions elsewhere in this letter, we are concerned with the implication in this definition that the loss of SRT treatment will automatically result in a conclusion that implicit support has been provided. Although the presence of implicit support will always result in the loss of SRT treatment, the converse is not true. The loss of SRT treatment might simply result from the originator exercising a right to unwind the transaction contemplated in the original documents; or the originator might simply have unwound the transaction (or part of it) via a liability management exercise.

In either case, the originator's intention may be nothing to do with supporting investors and everything to do with what is expedient for itself. Such actions should be outside the scope of the implicit support rules. Simply because SRT is lost does not mean that, in the examples provided, the sanctions contemplated in Article 98(3) of Directive 2013/36/EU should be incurred. The definition of "transactions not structured to provide support" should therefore be amended to remove the suggestion that the loss of SRT treatment in and of itself indicates the presence of implicit support.

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[2] See, for example: https://www.fdic.gov/news/news/financial/2002/FIL0252a.html

3. *Do you have any comments on the proposed definition of arm's length conditions?*

Paragraph 13 on the meaning of "arm's length conditions" for the purposes of Article 248 is appropriate in that it accurately describes the concept of "arm's length conditions" as understood by AFME members. That said, it is not very practically useful in that the definition is very theoretical and in practice requires institutions to come up with a hypothetical and somewhat arbitrary set of terms on which arm's length parties would have transacted in order to act as a benchmark for the transaction actually proposed or undertaken. This is necessarily a somewhat artificial exercise that AFME members are concerned would be hard to complete in a way that provides reasonable assurances that it would not be second-guessed by a competent authority.

The guidance in paragraph 14 that only information available to the parties at the time of the transaction will be used to assess whether the terms were "arm's length" is helpful.

4. *Do you have any comments on the proposed guidance regarding the factors contemplated in points (a)-(e) of Article 248(1) of Regulation (EU) No 575/2013?*

As a general matter, it should be borne in mind by competent authorities when making decisions in respect of implicit support that each of the factors contemplated in points (a)-(e) of Article 248(1) of the CRR is indicative, but none is necessarily conclusive. A holistic consideration of these factors – together with the underlying factors motivating the originator or sponsor to enter into the relevant transaction – is necessary to arrive at appropriate decisions in respect of implicit support. This is partly because few if any of the factors listed are helpful in distinguishing transactions designed to provide implicit support from simple management by a bank of its balance sheet. A transaction may be cancelled and restructured (changing the bank's capital position significantly) without any intention of supporting a third party investor. Rather, a bank may wish to repurchase the securitisation position purely for the purposes of adjusting its own risk profile or reducing ongoing operational commitments.

Fundamentally, a bank needs to be able to manage its own balance sheet. This may mean that it is appropriate to wind down transactions that might be years old, designed to support an outdated strategy or economic environment and are no longer worth the operational investment. The maturity mismatches applied to risk transfer transactions as they reach maturity erode the capital benefit that is gained from the transaction in the same way that the benefit of certain forms of regulatory capital issues (in respect of which balance sheet management techniques are widely used and accepted) erodes. Given this, as a general principle, balance sheet management techniques used in the context of such regulatory capital issues should be available to banks in the context of risk transfer transactions.

Turning to the criteria set out in the Draft Guidelines, while it is helpful to have, e.g. a framework for assessing the reasonableness of the repurchase price paid (as set out in paragraph 20 of the Draft Guidelines), this remains sufficiently vague as to provide relatively little predictability for institutions proposing to enter into a transaction that might be considered to provide implicit support. Similar concerns arise in respect of paragraphs 21-24 of the Draft Guidelines. So while the guidance here is practically helpful in some ways (more so than paragraph 13 in respect of "arm's length conditions") the level of certainty provided nonetheless falls short of what AFME members would hope for. Once again, illustrative examples may be one way to address this uncertainty.

A further concern arises specifically in the context of paragraph 20 and buybacks in that the originator and/or sponsor institution is the most likely institution to be making a market in the securitisation bonds. It would of course be very onerous (potentially to the point of discouraging market making entirely) if originator and sponsor institutions had to verify each individual market making transaction with a competent authority prior to completing it in order to have certainty that it would not be considered to provide implicit support to the transaction.

We understand from members who attended the Open Hearing on 18 February 2016 that this type of transaction-by-transaction verification is not the EBA's intention. Rather, it is intended that originator and sponsor institutions should have systems and controls in place intended to ensure that any purchases of securitisation bonds are made on arm's length terms. We agree that this is a sensible approach and would encourage the EBA to make clear this intention in the final version of the Draft Guidelines.

5. *Is the arm's length condition in paragraph 10.a of the draft guidelines sufficient to test in all cases whether a sponsor provides support? If not, what would be an appropriate requirement? Please provide examples.*

Subject to our comments elsewhere in this letter (e.g. on the definition of "arm's length conditions"), this definition seems sensible and we have no further comments on this subject specifically.

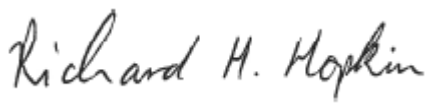
6. *Should transactions undertaken by a third party other than the sponsor institution or originator institution be subject to the same assessment with regard to the provision of implicit support as transactions undertaken by the sponsor institution or by the originator institution or should they be subject to different assessment standards (and, if so, which standards)?*

As a preliminary matter, the CP provides relatively little context for this question. It is consequently difficult to be certain of the situations the EBA is contemplating when posing it. That said, AFME members agree it is reasonable that the same rules should apply to the originator and its group companies. Likewise, the sponsor and its group companies should be subject to the same rules.

Beyond that, it seems unnecessary for the implicit support rules to apply at all. While a general anti-avoidance rule to be applied in exceptional circumstances may be justified, it must be weighed against the possible inefficiencies that will come with banks having to expand the scope of the transactions they examine to avoid implicit support. In particular, if arranging banks (who will often be neither originator nor sponsor) are required to enter into implicit support analysis for post-closing transactions they undertake in respect of securitisations they arrange, that could result in significant cost and a powerful disincentive to arrange securitisations in the future – an outcome contrary to the stated aims of the Capital Markets Union.

In closing, we wish to emphasise that the engagement of the EBA with market participants on issues related to implicit support is appreciated. We are grateful for the opportunity to comment on the Draft Guidelines and we would be happy to answer any further questions that you may have.

Yours faithfully



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