7 July 2014

To: The Bank of England and the European Central Bank
Submitted via email to:
Securitisation2014@bankofengland.co.uk and
Securitisation2014@ecb.europa.eu

# Re: Response to the Discussion Paper: The case for a better functioning securitisation market in the European Union

On behalf of the Association for Financial Markets in Europe ("**AFME**")[1] and its members, we welcome the opportunity to respond to the discussion paper (the "**DP**") entitled "The case for a better functioning securitisation market in the European Union" published by the Bank of England (the "**BoE**") and the European Central Bank (the "**ECB**" and, together with the BoE, the "**Central Banks**") and finalised on 29 May 2014.

AFME and its members would like to thank the Central Banks for producing a carefully thought-out and constructive discussion paper. Even though many discussion papers and consultation papers on individual pieces of legislation and policy affecting the securitisation markets have been published over the last several years, the DP makes a particularly worthwhile contribution because it examines the broader landscape and contributes significantly to encouraging the creation of vibrant, meaningfully reformed securitisation markets as a tool for funding the real economy. Although it has been apparent for some time that policy-makers within the European Union have recognised the positive impact securitisation can make market participants are very encouraged that the Central Banks have taken this concrete step to identify the factors preventing a revival of a sustainable securitisation market and to address the relevant impediments.

It is also worth noting that the DP is perhaps the most evolved attempt thus far to bring together disparate conversations that have been taking place about the concept of "high quality" or "qualifying" securitisation, how it should be defined and the consequences of falling in (or out) of such a classification. While it has been useful to date for that conversation to be wide-ranging and inclusive, it is necessary

[1] AFME represents a broad array of European and global participants in the wholesale financial markets, and its 197 members comprise all pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME was formed on 1 November 2009 by the merger of the London Investment Banking Association and the European operations of the Securities Industry and Financial Markets Association. AFME provides members with an effective and influential voice through which to communicate the industry standpoint on issues affecting the international, European and UK capital markets. AFME is the European regional member of the Global Financial Markets Association (GFMA) and is an affiliate of the US Securities Industry and Financial Markets Association (SIFMA) and the Asian Securities Industry and Financial Markets Association (ASIFMA). AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

in order for it to bear fruit that discussions should be brought together in a forum that is capable of producing credible policy proposals with the necessary political backing to produce real outcomes in a relatively short timeframe. The forum created by the Central Banks via the DP is clearly very helpful in this regard.

Finally, AFME welcomes the IOSCO and the Basel Committee on Banking Supervision market survey on broadly similar themes to those touched on in the DP, albeit at a more general level. We believe both exercises are beneficial, with the DP more likely to produce concrete results in Europe in the near to medium term and the IOSCO/BCBS survey likely to influence the long term direction of regulation at a global level.

Our substantive response consists of overall comments, followed by our answers to the 18 specific questions posed by the DP. The annex hereto contains our detailed thoughts on the proposed criteria set out in Box 3 of the DP for determining whether a particular transaction is a "qualifying securitisation". Should the Central Banks wish to discuss any aspect of our response in further detail, we would be pleased to arrange this.

## A. Overall Comments

As a general matter, AFME and its members agree with the analysis presented by the Central Banks in the DP. We believe it effectively sets out the principal benefits of a well-functioning securitisation market and the principal impediments to the development of such a market.

It is, of course, important to AFME and its members that this important work being undertaken by the Central Banks should be coordinated with other workstreams already in existence. Not least of these are EIOPA's development of level 2 standards under Solvency II for investments by insurance undertakings, the workstreams of the EBA on defining "high quality securitisation" and on the recognition of significant risk transfer in securitisations, continuing analysis of the eligibility of securitisations as HQLA in the LCR and the ongoing revisions to the Basel Securitisation Framework by the Basel Committee on Banking Supervision (and the EU's eventual implementation thereof) and the FSB's ongoing work on shadow banking (and its securitisation workstream in particular). If the thinking developed via the DP and the responses thereto is to be effectively implemented, the themes developed will need to feature in the final rules resulting from these workstreams (among others) as well.

