afme/
Finance for Europe

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SUBMITTED VIA

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European Banking Authority
One Canada Square
Floor 46
London E14 5AA

RE: EBA Consultation Paper on Draft Regulatory Technical Standards Specifying the Requirements for Originators, Sponsors and Original Lenders Relating to Risk Retention

Question 1: Do you have any general comments on the draft technical standards?

On behalf of the Association for Financial Markets in Europe (**AFME**) and its members, we welcome the opportunity to comment on the draft technical standards relating to the retention requirements under the Securitisation Regulation. The continuing engagement of the European Banking Authority (**EBA**) with market participants on issues related to risk retention is greatly appreciated.

AFME members have identified a number of general comments on the draft technical standards. These comments are set out below. In particular, we wish to draw the EBA's attention to our comments below on the uncertainty created by certain proposed changes to article 12 relating to the prohibition on selling or hedging the retained interest (please see item B below and the response to Q4), and on the uncertainty with respect to the scope of application of the retention requirements (please see item D below and the response to Q7). We would be happy to meet with the EBA to discuss these points and any of the other comments raised in our response.

A. General approach

As a starting point, we strongly support the EBA's proposed general approach of ensuring that the current risk retention technical standards are carried over in the new standards. Continuity is appropriate given the significant overlap in the key aspects of the requirements between the two regimes; a different approach involving a broader reworking of the technical standards would risk creating significant compliance confusion.

In addition, AFME members consider that continuity is essential for compliance feasibility in the context of transactions where both the current technical standards and the new standards will be relevant. Given the manner in which the transitional application provisions in the Securitisation Regulation are drafted, these transactions include repeat issuance arrangements, initial transactions under the new regime completed prior to the application date of the new standards (as the transitional provisions indicate that the current technical standards will need to be complied with until the new technical standards are available) and pre-2019 transactions where the simple, transparent and standardised (STS) designation is sought.

To ensure sufficient continuity is maintained, changes to the current technical standards should be limited to those necessary to address new provisions or considerations under the recast requirements, or to remedy certain specific issues.

B. Intended clarifications

The draft technical standards include certain changes described to "clarify certain matters which were not sufficiently addressed" in the current technical standards.

While AFME members support clearer drafting in regulation, we are concerned that not all of the proposed clarifications would result in greater clarity in the text, and indeed certain changes could result in materially different outcomes under the regime. Market participants are familiar with the current drafting and have established reasonable interpretations of the relevant provisions, and we are not aware of any material concerns on the part of the authorities in this regard (based on the EBA report published under article 410 of the Capital Requirements Regulation in April 2016 and other less formal communications related to the functioning of the current regime).

In particular, significant concerns arise under the draft technical standards in the context of the intended clarifications set out in the provisions identified below.

- *Article 12(1) relating to the prohibition on hedging or selling the retained interest – sale or transfer of all or part of the rights, benefits or obligations arising from the retained interest* – to date, in interpreting this prohibition the authorities have generally focused on the key principle that the credit risk of the retained position must remain with the retainer, and this principle has allowed for sensible interpretation across the full range of scenarios that may arise. However, the proposed addition to article 12(1) to refer to a restriction on the sale or transfer of "all or any part of the rights, benefits or obligations" arising from the retained interest is seemingly out of step with this key principle and risks raising significant issues in practice as a result. In particular, the additional wording is not aligned with the principle referred to in article 12(3) related to using the retained interest as collateral (which places emphasis on maintenance of credit risk exposure, in keeping with other aspects of the retention regime), and the intended interaction of the provisions is not clear. This gives rise to possible compliance uncertainty in respect of certain retention financing arrangements otherwise regarded to be permitted under article 12(3), such as certain title transfer financings including standard repurchase arrangements, and this uncertainty is highly problematic. We note that the rationale for the additional wording is not clear from an interest alignment perspective. If the thinking behind the wording is related to the Single Rulebook Q&A response provided in connection with question ID 2016_2878 (regarding passing on the net proceeds of a retained interest), then we would note that the drafting goes beyond the circumstances and principles referred to in that response. As a result of the foregoing, AFME members have significant concerns with the inclusion of the additional wording and consider that the wording should not be included. If the wording is included, then, at a minimum, clarification is needed with respect to article 12(3) to make it clear that it applies notwithstanding paragraph 1. For completeness, we note that the proposed changes provided for under corresponding recital (8) (current recital (7)) are confusing and also problematic as a result. The current wording which places emphasis on the retainer maintaining the credit risk of the retained position is clearer and should be maintained. Please see the response to Q4 below for our further comments on the importance and operation of article 12(3).

- *Article 12(2) relating to the prohibition on hedging or selling the retained interest – sale or transfer of excess interests* – the proposed change provided for under article 12(2) relating to the sale or transfer of any excess interests raises a number of questions. In the view of AFME members, the technical standards should include guidance on matters relating to interests retained in accordance with the Securitisation Regulation only and not any "excess" interests which may (voluntarily) be retained over and above the regulatory requirements on a contractual or other basis. To the extent that a retainer holds an interest that is larger than the minimum required level, we would note that in general the excess interest will not be covered by the retention commitment statement provided by the retainer and so will not be retained in accordance with the Securitisation Regulation. On this basis, the rationale for the inclusion of article 12(2) is not entirely clear. Moreover, concerns have been raised that the proposed condition relating to the same selection method being applied to identify the excess interest which may be disposed of does not make sense in the context of most holding options including the vertical slice and first loss tranche options.

- *Article 7 relating to the randomly selected exposures holding option* – oddly, article 7(1) is proposed to be amended to remove the high-level guidance on the factors to be taken into account when selecting assets to be retained under the holding option, and the text has been revised in a manner which suggests that the listed factors may be applied when identifying the initial portfolio of assets, i.e. the portfolio from which the retained assets should be selected. This shift in emphasis is not helpful and risks creating confusion. The rationale for the proposed changes to article 7(2) is also unclear as guidance is not needed on the re-designation of assets between the securitised portfolio and the retained portfolio. To be clear, AFME members consider that the current guidance in article 7(2) on the intended static nature of the retained portfolio except in the context of revolving securitisations should be maintained.

- *Article 3(4)(b) relating to retention by one originator or original lender in a scenario involving multiple originators or original lenders* – with respect to the proposed clarification of the measurement basis to be used when considering whether the relevant originator has contributed more than 50% of the total assets, rather than referring to "exposure value" here, reference should be made to the "*nominal* value" of the assets. This would ensure greater consistency in the application of measurement concepts used across different parts of the retention regime and avoid confusion with the exposure value concept as applied under the EU Capital Requirements Regulation which requires a more complicated value assessment and is unfamiliar to non-bank originators. To be clear, we consider that significant compliance confusion would arise if the proposed "exposure value" reference is pursued.