AFME and its members also agree in broad terms that defining a sub-category of securitisations for differential treatment on the basis of transparency and predictability (which, for the sake of simplicity, we will call "qualifying securitisations" or "QS", though please note our comments on the neutrality of terminology below) would be a helpful development. Indeed, the objectives and the achievement of the joint work undertaken from 2009 to 2012 by the European Financial Services Round Table ("**EFR**") and AFME to develop and launch the European Prime Collateralised Securities ("**PCS**") label were based on and consistent with this principle. Further thoughts on this are reflected in our detailed responses below, but we feel it helpful to outline the broad features that we feel are important to make the most of this development:

a) The first of these features is that the language used to describe qualifying securitisations should be as neutral as possible. In this respect, we find the Central Banks' use of the term "qualifying securitisation" preferable to the more broadly used term "high quality securitisation". AFME would recommend, however, that this principle be taken even further (resulting in an approach not unlike the proposed EIOPA terminology) and that the labels attached to the different kinds of securitisation be along the lines of "category 1" and "category 2" or "category A" and "category B". This would preserve the ability of regulators and market participants to quickly and easily distinguish between qualifying securitisations and others, which is the key policy driver behind the suggestion. It would also avoid the potential pitfall of the "high quality securitisation" approach which may implicitly shift the burden of stigma from the securitisation market as a whole onto that sector of the market which would fall outside the definition of "high quality securitisation" and hence by implication become "low quality" or "non-qualifying" securitisation even when the actual assets in the ineligible securitisation could not be regarded as problematic or poor quality. A further benefit would be to increase the level of market support for the creation of a qualifying securitisation category because those parts of the market that might not be eligible for better regulatory treatment would be less inclined to oppose it.

b) The second key positive evolution in the Central Banks' proposals for qualifying securitisations as compared to previous proposals is the Central Banks' transaction-based approach. Previous proposals have almost uniformly been tranche-based, with only the most senior tranche of any given transaction being allowed to qualify. This tranche-based approach implies that the purpose of qualification is to reduce or eliminate risk. One of the chief virtues of the Central Banks' proposals is their focus on transparency and the ability to understand and model risk, rather than an attempt to reduce or eliminate risk. The function of any efficient market is to price and allocate risk, not to eliminate it. In the case of the securitisation markets, the risk that ought to be priced and allocated is the credit risk of the underlying assets, as modified by the structuring of the transaction (via tranching and credit-enhancements such as swaps and liquidity facilities). It follows that investors need the information necessary to properly assess those risks and their ability to bear them so they can price the risk accurately. That makes requirements relating to simplicity, loan-level data and general ability to model the risk sensible and appropriate. Qualifying securitisations should not be risk-free, and should not give the impression of being risk-free. Rather, the badge of "qualifying securitisation" ought to represent a belief that the risks are capable of being modelled reliably by the targeted investor base using the information made available to them.

c) The third broad area on which AFME and its members wish to comment is to note that the term "securitisation" used in its CRR sense, is a very broad term and the criteria suggested, while broadly sensible, do not always take full account of this. An example of an important area that may not have been given full consideration by the Central Banks is asset-backed commercial paper. Although ABCP conduits are "securitisations" in the regulatory sense, they do not fit the paradigm of a securitisation we imagine the Central Banks will have had in mind when developing the criteria in Box 3. As a result, ABCP would not be a QS under the Central Banks' proposals despite the fact that it delivers many of the benefits of securitisation outlined in the DP (e.g. funding trade receivables and other real economy assets, diversification of funding sources for non-bank clients and warehouseing of assets for later ABS transactions), its robust structure (featuring, e.g. significant overcollateralization and retention by originators of a dynamically adjusted first-loss tranche) and the fact that most conduits are supported by strong sponsor banks. The definition of "securitisation" has long caused problems of this sort, so adjusting that regulatory definition may be the most sensible solution to this issue. Alternatively, AFME would urge the Central Banks to adjust the criteria to recognise positively the special structural considerations associated with the ABCP market.

d) The fourth key aspect of an effective regime for qualifying securitisations is that there should be certainty surrounding the categorisation of each transaction. Given the importance of the mooted effects of being a qualifying securitisation (or not), parties to a securitisation transaction need to be able to have a high degree of certainty early on as to whether the transaction is likely to fall within that category. This will affect structuring, marketing and a host of other matters that become much more difficult and costly to change after the initial steps of putting together a transaction have taken place. Equally, it is crucial that investors know early in the investment decision process whether they are reviewing a qualifying securitisation or not and that they should be able to rely on that categorisation absent a subsequent change in the transaction itself (e.g. the failure of the transaction parties to provide ongoing asset disclosure).

e) The fifth key aspect of an effective regime for qualifying securitisations is that determinations should be timely. The categorisation process should not unduly delay the overall issuance process and it should be clear at the beginning of the marketing process for any securities whether a securitisation will be a qualifying securitisation or not. To draw an analogy, at the moment, it can sometimes take up to several weeks after issuance before it becomes clear whether a securitisation will be accepted as eligible

collateral for the purposes of either of the Central Banks' liquidity operations. This is not helpful, so if the concept of qualifying securitisations is to have an effect on marketing, pricing and initial liquidity of an instrument, it must be clear based on formal feedback from the certifying body that it will be a qualifying securitisation prior to the marketing process. In this context, we would note that if private sector involvement in the administration of QS were to be adopted by the relevant authorities then it would be relevant that this is how the PCS scheme currently operates and we understand that the infrastructure that it has in place for certifying compliance with PCS criteria could readily be adapted to the proposed criteria for QS in the DP.

In order to address points (d) and (e) above, AFME recommends as a general matter that the criteria should be clear and precise so that, so far as possible, a "tick box" approach to compliance can be used. Clearly, a level of discretion and judgment will be required in order that any new innovation in the securitisation market should not immediately cause transactions to fall out of the category of qualifying securitisations.

AFME would urge the Central Banks to bear the above in mind when formulating a mechanism for categorisation of transactions. See our response to question 7 below for more detail on this point.

## B. Answers to Specific Questions

### 1. *Do respondents agree with the benefits of a well-functioning securitisation market as outlined in Section 2?*

Yes, we believe the benefits outlined are comprehensive and thoughtful.

**Paragraph 37** notes the relatively short maturities of market-placed ABS. The European ABS market is of course almost entirely floating-rate. It is difficult to place bonds with maturities of more than say, a weighted average life of 7 years with bank or other funded investors as their risk appetite tends to peter out beyond this maturity. From a structural point of view, creating a fixed rate issue with predominantly floating rate assets (as most European assets are, ultimately) is difficult outside master trusts, which in turn place heavy reliance on substitution. The reduced availability and increased cost of interest rate and currency swaps further reduces structuring flexibility. Increasing insurer investment appetite is probably more easily achieved by going down the credit spectrum than by seeking to create a fixed-rate market.

**Paragraph 39 Encumbrance:** it is particularly encouraging to see this noted as a "benefit" of (or being less significant for) securitisation as we believe this positive aspect of securitisation as a technique is not sufficiently noted by regulators.

**Paragraph 50:** we agree that different objectives may require different market characteristics. AFME is in favour of a "modular" approach to the definition of "qualifying securitisations", namely a "core" definition comprising key principles,

to which could be added additional requirements or "filters" intended to address specific requirements. For example, an entire transaction might qualify as QS but only the senior tranche would qualify as being HQLA under the LCR.

*2. Do respondents agree with the impediments to and economic concerns of investors that have been identified? Do respondents think that there are any additional impediments to investors, and if so, what are they?*

Broadly, yes. We believe the paper identifies the key impediments which are also listed in AFME's June 2014 paper: "High quality securitisation for Europe: the market at a crossroads." We are encouraged by the progress that has been made to date in the discussions around Basel 269, Solvency II and (we hope, although official information has not been published) the inclusion of a wider range of securitisations than just some forms of RMBS as HQLA in the LCR.

**Paragraph 74 risk retention:** this rightly identifies inconsistent implementation of risk retention requirements across jurisdictions. However, impediments also exist within the EU but across different types of investors, for example between the CRR rules for bank investors, the AIFMD rules for AIFMs and the Solvency II rules (still relatively nascent) for insurers. There is no sensible reason why these could not be made entirely consistent save for adjustments necessary to reflect the unique characteristics of the different types of investors involved. Please refer to AFME's "Initial response to EBA questionnaire on the securitisation risk retention, due diligence and transparency requirements" dated April 22nd 2014 for more detail on this point.

**Paragraph 77 behavioural constraints:** this again makes a good point. Within investor firms, greater participation in securitisation investment has been far from a career-enhancing recommendation in recent years. The stigma needs to be removed and replaced by more positive signalling. This is beginning to happen and the recent announcement by the ECB of their consideration of an ABS purchase programme will no doubt help in this regard (even if there are some longer term reservations about the possible "crowding-out" effects).

**Paragraph 78 risk assessment and management:** it is axiomatic that securitisation is (and should be) a data-rich form of investment.