- *Article 15 relating to retention commitment disclosures* – with respect to the proposed clarification that various disclosures should be made via the final offering document or prospectus, we note that this risks creating confusion as not all securitisations will involve an offering document (e.g. warehouse transactions, certain synthetic transactions and underlying transactions in ABCP programmes). Article 15(3) already specifies that disclosures shall be appropriately documented and be made publicly available except in the context of private transactions, and confirms that the prospectus is an appropriate means for these purposes. This is a sensible approach and has resulted in the common practice on public transactions of inclusion in the prospectus of the retention commitment statement and also allowed for appropriate adjustments in the context of relevant arrangements including private transactions. As a result, we consider that the proposed clarifications relating to disclosures being made within the final offering document or prospectus in article 15 of the draft technical standards (as well as the similar proposed amendments to recital (7) and article 4(1)(b)) should be removed. Please see the response to Q2 below for further feedback on article 15.

To reiterate, AFME members would encourage the EBA to only pursue those clarifications in the technical standards considered essential and to reconsider the proposed approach in particular in respect of the points highlighted above.

C. Sole purpose test

In general, AFME members support the principles-based approach proposed to be applied under article 3(6) of the draft technical standards with respect to the guidance to be provided on the new so-called "sole purpose test" under article 6(1) of the Securitisation Regulation. It is essential that the guidance is sufficiently flexible so as to allow for appropriate application across the full range of scenarios that may arise and an approach focused on high-level principles is in keeping with this.

That said, concerns have been raised by AFME members with respect to the drafting of the introductory wording of article 3(6), as this could be read to mean that the sole purpose test may only be regarded to be satisfied if each of the identified principles is given equal weight and fully satisfied in all circumstances. This interpretation would result in the effective replacement of the test in article 6(1) with a more detailed and rigid test and one seemingly less conducive to appropriate functioning across all potentially relevant arrangements. We consider that the significant concerns raised in this regard could be addressed through relatively minor amendments to the introductory wording set out at the end of this section.

The amended wording makes it clear that each of the principles should be taken into account when assessing whether the sole purpose test is satisfied and allows for adjustments in weighting through the reference to appropriate consideration. Such adjustments may be required, for example, where the relevant entity has been established relatively recently and it is intended to operate for purposes consistent with a broader business purpose but it is not possible to point to a material operating history at the time of closing.

The corresponding proposed disclosure obligation set out in article 15(1)(a) should also be amended for consistency. In particular, we would suggest that the wording be amended as follows: "*and, where the retainer is the originator, of how it meets ~~the conditions~~ the test set out in article 6(1) of Regulation (EU) 2017/2402 taking into account the principles set out in article 3(6)*".

With respect to the principles identified in proposed article 3(6) of the draft technical standards, AFME members agree that these are the appropriate matters to be taken into account in general, provided that there is flexibility for adjustment in weighting and subject to certain further clarifications set out below. The principles broadly correspond to those commonly applied by market participants when assessing whether a retention arrangement involving an originator retainer satisfies the policy of the retention requirements in keeping with the comments made by the EBA in its risk retention report published in December 2014. To be clear, if the principles are further revised and any flexibility is removed, this would result in significant issues.

> "*For the purposes of Article ~~[~~6~~]~~ of Regulation (EU) ~~[XXX/201X]~~2017/2402, in assessing whether an entity has ~~shall be deemed not to have~~ been established or*

~~to~~ operates for the sole purpose of securitising exposures, appropriate consideration should be given to ~~and, therefore, may constitute an originator if it satisfies each of~~ the following principles ~~conditions~~ at the closing of the relevant securitisation:

(a) it has a business strategy and the capacity to meet payment obligations consistent with a broader business enterprise and involving material support from capital, assets, fees or other income available to the entity, but disregarding the~~any~~ exposures being~~to be~~ securitised by that entity and any interests retained or proposed to be retained in accordance with this Regulation, as well as any corresponding income from such exposures and interests;

(b) it has been established and operates for purposes consistent with a broader business enterprise;

(c) it has or has access to sufficient decision makers with the required experience to enable it to pursue the established business strategy, as well as an adequate corporate governance ~~structure~~ arrangement."

AFME members consider the above suggested amendments to be necessary for sensible application of the guidance, and to ensure that the sole purpose test set out in the Securitisation Regulation is not effectively replaced by another test. Moreover, the revised wording should function to deliver appropriate outcomes under the retention requirements from a policy perspective, and there will be transparency in this regard given the corresponding disclosure obligation set out in article 15(1)(a).

D. Key matters not addressed

While the draft technical standards helpfully seek to address certain new provisions included in the retention requirements under the Securitisation Regulation (such as the sole purpose test (discussed above) and the adverse selection restriction (see the responses to Q5 and Q9 below)), not all key new matters forming part of, or raised by, the recast regime are addressed in the proposals.

In particular, the key topics referred to below are not covered in the draft technical standards. Given that the technical standards mandate provided to the EBA in article 6(7) of the Securitisation Regulation refers in broad terms to further specification of the retention requirements and that the list of specific matters referred to in this article is non-exhaustive, we would respectfully suggest that it is possible for the technical standards to cover these matters (except where noted below). In the absence of guidance on these topics, AFME members have expressed concerns with their ability to sensibly interpret and comply with the new regime.

- *Scope of application*

    - Jurisdictional scope – based on certain indirect references to risk retention compliance and supervision in the Securitisation Regulation, AFME members understand that it is intended that the retention requirements in article 6 of the Securitisation Regulation should apply in respect of originators, sponsors and original lenders established in the EU only. Such indirect references include, e.g., article 5(1)(c) and (d) relating to the so-called "indirect approach" or investor due diligence obligation with respect to risk retention and article 29(4) relating to the designation by member states of competent authorities to supervise compliance with the retention requirements and certain other obligations. Reading these references in this manner also lines up with statements included in the explanatory memorandum published by the Commission in conjunction with its original legislative proposals on the Securitisation Regulation (as the memorandum indicated that non-EU established entities should be subject to the indirect approach with respect to risk retention only). However, on a fundamental matter such as jurisdictional scope of application, it seems inappropriate that market participants would need to "read between the lines" in this manner and AFME members consider that the position should be clearly confirmed to remove any uncertainty in this regard. The draft technical standards do not refer to this point and AFME members urge the EBA to reconsider this point. While questions relating to jurisdictional scope also come up under certain other provisions of the Securitisation Regulation, this should not preclude the provision of clarification under article 6 via the technical standards.