Indeed, standards of disclosure have always been very good in mainstream securitisation. Problems emerged during the crisis in CDOs: drilling down into the underlying data of dozens of different ABS issues was not possible – or practical – encouraging over-reliance on credit ratings. AFME's members support sensible, useful and practical disclosure in compliance with the Prospectus Directive, the CRR and other applicable legislation. However, over-emphasis on "transparency" as the single answer to the industry's problems – especially repeated new transparency regulation of areas already regulated for transparency - can risk diverting attention from other issues holding back the market.

Information disclosure has also increased markedly in recent years: ECB and Bank of England loan-level data requirements; investor reports, cashflow models and transaction summaries; underlying legal documentation (suitably redacted

to protect reasonable commercial confidentiality); CRR requirements supported by EBA "principles-based" guidance.

However, rather than repeated new regulation from different sources, we believe future attention in this area should be focused on improving compliance with and consistency of existing requirements; improving the quality of data, not just the quantity; making the data already available more "user-friendly" for investors; and facilitating, rather than hindering, cross-border flows between regions, through mutual recognition or substituted compliance of loan-level data templates and other requirements.

**Paragraph 82 long-dated fixed or predictable cashflows:** this can prove challenging – see the structuring challenges listed in the answer to question 1, Paragraph 37 above.

The newly announced TLTRO is the latest proposal that industry fears could have the unintended consequence of reducing issuance even further with the knock-on effect of discouraging the entry of new investors who will not commit resources for investments in a tiny market. Established investors may also consider exiting the market for the same reason.

A final impediment to the development of sustainable securitisation markets is capital treatment and the lack of a level playing field between investors in the current legislative proposals. Capital treatment of securitisation investments is clearly a major factor in investment decisions. Despite some progress, both the latest proposals for a revised Basel Securitisation Framework and the proposed treatment of securitisations under Solvency II remain unfairly punitive and create an unlevel playing field both between different kinds of investors and between different kinds of assets with similar credit risk.

3. *Do respondents agree with the impediments to and economic concerns of issuers that have been identified? Do respondents agree that the infrastructure concerns raised above affect the economics of securitisation? Do respondents think that there are any additional impediments to issuers, and if so, what are they?*

Broadly, yes. We believe the paper identifies the key impediments.

**Paragraph 89 reliance on CRAs:** See answer to question 13 below.

**Paragraph 91 availability of ancillary facilities:** on swaps, it is critical that an appropriate exemption is created for securitisation swaps (as it has been for covered bonds) in EMIR. This is an issue which AFME is addressing in detail in its response to the joint ESAs consultation on draft Regulatory Technical Standards on risk-mitigation techniques for OTC-derivatives not cleared by a CCP under Article 11(15) of Regulation (EU) No 648/2012 which has significant implications for swaps entered into in connection with securitisation transactions. Responses are due by July 14th 2014.

On issuer accounts and GICs: To the extent it is practical and the cost of implementing it is proportionate in the specific jurisdiction, any specific legislation to facilitate the creation of bankruptcy-remote accounts would be of great assistance. It would reduce legal uncertainty, help simplify structures and

lower required enhancement levels thereby increasing the attractiveness of securitisation for both investors and issuers. The recent changes made in Italy and France in this context are instructive, as is the US concept of segregated trust accounts in a bank's trust department.

**Paragraph 92 alternative funding conditions:** while the reasons for the official sector schemes are understood, and are driven by wider macro-economic policy objectives, their effect in dampening securitisation issuance should not be underestimated. Funding and capital pressures will only intensify if a framework to encourage the recovery of securitisation in Europe is not in place in time to play a larger role, as such schemes are withdrawn.

*4. Do respondents agree that market liquidity may be a barrier to a well-functioning securitisation market?*

We believe the question should be read as asking "Do respondents agree that the *absence of* market liquidity may be a barrier to a well-functioning securitisation market?" If so, the answer is no.

As AFME has argued many times in the context of the LCR, liquidity is not the same as secondary trading. The securitisation market may function perfectly well with relatively little secondary trading and still be liquid in the sense that assets can be converted into cash in a short (say, 30 day) period if this is required.