    - Consolidated application – based on the amendments made to article 14 of the Capital Requirements Regulations, unless changed, the direct risk retention requirements under article 6 of the Securitisation Regulation will apply in respect of EU regulated banks and relevant investment firms on a consolidated basis. This gives rise to significant unlevel playing field issues for EU banking groups. In effect, consolidated application of the direct retention requirement will require a third country consolidated entity acting as an originator, sponsor or original lender in respect of a local securitisation transaction to comply with the EU retention requirements, while this requirement would not apply to domestic (non-EU) entities operating in that country. An example of a relevant third country consolidated entity in this context could include a U.S. established subsidiary of an EU bank operating in the U.S. securitisation market. Moreover, the securitisation definition which triggers the application of the EU requirements is very broad, meaning that many different financing transactions involving credit risk tranching would be drawn in (including private transactions involving tranched loans) notwithstanding that such arrangements are unlikely to be regarded as securitisations or asset-backed securities under local law requirements. While the necessary solution to these issues needs to involve further amendments to article 14 of the Capital Requirements Regulation such that only the investor due diligence obligations (including the indirect retention requirements) apply on a consolidated basis, and AFME members acknowledge that the concerns cannot be addressed through the draft technical standards alone, we have raised this in our response given the importance of the issues involved and the fact that they directly relate to the retention requirements. We urge the EBA to take any available action to assist with the necessary amendments being made to article 14. Please see the response to Q7 below for views on the guidance which should be included in the draft technical standards on the operation of this article.

- *Grandfathering* – based on the transitional provisions set out in article 43 of the Securitisation Regulation, it is our understanding that pre-2019 securitisations will benefit from full grandfathering with respect to risk retention only if no securities are issued (and no new securitisation position is otherwise created) from 1 January 2019. This means that repeat issuance arrangements will be brought in scope and will be subject to the new retention requirements from the time of the first new issue on or after that application date. It also means that amended transactions may be brought within scope to the extent that such amendments result in the creation of a new securitisation position from the application date. In line with previous comments made by AFME members through the political negotiation process relating to the Securitisation Regulation, we consider that basing grandfathering on the timing of new liabilities rather than on the date of establishment of the relevant securitisation gives rise to uncertainty in general. Moreover, certain compliance questions arise in a risk retention context, and in this regard we note that retention arrangements will often not be series-specific and instead will be established and addressed on a transaction-wide or programme-wide basis. As a result, continuing compliance under the new regime will be challenging if there are mismatches between the current and new retention requirements and, in turn, the potential issues in this regard will be reduced if the requirements are consistent. As noted above, continuity between the new retention technical standards and the current technical standards is key to avoid significant issues for various types of transactions including repeat issuance arrangements. AFME members encourage the EBA to only pursue those clarifications to the technical standards considered essential. In this regard, please refer to the related feedback provided in item B above and also in response to Q8 below.

- *Retainer agreement and backstop originator obligation* – we note that article 6(1) of the Securitisation Regulation stipulates that "where the originator, sponsor or original lender have not agreed between them who will retain the material net economic interest, the originator shall retain". This concept of an agreement among retainers is new, as is the concept of a backstop originator obligation for retention compliance, and certain clarifications are needed to ensure that issues do not arise under the new regime. First, as an initial point, we would ask that confirmation be provided through the technical standards that the backstop obligation will only extend to originator entities (being asset creators and purchasers) that are *directly involved* in the securitisation. This interpretation is in keeping with the reference in the first line of article 6(1) to "the originator, sponsor or original lender *of a securitisation*" (emphasis added) and confirmation of this reading in the technical standards would remove any doubt in this regard, particularly given that multiple parties may be considered to be originators given the different limbs of the definition and the reference to related entities. Second, we consider that confirmation is required that where an entity provides a retention commitment statement this shall be deemed to reflect the agreement between all relevant retainers as referred to in article 6(1), so that no express written agreement between these parties is required, and that any failure on the part of the relevant retainer to hold and maintain the required interest for any reason post-closing will not give rise to an obligation for any other originator, sponsor or original lender entity involved in the securitisation to retain. In the absence of guidance on this second point, originator or sponsor entities that participate in a securitisation involving retention by another eligible entity may regard their ongoing regulatory compliance position as insufficiently certain, particularly if this may be affected by the ongoing performance of the committed retainer, being a matter clearly outside of the other entity's control (as well as the control of the committed retainer in certain respects, e.g. in the event of its insolvency).

- *Measuring the minimum retained interest and taking into account the acquisition price* – in keeping with the current technical standards, article 10 of the draft technical standards indicates that calculation of the level of retention shall be based on nominal values and the acquisition price of the assets shall not be taken into account. While AFME members support continuity in general in the technical standards as noted above, this is one area where issues are regarded to arise in practice under the existing regime. In particular, such issues arise in the context of transactions involving assets acquired by the relevant originator at a material discount. The existing rule presents potential challenges to the economic efficiency of using securitisation to finance certain acquired portfolios of non-performing loans. Any flexibility which may be provided through the technical standards to take into account the acquisition price of the assets and/or the loss already suffered by the original originator in the context of these transactions would assist with the functioning of this portion of the market if drafted appropriately. We would like to discuss this matter further with you if there is any scope for adjustment, so that any options may be fully considered and responded to.

- *Changes in the retention holding option* – in keeping with the current technical standards, article 10 of the draft technical standards indicates that the retention holding option should not change during the life of the securitisation transaction but for in certain scenarios involving exceptional circumstances and where the change is not used as a means to reduce the amount of the retained interest. AFME members have noted that it would be very helpful if the circumstances in which a change may be made could be broadened out to also allow for changes where the transaction is fully retained and the change is not used as a means to reduce the amount of the retained interest. In particular, this would allow for a sensible change to be made where, for example, from the start of 2019 a securitisation is done for funding purposes at the outset through full retention of the transaction and use of certain positions as collateral in central bank liquidity operations and a first loss tranche is held, but later it becomes desirable to seek significant risk transfer in respect of the transaction, meaning that it is preferable to retain a vertical slice. Such a change would seem to be consistent with a broader policy objective to restore securitisation markets, build Capital Markets Union, help banks transfer risk and adjust to more normal monetary policy conditions in due course. This could be addressed in the technical standards by amending the relevant wording of article 10 as set out below. We understand that the current technical standards will continue to apply in respect of pre-2019 securitisations in general and acknowledge that, as a result, provision for greater flexibility under the new technical standards would only be relevant in respect of in-scope transactions subject to the retention requirements under the Securitisation Regulation.
  "*the same retention option and methodology shall be used to calculate the net economic interest during the life of a securitisation transaction, unless exceptional circumstances require a change or the retainer and/or a related entity holds all of the issued tranches in respect of the securitisation and, in each case, ~~that~~ the change is not used as a means to reduce the amount of the retained interest.*"

- *Ability to combine holding option; L-shaped holding option* – in keeping with the current technical standards, the proposals do not provide for use of the so-called L-shaped holding option (involving retention through a first loss tranche in part and a vertical slice in part). As noted by AFME members in the context of previous engagement opportunities with the EBA related to risk retention, additional flexibility for this holding option would be helpful and would create greater alignment with the US retention rule. If there is any scope for adjustment in this regard, AFME members would welcome the opportunity to discuss this matter with the EBA further.

Question 2: Considering the mandate granted to ESMA in Article [7(3)] of the STS Regulation, do you believe that these technical standards should include disclosure-related provisions relevant to risk retention and, if so, do you agree with the scope of the obligations set out in the draft technical standards?