A number of regulators have disagreed with AFME over this issue in recent years, citing the financial crisis and SIV unwind as evidence of the fact that securitisation is a fundamentally illiquid product. Much can be said in response to this view: selective use and partial interpretation of data, failure to take into account institutional support for secondary trading in certain other fixed income sectors, and so on. At the end of the day, during the deepest phases of the financial crisis, high quality short-dated ABS not linked to mortgage risk was one of the easiest asset classes to sell. See "AFME briefing note on market behaviour and securitisation price volatility" dated March 2014 for further comment on this topic. Also, Perraudin "Covered Bond versus ABS liquidity" (January 24th 2014) and "High quality securitisation: an empirical study of the PCS definition (May 2014) available here

*5. The view of the Bank of England and the ECB is that a 'qualifying securitisation' should be defined as a security where risk and pay-offs can be consistently and predictably understood. Do respondents agree with this definition? What characteristics of a 'qualifying securitisation' not already included in the principles in Box 3 should warrant such treatments? Do respondents have any comments on the principles in Box 3?*

See overall comments above and the annex to this letter.

*6. Do respondents think that a liquid market for 'qualifying' securitisations used for funding would result from a 'qualifying certification'?*

A "liquid market" is difficult to define, and in any event it is difficult to predict the future. As stated above, a "liquid market" is not necessarily the same thing as a market in which frequent secondary trading occurs. Many investors in European ABS are buy and hold investors, who are not concerned by the need to trade their investments actively. Having said that, even buy and hold investors need access to liquidity to protect them from market volatility during stressed market conditions. Considerable assistance in the recovery of the market in this regard would be provided by a positive outcome in the treatment of ABS under the LCR (at the time of writing this remains uncertain). If, as AFME has consistently argued for many months, a broad rather than a narrow range of high quality, or qualifying, securitisations were included as HQLA in the LCR, a virtuous circle would be created and more active trading could result. In a similar vein an ABS purchase programme for qualifying securitisations with the Central Banks acting as "purchasers of last resort", could underpin banks' market making activities, sending a powerful message to encourage more active participation in the market. After all, the bulk of losses on European securitisation incurred during 2007-08 were due to mark-to-market requirements rather than actual credit losses.

*7. These principles may then provide a framework to aid various authorities and market participants to set their own eligibility criteria. How might such a framework be developed? What role could the appropriate authorities play in the process of certifying that a transaction is a 'qualifying securitisation'? What are the associated risks?*

AFME very much welcomes the interest of the authorities in developing a framework based on defined principles of QS. It is crucial for industry and policymaker discussions of the concept of QS to converge in a single forum, where we can all work together constructively in a co-ordinated way. The objective will be to reach an agreed standard that can be applied widely, usefully, easily and clearly to help revive the market.

We suggest the authorities first appoint a single regulator or supervisor to lead and co-ordinate the work (for example, the EBA – who have already begun this work). Secondly, such lead authority should engage widely and extensively with issuers, originators and sponsors as well as investors, underwriters and important third party advisers such as law and accounting firms. If it would be helpful for AFME to establish a small technical working group selected from its members and reflecting the diversity of our membership to assist in these discussions we would be delighted to do so. This need not, of course, rule out selected bilateral discussions that the lead authority might wish to initiate. Thirdly, we suggest that a timetable should be established with a target date for conclusions to be reached, and regular meetings scheduled to achieve this. Discussions should use as a good starting point the criteria developed by EIOPA in its December 2013 report.

In terms of a role for the authorities, it is suggested that the authorities should play a supervisory role in determining the criteria for a QS, and then appointing and regulating one or more independent, credible bodies to issue certifications. A number of bodies already exist to assign similar labels in the debt capital markets. To the extent that they are willing and able to administer the criteria for qualifying securitisations eventually decided upon, they are natural candidates to act as certifying bodies. Of these bodies, the PCS label is the only Europe-wide securitisation label and resulted from the work undertaken from 2009 to 2012 involving a broad range of European market participants (arrangers, originators, investors and legal experts) led by EFR and AFME. As such, and also because PCS has been designed to be responsive to the needs of issuers and investors in terms of giving certainty around the receipt of the label for marketing purposes (as mentioned above), PCS is an obvious and strong candidate to act as a certifying body. True Sale International (TSI) and the Dutch Securitisation Association (DSA) are other securitisation labels but currently only have a national scope. The lead regulator should also play a supervisory role, reviewing the criteria regularly to adapt to market evolutions, ensuring that standards are applied uniformly and regulating the conduct of the certifying bodies generally.

Regarding the risks: much work remains to be done, and there remain difficult challenges to resolve – for example, how to avoid cliff effects; how to address the different motives and requirements of different stakeholders; and how to strike the right balance between meeting the needs of the real economy while maintaining high quality. There will also be a need to avoid political interference: the history of the growth of the sub-prime mortgage market in the US is instructive in this regard. It needs to be very clear that the definition of QS is not a "badge of regulatory approval" or a rating, and that it should not be used as a substitute for proper due diligence and credit analysis.

*8. Do respondents think that harmonisation and further conversion software could bring benefits to securitisation markets? If so, which asset classes should be targeted? How can accessibility to the existing loan level data be improved, so that it provides most value to investors?*

AFME believes that harmonisation of data templates and formatting would be a positive development. Investors frequently point out to us that while it is useful having loan-level data available from the European DataWarehouse or the Bank of England, the data is not always available in a user-friendly format. The differences (IT, technical and in substantive content) between the two platforms are also not helpful and it is good that this is noted in your paper. We have also heard that technical difficulties have sometimes resulted in data being corrupted when being uploaded to the European DataWarehouse.

Clearly, more work needs to be done to resolve these practical and technical issues, and perhaps further discussion is required around the incentives necessary to encourage private-sector solutions to the absence of user-friendly software to assist in the ease of digestion, and proper understanding, of data.

*9. Do respondents think that initiatives currently undertaken by authorities in the area of standardisation of prospectuses and investor reports and trade transparency are sufficient or is there scope for further improvements? Would the availability of prospectuses and standardised investor reports in a single location be helpful to securitisation markets?*

Cash securitisations have to be structured around the cash flows of the securitised assets, the needs and capabilities of originators and their systems, and commercial terms. There will therefore always be natural limits to the degree of standardisation that can be achieved.

Commercial pressures have already produced considerable standardisation of transaction structures and documentation - neither issuers nor investors seek inconsistency for its own sake.

Standardisation should not lead to "box-ticking", detract from the need for sensible flexibility (the "comply or explain" principle), unreasonably restrict the freedom of commercial parties to agree suitable terms or unreasonably restrict the choices of consumers.

Having said that, we agree that further simplifying work could be undertaken regarding prospectuses and investor reports. However, a balance will need to be struck between the need to achieve greater standardisation (and simplicity) on the one hand and the legal obligation to make appropriate disclosure under the terms of applicable legislation on the other.

Securitisation is captured under the new transaction reporting and pre- and post-trade transparency requirements for fixed income under MiFID II. Following implementation of these requirements, there will be a high-level of European-wide harmonised public trade transparency in the securitisation secondary markets.

We also agree that, provided the cost is proportionate, having prospectuses and investor reports collected in a single repository would be a useful evolution. It seems to us, however, that such a repository is already being considered in the form of the website to be established by ESMA under Article 8b of the Credit Rating Agencies Regulation.[2] To the extent that a single repository is created under that regime, it should be coordinated with the single repository suggested by the Central Banks in the DP so as to avoid duplication of efforts.

*10. Do respondents agree that facilitating investors' access to credit data in an appropriate manner could support the emergence of securitisation markets? Would credit registers be helpful in this respect? If so, which asset classes should be targeted? In what form could access be granted to ensure that borrowers' confidentiality is preserved?*

Yes, facilitating access to such data for certain asset classes such as loans to SMEs or certain types of leasing transactions would make securitisation of these assets

[2] In this respect we would note that AFME and its members still have significant concerns with the Article 8b regime. These have been summarised in the AFME response (dated 10 April 2014) to ESMA's Consultation paper on CRA3 implementation – Draft regulatory technical standars on information on structured finance instruments (SFIs), available here.

easier. See "ABLe – an agency for business lending", a report prepared by AFME for the UK Department of Business Skills and Innovation in October 2012.

For other asset classes such as residential mortgages, auto loans and leases, consumer loans and credit card receivables we believe that the credit data available already is sufficient, although we note the importance of harmonisation of reporting regimes in this respect.

Preserving borrower confidentiality is challenging, and has been a difficult issue to resolve in the context of the existing ECB and Bank of England loan-level data templates. The solution adopted has been to anonymise or disguise data in various ways: for example, not just by hiding borrower names but also by truncating postcodes, approximating up or down amounts outstanding, etc. The legal requirements which need to be satisfied vary from one country to the other, but in the UK (for example) the key criterion is the extent to which the information published, *when read with other data already in the public domain*, could cause a breach of confidentiality. Given the severity of the sanctions on originators for breach, both legal and reputational, this is a difficult issue.