We note that article 7 of the Securitisation Regulation provides for retention commitment statement-related disclosures on an ongoing basis in the context of the investor reporting obligations. In turn, the mandate provided to the European Securities and Markets Authority (**ESMA**) in article 7(3) refers to, among other things, the development of regulatory technical standards to specify the information to be provided in investor reports. As a result, it is our understanding that article 7 addresses certain retention commitment statement-related continuing disclosure obligations but does not extend to initial retention commitment disclosures or to so-called "exceptional circumstances" disclosures.

Based on the foregoing, AFME members agree that it is sensible for the regulatory technical standards made under article 6 to provide further specification of the retention requirements in terms of required disclosures. We also agree that such specification should cover initial retention commitment disclosures.

In terms of the specific proposed drafting in this regard, as noted above we consider the references added to article 15 requiring disclosures to be made in the final offering document or prospectus to be confusing (as not all transactions will involve such documents) and unnecessary (given the general principles referred to in article 15(3) in this regard). Please refer to the response set out in item B of Q1 above for further details.

Beyond initial disclosures, we consider that the regulatory technical standards made under article 6 should also provide further specification with respect to retention disclosures in exceptional circumstances as these are not clearly covered by article 7 of the Securitisation Regulation. Such disclosures would include communication of any change to the modality to retain a material net economic interest in accordance with article 10(1)(d) and, to the extent that article 17 is pursued, communication of any change in retainer in accordance with that article, albeit that the latter should only be required where reasonably practicable. Please refer to the response to Q6 below for our further comments on article 17.

Lastly, we also consider that article 15(1)(a) of the draft technical standards should be amended to reflect our comments related to the guidance on the sole purpose test. Please refer to the response set out in item C of Q1 above for further details.

Question 3: Do you believe that the provisions in Article 11 of the draft technical standards (relating to the measurement of retention for the undrawn amounts in exposures in the form of credit facilities) are needed?

AFME members strongly support the proposed general approach of ensuring that the current risk retention technical standards are carried over in the new standards. In keeping with this, we consider it to be most helpful if all elements of the current standards are carried over, including article 11.

While the principle referred to in article 11 seems relatively straightforward at this point, the guidance on which it is based (which was set out in paragraph 65 of the original retention guidelines made by the Committee of European Banking Supervisors at the end of 2010) was initially sought by market participants to clarify the confusing reference in the retention requirements to the retained interest being "determined by the notional value for off-balance sheet items". This same wording is included in article 6(1) of the Securitisation Regulation, and so the guidance in article 11 remains relevant in general.

Moreover, the removal of article 11 could be interpreted to suggest that a different principle should be applied in this regard, which would detract from the functionality of the new regime.

As a relatively minor matter, we would note that the title of article 11 would be clearer if it was amended to remove the words "for the undrawn amounts in exposures" (and so read as "*Measurement of retention for ~~the undrawn amounts in exposures~~ in the form of credit facilities*"). Given that the undrawn amounts are not relevant in general with respect to calculating the retained interest and this is confirmed by article 11, the reference to retention for undrawn amounts in the title is confusing.

Question 4: Do you consider the provisions of Article 12(3) of the draft technical standards to be useful and how would you see such a transaction working in practice, including following a default by the retainer under the secured funding arrangements?

Yes, AFME members consider article 12(3) (confirming that the retainer may use the retained interest as collateral for secured funding provided that the credit risk of the relevant interest is not transferred) to be very useful. To be clear, this provision is a key component of the current technical standards. This will not change under the new regime and indeed we would expect this article to have heightened significance as a result of the direct retention obligation on originators, sponsors and original lenders.

We strongly support the proposal to carry over article 12(3) intact. Given its principle-based nature, the provision is considered to function sensibly in general across a range of possible financing scenarios. Moreover, any changes to the drafting of this provision would risk creating compliance confusion as such amendments could be interpreted to signal a shift in views with respect to what is acceptable in this regard.

In addition to maintaining article 12(3), we consider it to be essential that changes are not made to other provisions in the technical standards which could be read to be inconsistent with article 12(3). As noted above, significant concerns have been raised with respect to the proposed changes to article 12(1) as the interaction of the additional wording with the guidance provided in article 12(3) is not clear. Please see item B of the response to Q1 above for our detailed comments in this regard.

With respect to the function of article 12(3) in practice, we would note that, given that the article focuses on the high-level principle of credit risk exposure and refers in general terms to secured funding arrangements, it may be applied in various transaction contexts. To take one example of its possible application: where a retainer wishes to obtain financing, it may enter into a loan agreement with a lender involving a corresponding security package which extends to the retained interest; however, in keeping with the principle referred to in the article, care will be taken to ensure that the credit risk of such interest is not transferred in economic substance to the lender. This will typically be achieved through ensuring that the fixed debt financing is on "full recourse" terms, broadly meaning that the retainer (as borrower) is obliged to pay the specified liabilities under the loan in full, including in circumstances where there is a shortfall should the proceeds of the security prove insufficient.

In a default scenario, the security provided with respect to the retained interest would be available for enforcement to meet the loan liabilities, thereby enabling the lender to have recourse to such interest in priority to other creditors, including through taking possession of the interest and/or selling such interest. Given the full recourse nature of the financing, to the extent that the proceeds of the security are insufficient to cover the loan liabilities, the lender would have a remaining corresponding debt claim against the retainer for the relevant shortfall amount. To be clear, a retainer will typically be highly incentivised to avoid defaulting on its payment obligations where possible, including in a retention financing context, and this should not occur other than in circumstances where the retainer is under significant financial stress.

We note that the regulatory consequences of default and security enforcement under the current regime and the indirect approach obligations on investors are not entirely clear. In particular, where the lender has enforced its security interest in respect of the retained interest in a manner involving the transfer of such interest from the retainer, concerns have been raised with respect to the continuing compliance position of the relevant arrangement.

While it seems highly unlikely that an existing relevant investor in respect of the relevant securitisation would be considered in this scenario to have failed to meet its due diligence obligations by reason of its negligence or omission as described in article 407 of the Capital Requirements Regulation (and so no regulatory penalties should apply), the position of new relevant investors in respect of the relevant securitisation is less certain.

This is because, on its face, prior to investing a new relevant investor would seemingly be unable to confirm that the originator or sponsor holds the required interest. However, bearing in mind the credit risk focus which underlies the retention requirements, another reasonable view is that no compliance issues should arise on the basis that the retainer has, as a result of the security enforcement involving the transfer of the interest, effectively suffered a full loss in respect of the relevant interest, meaning that the retention requirements should be regarded to have been fully satisfied. Given the regulatory uncertainty under the indirect approach for new relevant investors (which we note gives rise to potential liquidity concerns for existing investors as well), it would be helpful to receive confirmation of this view.

Leaving aside the indirect approach, of course the recast requirements under the Securitisation Regulation give rise to regulatory compliance considerations in a default and security enforcement scenario for originators, sponsors and original lenders as well due to the direct obligation to retain. While these entities have been motivated by contractual commitments and reputational matters to maintain the required interest to date and this will continue under the new regime, the direct obligation adds a further regulatory compliance consideration with respect to retention financing arrangements. We see the compliance considerations and possible views in a retainer context as being very similar to those set out above in the context of investors. This further reinforces the need for clarity in this area and, in particular, for confirmation that the view outlined above should also apply in the context of the direct obligation to retain.