AFME does not believe that credit registers would be helpful for asset classes other than SME loans. Data on underlying obligors is already reported by transaction parties and creating another source for the same data would not produce benefits commensurate with the cost of establishing credit registers. Rather, it is important to simplify and harmonise the formats in which information is reported to ensure it can be easily analysed and compared by investors.

*11. In order to aid performance measurement and to provide investors with industry-level data, would it be helpful if certain macro-economic data were disclosed or if banks/ non-banks published certain aggregated standardised data? What are the challenges of providing potential investors with sufficient borrower and loan-level data to enable them to model credit risk, and how can these be overcome? What other elements would in your view help to improve secondary market functioning for high-quality securitisation?*

We believe that sufficient macro-economic data is already available from many sources, including from originators, the rating agencies and other sources.

Much securitisation-specific data is of course already disclosed pursuant to the existing ECB and Bank of England requirements and European DataWarehouse. Article 8b of the Credit Rating Agencies Regulation contemplates further similar (and in some cases overlapping) disclosure. In principle, a single repository for relevant data would be helpful to all market participants: to issuers and originators by reducing costs and removing overlapping compliance and filing requirements (thereby making securitisations easier to execute), and to investors and credit rating agencies in providing a single source of information for their initial investment or rating decision as well as ongoing credit assessment. However, we are concerned by what appear to be competing initiatives in this area. We urge all the different authorities involved to focus on harmonising and simplifying both data reporting templates (where possible) and also formats (there seems to us no sensible reason for competing formats in data files, for

example), so that information only needs to be submitted once, in one place and in a single format.

*12. Do respondents think that authorities should consider encouraging the industry to develop such benchmark indices? What risks might these give rise to? What indices would be useful and which could be easily produced?*

It is possible that these could be helpful, but only if the relevant indices are supported by a meaningful volume of transactions that is characteristic of a liquid market. AFME would therefore recommend a "wait and see" approach in order to allow this to be assessed in the light of evolutions in the secondary market for securitisation assets following the implementation of any initiatives resulting from the DP.

*13. Do respondents agree that additional information in the form of a matrix showing implied ratings if the sovereign and ancillary facilities rating caps were to be set at higher levels would be helpful in supporting the investment process and contribute to increased transparency and liquidity?*

Overall, AFME members who are users of credit ratings believe that the publication of "uncapped" ratings would be a useful innovation because it provides useful information to investors about the quality of the underlying assets and the credit enhancement applied thereto.

This is clearly an issue for both the originator and the investor sides of the market. Some rating agencies impose ceilings on securitisation ratings that are derived from their rating on the relevant sovereign. These rating ceilings are intended to reflect certain “tail risks” associated with a potential sovereign default, and that cannot be mitigated e.g. by additional credit enhancement, in the agencies’ view. Many market participants, however, disagree with the agencies’ assessment of the scale of these risks and therefore with the calibration of these rating ceilings. This could be remedied in part by requiring credit rating agencies to publish "uncapped" ratings, which would allow investors to overlay their own view of such sovereign-related risks. This would, however, only be of limited usefulness because investors would presumably still be required to use the lower, capped rating e.g. for purposes of capital allocation.

It is also worth noting that pursuing this avenue would be a complex endeavour for credit rating agencies because it would require them to analyse every input of sovereign risk into the ultimate rating of the securitisation, e.g. in the rating of the counterparties. Harmonising this approach across rating agencies may be difficult, but would be necessary if the "uncapped" ratings are to be meaningful in the market.

That said, an obvious benefit of publishing the matrix suggested by the Central Banks would be to allow investors to readily distinguish between deals are structured to the relevant sovereign cap rating (which is commonly done because it is known that it will not be possible to achieve a higher rating in any case) from those structured to AAA level but rated lower because of a sovereign cap.

*14. How important do respondents see the impediment related to the availability of ancillary facilities? Would the benefits of facilitating SPV bank accounts that fall outside the originator's insolvency estate outweigh the costs of such an initiative? Are there other initiatives in this area that would be beneficial?*

This is a significant issue in part because the cost of ancillary facilities is so high. These costs arise in part because of the contingent liquidity outflows arising from minimum required credit ratings for providers of ancillary facilities such as bank accounts and interest rate or currency swaps ("**Ratings Triggers**"). These Ratings Triggers typically require ancillary service providers to find a replacement provider or collateralise the relevant exposure if they fall below the required rating. In both cases, there is a contingent outflow that drains the provider's liquidity assets.