Please see our related comments below in response to Q6 where we provide suggested drafting for the requested confirmation. We consider that this confirmation would significantly enhance the functionality of the retention regime and avoid unhelpful compliance uncertainty for prospective investors in particular in retainer insolvency scenarios where the retained interest is subsequently transferred to another entity.

Please also see our related comments above in item B of the response to Q1, which refer to concerns identified in connection with other aspects of article 12 as proposed.

Question 5: Do you believe that the provisions of Article 16 of the draft technical standards relations to assets transferred to the SSPE are adequate?

In general, yes, AFME members consider the provisions of article 16 (and corresponding recital (11)) of the draft technical standards to be adequate, subject to the important comments set out below.

AFME members strongly support the inclusion of guidance in the technical standards on the so-called "adverse selection restriction" set out in article 6(2) of the Securitisation Regulation. As this restriction was a relatively late addition to the regulation text, aspects of the drafting are unfortunately not entirely clear and so clarification through the technical standards is needed. Moreover, significant concerns had been raised by AFME members previously that the compliance position of originators participating in transactions involving non-performing loans could be affected as a result of the operation of the provision, although recital (11) of the Securitisation Regulation clearly indicates that this is not the intention.

The proposed guidance set out in article 16 of the draft technical standards is very helpful in addressing certain key areas of uncertainty under the adverse selection restriction. In particular, we consider article 16(1) to provide essential confirmation with respect to the availability of the approach outlined in recital (11) of the Securitisation Regulation and to be necessary for compliance with the restriction in the context of transactions involving non-performing loans.

That said, given that article 6(2) of the Securitisation Regulation refers to originators only, the reference to sponsors in article 16(1) (and corresponding recital (11)) of the draft technical standards is confusing and we would suggest that this be removed. The obligation under article 6(2) does not apply to sponsors.

In addition, it is not clear why article 16(1) refers to communication of the higher credit risk profile of the selected assets to the competent authorities as well as to investors and potential investors. We would respectfully suggest that clear disclosure to (potential and existing) investors should be sufficient, in keeping with recital (11) of the Securitisation Regulation. If it is considered necessary to refer to the competent authorities as well in this context, we would suggest that reference should instead be made to the information being provided *upon request* by a competent authority, so as to avoid the imposition of a disproportionately onerous obligation on originators.

With respect to article 16(3), while AFME members consider it helpful for guidance to be provided on certain compliance principles which may be applied in a scenario where the selected assets do not have a higher credit risk profile, as drafted, the provision could be read to effectively shift the onus of demonstrating compliance under article 6(2) of the Securitisation Regulation to the originator. This does not seem consistent with the wording of article 6(2). Moreover, given that a range of scenarios may arise, greater flexibility is required with respect to the ways in which an originator may demonstrate that the required element of intent under the restriction is not satisfied. The necessary drafting changes to the current proposals to reflect these comments are set out below.

> "*Article 16(3). If a competent authority finds evidence suggesting contravention of the prohibition in Article 6(2) of Regulation (EU) 2017/2402 and no communication as set out under paragraph 1 has been made, an originator may demonstrate that ~~shall, in the absence of evidence to the contrary, not be considered to have satisfied~~ the intention requirements in Article 6(2) of Regulation (EU) [XXX/201X] are not satisfied and, therefore, that the originator is not ~~shall not be~~ in breach of the prohibition in that paragraph if it ~~proves~~ provides information on actions taken which are inconsistent with those intention requirements being satisfied such as by showing that it has established and applied policies and procedures (such as appropriate asset eligibility criteria) to ensure that the securitised assets would reasonably be expected not to lead to higher losses than the losses on comparable assets held on the balance sheet of the originator, provided that the criteria defined in the originator's policies and procedures are appropriate to that end.*"

Lastly, to confirm, we support the inclusion of clarification in recital (11) of the draft technical standards that the adverse selection restriction should not apply in circumstances where there are no comparable assets involved. This provision would be helpful to remove any doubt in this regard.

Question 6: Do you consider that the provisions of Article 17 of the draft technical standards relating to a change of retainer are adequate?

AFME members have significant concerns with article 17 of the draft technical standards as drafted.

In particular, concerns have been raised with respect to the seemingly mandatory nature of article 17 (given the use of the word "shall" in the drafting) as the imposition of a retention obligation on another eligible retainer during the life of the transaction is regarded to be highly problematic. AFME members consider that there should be *flexibility* for a change to be made in the retainer only. This position is consistent with our comments above in item D of the response provided to Q1.

Concerns have also been raised with respect to the circumstances in which article 17 would apply if it was amended to be permissive only (which, as noted above, is the only basis upon which AFME members would support the inclusion of the provision).

By referring to only circumstances involving changes in the holding of the retainer or legal reasons beyond the retainer's control, the likelihood of the provision potentially coming into play seems low. Moreover, certain imaginable scenarios where flexibility for change would seem appropriate are unlikely to be captured, such as retainer insolvency or more generally where a sponsor retainer no longer holds a management role in respect of the relevant securitisation.

In addition, the intended interaction between article 17 and the prohibition on hedging or selling the retained interest (including the corresponding guidance in article 12) should be clarified. We consider that this could be achieved through the addition of a statement to article 17 confirming that a change in accordance with the article will be deemed not to breach the prohibition.

To address these various concerns, we would suggest that article 17 should be revised as set out below. We also set out below suggested wording related to our response to Q5 above (see the second paragraph below). This wording is intended to clarify that, in a retainer insolvency scenario where the retained interest is subsequently transferred to another, no compliance issues should arise (for the retainer or for existing or prospective investors in the securitisation) on the basis that the retainer has effectively suffered a full loss in respect of the relevant interest and the retention requirements should be regarded to be fully satisfied.

> "*Where exceptional circumstances arise in respect of the retainer such that it may no longer be an appropriate entity to which the interests of investors should be aligned and/or the retainer no longer satisfies all relevant conditions for constituting the retainer~~the retainer is, due to the transfer of a direct or indirect holding in the retainer or for legal reasons beyond its control and beyond the control of its shareholders, unable to continue acting as retainer~~, the remaining retained material net economic interest may~~shall~~, instead, be retained by another entity which, had the securitisation been closed as of the date when such entity becomes the retainer, would have satisfied all relevant conditions for constituting the retainer (except, where relevant, for any requirement for the relevant entity to have established the ABCP programme or other securitisation).*
>
> *In the event of the insolvency or prospective insolvency of the retainer and a subsequent transfer of the remaining retained material net economic interest to another entity (regardless of the nature of that entity), the requirements in Article 6 of Regulation (EU) 2017/2402 shall be deemed to be fully satisfied.*

<u>Retainers shall be deemed not to be in breach of the prohibition on hedging or selling the retained interest (including the provisions of Article 12) if a change is made in accordance with this Article 17.</u>"

To be clear, without these changes, we do not consider article 17 to be adequate and we would instead anticipate that it would give rise to potential issues.

Please refer to the response to Q2 above for our comments on the disclosure obligations which should arise where reasonably practicable in a scenario where a change in retainer occurs under article 17.

Question 7: Should the draft technical standards contain any additional guidance on the operation of Article 14 of Regulation (EU) No 575/2013?

As a starting point and in keeping with our related comments above in item D of the response to Q1, we note that AFME members consider it to be essential that article 14 of the Capital Requirements Regulation is amended such that only the investor due diligence obligations will apply to EU regulated banks on a consolidated basis.

The significant issues which will arise if the risk retention requirements set out in article 6 of the Securitisation Regulation are applied on a consolidated basis should not be underestimated. In this regard, we refer to our comments above and also to the AFME briefing paper on article 14 prepared in October 2017 and updated in March 2018 (enclosed with this response).

Assuming that article 14 is amended to refer to application of the investor due diligence obligations only on a consolidated basis, we strongly support the pursuit of article 2(4) of the draft technical standards as proposed. The provision of continuity in this regard with the current regime is essential for compliance with the due diligence obligations on a consolidated basis under the new regime.

Question 8: Do you consider that wording similar to that which is set out in Article 5(1)(a) of Commission Delegated Regulation (EU) No 625/2014 relating to revolving securitisations should be maintained in these technical standards?

Yes, we consider that this wording should be maintained. AFME members strongly support the general approach of ensuring that the current risk retention technical standards are carried over in the new standards.

While we appreciate that the critical need for the wording relating to revolving securitisations in article 5(1)(a) is reduced given that the originator's interest holding option has been clarified in the Securitisation Regulation to be available in the context of revolving securitisations in general, it is possible that certain existing repeat issuance arrangements (or other legacy arrangements that may be brought within the scope of the new regime through creation of a new securitisation position) will have relied on the current guidance set out in article 5(1)(a) and, as a result, identified the vertical slice holding option as the selected modality in respect of the transaction retention arrangement.

Given that the technical standards indicate that the selected holding option is not permitted to change but for in exceptional circumstances (which may or may not include the scenario in question), we consider that the current wording should be maintained as this mitigates the risk of compliance confusion arising under the new regime.

Please see our related comments above in items A and D of the response to Q1.

Question 9: Do you consider that guidance is required on what constitutes a significantly lower performance for the purposes of Article [6(2)] of the STS Regulation and, if so, what would you propose?

No, on balance, AFME members do not consider that guidance is required on what constitutes "significantly lower performance" for the purposes of article 6(2) of the Securitisation Regulation.

We consider that it would be most appropriate for this to be assessed in the context of the relevant assets and transaction in question. The principles proposed to apply to assess compliance as set out in article 16 of the draft technical standards will assist originators in general with finding a way forward under article 6(2). Please refer to the response to Q5 above for further comments on these principles.

Association for Financial Markets in Europe

Briefing Paper March 2018

The new securitisation framework and its impact on Article 14 Capital Requirements Regulation: new and unintended extra-territorial impact

Executive Summary

AFME supports the work undertaken by the European Commission and the co-legislators in reaching an agreement on the regulation laying down common rules on securitisation (the "Securitisation Regulation") and on the corresponding regulation amending the Capital Requirements Regulation (the "CRR Amendment Regulation"). These regulations will apply from 1st January 2019.

The current position

Part Five of the Capital Requirements Regulation (the "CRR") imposes certain obligations on relevant institutions involved in securitisation transactions as investor or as originator or sponsor: to undertake due diligence to a certain standard (including with respect to risk retention), to comply with certain credit granting standard-related obligations and to make certain disclosures (the "CRR Obligations").

Under the current regime, each of the CRR Obligations generally applies on a consolidated basis to European banks and relevant investment firms. When this was first proposed under the precursor CRD2 regime, concerns were raised by market participants that this application basis created an extra-territorial reach such that a third country consolidated entity (for example, the US subsidiary of a European bank) was brought within scope and, from an investor perspective, this would be the case, for example, even if the third country entity was trading US credit card asset-backed securities in New York, backed by receivables originated in the US by a US originator and with underlying US resident obligors. The effect was thus to force such third country consolidated entity to comply with onerous obligations arising under EU law notwithstanding the significant compliance challenges that would arise for non-EU entities in connection with this, particularly in the context of the more detailed investor due diligence requirements (including the indirect risk retention requirements).

The concerns raised by market participants were acknowledged by the EU authorities especially with regards to the requirements on due diligence (including indirect risk retention) and the issue was consequently addressed by guidelines made by the Committee of European Banking Supervisors (CEBS). When the CRD4 recasting process took place, the issue was again acknowledged and certain key principles referred to in the relevant provisions of the CEBS guidelines were carried over via Article 14(2) of the CRR and Article 2(4) of Regulation No. 625/2014 (the "Retention RTS"). These provisions provide essential flexibility under the current regime.[1]

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[1] Article 14(2) of the CRR indicates that banks shall apply an additional risk weight on a consolidated or sub-consolidated basis if the requirements set out in article 405 or 406 of the CRR (being the investor due diligence obligations, including the current indirect risk retention requirements) are breached at the level of an entity established in a third country included in the regulatory consolidation if the breach is material in relation to the overall risk profile of the group. Article 2(4) of the Retention RTS broadly provides for compliance flexibility under the risk retention requirements in the context of market making activities by allowing relevant entities to take account of the materiality of the investment in the context of the overall risk profile of the group.

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Today's issue

The Securitisation Regulation creates new and in many respects enhanced versions of the CRR Obligations. An unexpected and unintended consequence of Article 1(11) in the CRR Amendment Regulation, which makes amendments to Article 14 of the CRR, is that these new obligations (plus the ban on re-securitisations) will be generally applied on a consolidated basis. This is the case seemingly without the necessary compliance flexibility being available under the new regime in respect of all of the relevant requirements.

Consolidated application of the new and enhanced requirements re-creates the issue of extra-territorial reach on a heightened basis. This has serious consequences: unless addressed, EU banking groups operating in third country jurisdictions will be placed at a significant competitive disadvantage as compared to domestic (non-EU) entities operating in those jurisdictions, calling into question the viability of these business lines conducted in third countries and creating unlevel playing field issues.

We do not believe this is the intended policy objective. We therefore ask for limited further amendments to be made to Article 14 of the CRR and for Article 2(4) of the Retention RTS to be carried over and updated (whether as part of the technical standards to be made under the direct retention requirements or otherwise): our suggested drafting is set out in the Appendix. We ask that this be achieved via whatever legislative route legislators feel is appropriate in order to avoid this damaging result, however, we consider that it is essential that a fix be certain when the new regime applies from the start of 2019.

Background and proposed solution

In summary, Article 1(11) of the CRR Amendment Regulation amends Article 14 of the CRR by replacing the references to "Part Five" with references to "Chapter 2" of the Securitisation Regulation.[2] Therefore, as noted above, the new and enhanced investor due diligence, risk retention, transparency and credit granting standard obligations under the Securitisation Regulation, as well as the ban on re-securitisation, will generally apply in respect of EU regulated banks and relevant investment firms on a consolidated basis.

Other than in the context of investor due diligence, the application of such new and enhanced requirements and the ban on re-securitisation on a consolidated basis gives rise to significant concerns as described below. While we strongly consider that Article 14(2) of the CRR should still apply to provide flexibility in the context of the recast investor due diligence obligations (including the recast indirect risk retention requirements) and the direct retention obligations,[3] it is not helpful that this article has not been clearly updated to reflect the Securitisation Regulation and the current wording risks creating confusion.

AFME members consider that the solution is to make further amendments to Article 14 of the CRR such that only the recast investor due diligence obligations under the Securitisation Regulation (and not the direct risk retention, transparency or credit granting standards requirements, or the ban on re-securitisation) apply in respect of EU regulated banks and relevant investment firms on a consolidated basis. However, the application of the due diligence obligations on this basis should involve clarification of Article 14(2) to refer to the appropriate updated cross-references under the

2 This chapter includes the recast investor due diligence, risk retention and transparency obligations.

3 Article 14(2) cross-refers to current Articles 405, 406 and 407 of the CRR which will be repealed via the CRR Amendment Regulation.

Securitisation Regulation. In addition, it is essential that the existing guidance set out in Article 2(4) of the Retention RTS on compliance by consolidated entities with the indirect risk retention obligations is also carried over.

Our specific suggestions with respect to the necessary revisions and updates to each of Article 14 of the CRR and Article 2(4) of the Retention RTS are set out in the Appendix.

Investor due diligence requirements (Article 5)

As noted above, under the current CRR regime, the investor due diligence obligations (including the indirect retention requirements) are applied on a consolidated basis and the flexibility given in Article 14(2) of the CRR (as well as the guidance provided under Article 2(4) of the Retention RTS with respect to the indirect risk retention requirements) ensures that this does not create significant issues for EU banking groups.

To be clear, in the absence of this flexibility, consolidated application of the investor due diligence requirements would operate as an effective restriction on the ability of EU banking groups (acting through third country consolidated entities such as broker-dealer subsidiaries) to remain active in important non-EU securitisation markets. This is because transactions done in these non-EU markets are unlikely to be structured to be compliant with EU risk retention rules as a matter of course (indeed the only EU connection may be through the broker-dealer sitting within a consolidated group of an EU regulated bank). Heightened compliance challenges arise under the recast investor due diligence requirements under the Securitisation Regulation given that they also cross-refer to compliance with the transparency obligations under the Securitisation Regulation, which domestic transactions in third countries are also unlikely to reflect as a matter of course.

Indeed, without appropriate flexibility, consolidated application will result in EU banking groups being placed at a significant competitive disadvantage as compared to domestic (non-EU) entities operating in third country jurisdictions, calling into question the viability of these business lines conducted in third countries. As noted above, the issues in this regard were acknowledged under the current regime and addressed through Article 14(2) of the CRR (and Article 2(4) of the Retention RTS with respect to the indirect risk retention requirements).

As a result of the foregoing, given that the recast investor due diligence obligations will apply on a consolidated basis, to avoid any possible confusion, Article 14(2) of the CRR should be updated to cross-refer to Article 5 (Due diligence requirements for institutional investors) of the Securitisation Regulation. In addition, with respect to the indirect risk retention obligations, it is essential that the existing guidance on compliance by consolidated entities with the current requirements, which guidance is set out in Article 2(4) of the Retention RTS, is carried over under the new regime (whether as part of the technical standards to be made under the direct retention requirements or otherwise).

Risk retention requirements (Article 6)

As noted above, under the current CRR regime, the *indirect* retention requirements (as well as the other investor due diligence obligations) are applied on a consolidated basis. EU banking groups operating in third countries are able to make this work as a result of the flexibility provided by Article 14(2) of the CRR and Article 2(4) of the Retention RTS, the latter of which allows for compliance flexibility in the context of market making activities and functions sensibly in an investment scenario.

The application of the *direct* retention requirement on a consolidated basis gives rise to heightened issues for consolidated entities operating in third countries and the investment focused guidance provided under Article 2(4) of the Retention RTS would not address these concerns. In effect, consolidated application of the direct retention requirement will require a third country consolidated entity undertaking activities in its home country which result in that entity being an originator, sponsor or original lender in respect of a third country securitisation transaction to comply with the EU retention requirements. Domestic (non-EU) entities operating in that third country will not be so affected. An example of a relevant third country consolidated entity in this context could include a U.S. established subsidiary of an EU bank operating in the U.S. securitisation market.

It should be noted that compliance with the EU regime will be an *additional* obligation, applying on top of any local law retention requirements which may come into play, meaning that dual compliant retention arrangements may need to be identified and adopted by the relevant entity. While dual compliance is relatively straightforward as between the EU and U.S. regimes in the context of certain traditional securitisation structures, it is more complicated in the context of asset classes and structures which fit less easily into the retention template and in the context of transactions involving acquired portfolios. In all scenarios where dual compliance is necessary, the relevant entity would need to identify the more onerous standard as between the EU and U.S. regime and apply that standard.

It should also be noted that relevant consolidated entities will need to comply with EU retention requirements across a wide range of transactions. The securitisation definition which triggers the application of the EU requirements is very broad meaning that many different financing transactions involving credit risk tranching would be drawn in (including private transactions); these are unlikely to be regarded to be securitisations under local law requirements. This gives rise to heightened unlevel playing field issues for EU banking groups (via third country consolidated entities) seeking to conduct finance related business lines in third countries.

Transparency requirements (Article 7)

As noted above, under the current CRR regime, the transparency requirements set out in Article 409 of the CRR are applied on a consolidated basis. EU banking groups operating in third countries are able to make this work as a result of the principles-based nature of these requirements, which allows for a degree of compliance flexibility.

The transparency requirements under the Securitisation Regulation are fundamentally different from those set out in Article 409 of the CRR. Article 409 imposes a principles-based disclosure obligation: a high-level requirement to provide materially relevant data in respect of the underlying assets and cashflows and necessary information to conduct certain stress tests. In contrast, the transparency requirements under the Securitisation Regulation are detailed and specific, as they require (amongst other things) the provision of loan-level information via specified templates.

While it is possible for consolidated entities operating in third countries and undertaking securitisation activities in those countries to make necessary adjustments under a *principles-based obligation* to sensibly comply, this is far more difficult to make work under a *detailed disclosure standard*.

Under the current regime, a third country consolidated entity that is an originator in respect of a domestic securitisation is required to ensure that it provides all materially relevant data and to the extent that this is considered to extend to loan-level information, this may be done in the form considered appropriate by the originator for the relevant assets and taking account of any local law requirements. Under the coming regime, such an originator will be required to disclose loan-level information using the templates made under the Securitisation Regulation in general and this would be in addition to any applicable local requirements (which requirements may also require the provision of loan-level information in a particular form). We note that the templates made under the Securitisation Regulation are likely to reflect the nature of, and corresponding data fields appropriate for, common EU originated assets and as such they may not fully accommodate assets originated in other countries.

In addition to the compliance related issues described above, consistent with the position in respect of risk retention noted above, consolidated application of the transparency requirements will put EU banking groups operating at a competitive disadvantage compared to domestic entities operating in the relevant local market. The concerns referred to above with respect to the breadth of the securitisation definition also equally apply in the context of the transparency requirements.

Credit granting standard requirements (Article 9)

As noted above, under the current CRR regime, the credit granting standard requirements set out in Article 408 of the CRR are applied on a consolidated basis. EU banking groups operating in third countries are able to make this work as a result of the principles-based nature of these requirements and the fact that they focus only on consistency of standards as between securitised and non-securitised assets, which allows for a degree of compliance flexibility.

The credit granting standard requirements set out in Article 9 of the Securitisation Regulation are fundamentally different from those set out in Article 408 of the CRR. In particular, an additional sentence is included at the end of Article 9(1) which seems to impose an additional qualitative requirement with respect to the relevant standards applied as it refers to relevant entities having "effective systems in place to apply those criteria and processes [i.e. sound and well-defined criteria and established processes for approving etc. credits] in order to ensure that credit granting is based on a thorough assessment of the obligor's creditworthiness taking appropriate account of factors relevant to verifying the prospect of the obligor to meet his obligations under the credit agreement".

It is not clear why this wording has been added but we would note that it is similar to Article 18 of the EU mortgage credit directive in certain respects (notwithstanding that Article 9(1) of the Securitisation Regulation applies across all securitisations and is not limited in its application to transactions involving residential mortgage loans). Concerns arise with respect to the ability of third country consolidated entities acting as originators in respect of domestic securitisations to comply with this obligation with certainty given that local laws relating to credit granting standards and asset underwriting processes may be materially different. It is not clear why an additional EU based compliance standard for asset underwriting should be necessary for non-EU entities that will already be subject to local law requirements as considered appropriate by the relevant authorities in respect of that market.

In addition, the prohibition on securitising so-called self-certified residential mortgage loans in Article 9(2) of the Securitisation Regulation is new and does not form part of current Article 408 of the CRR. The application of this prohibition to third country consolidated entities is problematic. While borrower affordability assessment requirements have been an area of regulatory focus in the EU and potentially certain other countries, this may not track through in all relevant jurisdictions. In addition, even if the prohibition is clarified to only apply in respect of securitisations involving certain non-legacy self-certified loans, it is not clear that the date selected to identify relevant non-legacy assets would be appropriate in the context of other jurisdictions, meaning that this may not provide appropriate relief in a non-EU context.

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In addition to the concerns identified above, consistent with the position in respect of risk retention and transparency, consolidated application of the credit granting standard requirements will put EU banking groups at a competitive disadvantage compared to domestic entities operating in the relevant local market. The concerns referred to above with respect to the breadth of the securitisation definition also equally apply in the context of the credit granting standard requirements.

Ban on re-securitisation (Article 8)

As the new ban on re-securitisation sits in Chapter 2 of the Securitisation Regulation, this provision would also apply on a consolidated basis under Article 14 of the CRR. This is highly problematic given that the operative elements of the ban are unclear (i.e. it is not certain which entity the ban is intended to apply to, originators and sponsors, issuers and/or investors), meaning that consolidated entities operating in non-EU securitisation markets could be drawn in through undertaking various activites and notwithstanding that such a ban is unlikely to apply under local law in respect of their local competitors.

While re-securitisation activities have been limited in general across many common securitisation markets in recent years, the definition used to identify these arrangements may vary between jurisdictions and consolidated entities may operate in non-EU markets involving common transaction structures at risk of being regarded to be a re-securitisation under the EU definition. As a result, once again, the application of this provision of the Securitisation Regulation on a consolidated basis runs the risk of creating unlevel playing field issues.

Conclusion

We do not believe that the issues highlighted above reflect the intended policy objective.

We therefore ask for limited further amendments to be made to Article 14 of the CRR and for Article 2(4) of the Retention RTS to be carried over and updated (whether as part of the technical standards to be made under the direct retention requirements or otherwise): our suggested drafting is set out in the Appendix. We ask that this be achieved as soon as possible via whatever legislative route legislators feel is appropriate in order to avoid this damaging result however, we consider that it is essential that a fix be certain when the new regime applies from the start of 2019.

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APPENDIX

Revisions to Article 14 of the CRR and Article 2(4) of the Retention RTS

Article 14 CRR

Application of requirements of Article 5 [Due-diligence requirements for institutional investors] of Regulation (EU) 2017/2402 on a consolidated basis

1. Parent undertakings and their subsidiaries subject to this Regulation shall meet the obligations laid down in Article 5 [Due-diligence requirements for institutional investors] of Regulation (EU) 2017/2402 on a consolidated or sub-consolidated basis, to ensure that their arrangements, processes and mechanisms required by those provisions are consistent and well-integrated and that any data and information relevant to the purpose of supervision can be produced. In particular, they shall ensure that subsidiaries not subject to this Regulation implement arrangements, processes and mechanisms to ensure compliance with those provisions.

2. Institutions shall apply an additional risk weight in accordance with Article 270a when applying Article 92 on a consolidated or sub-consolidated basis if the requirements of Article 5 [Due-diligence requirements for institutional investors] of Regulation (EU) 2017/2402 are breached at the level of an entity established in a third country included in the consolidation in accordance with Article 18 if the breach is material in relation to the overall risk profile of the group.

3. Obligations resulting from Article 5 [Due-diligence requirements for institutional investors] of Regulation (EU) 2017/2402 concerning subsidiaries, not themselves subject to this Regulation, shall not apply if the EU parent institution or institutions controlled by an EU parent financial holding company or EU parent mixed financial holding company, can demonstrate to the competent authorities that the application of Article 5 [Due-diligence requirements for institutional investors] of Regulation (EU) 2017/2402 is unlawful under the laws of the third country where the subsidiary is established.

Article 2(4) Retention RTS

Institutions shall not be deemed to be in breach of ArticleArticle 5 [Due-diligence requirements for institutional investors] of Regulation (EU) 2017/2402 in accordance with Article 14(2) of Regulation (EU) No 575/2013 on a consolidated basis provided that the following conditions are met:

(a) the entity which holds the securitisation positions is established in a third country and is included in the consolidated group in accordance with Article 18 of Regulation (EU) No 575/2013;

(b) the securitisation positions are held in the trading book of the entity referred to in point (a) for the purposes of market making activities;

(c) the securitisation positions are not material with respect to the overall risk profile of the trading book of the group referred to in point (a) and do not form a disproportionate share of the trading.