The cost of Ratings Triggers could be reduced (and thereby the universe of possible ancillary service providers presumably expanded) via adjustments to the LCR (e.g. reducing the factor applied to outflows for qualifying securitisation Rating Triggers to less than 100% or allowing greater amounts of qualifying securitisations as HQLA) or via more direct central bank support (e.g. allowing emergency funding drawing capacity to be allocated to qualifying securitisations or providing bank account and swap capacity directly to bank-sponsored qualifying securitisations).

This is also a significant issue particularly in jurisdictions where the sovereign cap is materially higher than the ratings of providers of ancillary facilities. In such jurisdictions the market expectation is that transactions will be rated at or, if possible, above the sovereign cap and reaching that rating level can therefore be challenging if the providers of ancillary facilities have materially lower ratings.

For certain categories of issuers, particularly large commercial banks with significant bank account business, the risk of losing cash collections can materially increase the operational inefficiencies of securitisation transactions and the cost of credit enhancement for the structure. Moreover, investor concerns around bank issuers (and negative rating agency assumptions) are exacerbated in times of financial stress as a result of such issues, thereby adversely affecting the effectiveness of securitisation as a counter-cyclical tool for bank issuers.

Given the pressure on counterparty ratings, and the small number of counterparties available, consideration should be given to a possible role for a suitably rated public sector entity to provide guarantees of swaps or other ancillary facilities. This is not without risk to the guarantor, and adjustments to mandates might be required, but the market impact of this type of public sector intervention could be considerable.

*15. With regard to the policy options mentioned, are there any other considerations authorities should be mindful of?*

See the responses of AFME (and GFMA) to recent consultations of the BCBS and European authorities on capital, liquidity, risk retention and high quality

securitisation, *passim*. Several of these are referred to in this paper and can be found at www.afme.eu.

*16. Do respondents think there are other policy options authorities should consider to support the emergence of simple, transparent and robust securitisation markets?*

The recently announced (in principle) ECB purchase programme, if correctly structured and targeted to support qualifying securitisations, could provide a cornerstone to support market making by banks, re-building confidence and sending positive signals to the wider non-bank investor base. However, we would note that the purchase programme if not targeted properly risks "crowding out" investors from the market, in the short term as well as doing potentially permanent damage to private investment demand. In order to avoid that negative outcome, we would recommend designing the programme with one or more of the following features:

- make public placement of a minimum proportion of the securities an eligibility criterion for the purchase programme; and/or

- target some of the purchases at the mezzanine tranches of ABS transactions therefore limiting the impact of the programme on the availability of highly-rated ABS in the public markets; and/or

- place strict limits on the amount of ABS collateral that can be purchased so as to ensure continuing availability of ABS in the hands of private investors.

Otherwise the DP seems wide-ranging and comprehensive.

*17. Beyond securitisation, might there be other ways of achieving (some of) the benefits of securitisation as outlined in Section 2? What might be the associated risks of such options?*

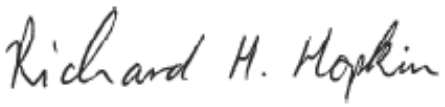
AFME believes that securitisation is the best way to achieve these benefits.

*18. Do the principles set out in Box 3 seem broadly sensible given the objective of encouraging a set of securitisations that are more amenable to risk assessment? Are there any obvious unintended consequences?*

See annex.

In closing, we wish to emphasise that the engagement of the Central Banks with market participants on the revival of the securitisation market in the European Union is greatly appreciated. We hope this response in helpful. We are grateful for the opportunity to comment on the DP and we would be happy to answer any further questions that you may have or develop further issues of interest to you.

Yours faithfully



Richard Hopkin, Managing Director
Association for Financial Markets in Europe

## ANNEX

### Feedback on criteria for qualifying securitisations (Box 3)

AFME believes that the principles set out in Box 3 are broadly sensible given the objectives set out in the DP. The principles are a good starting point but are, in many cases, very general and will need further refinement and specification in order to allow for predictability in the assignment of a QS certification. We have the following specific comments on the principles as set out in the DP:

**Paragraph 128:** This is broadly sensible, though we would note that derivatives should be acceptable in a qualifying securitisation to the extent they are present for hedging purposes. We would note further that many of our members see no reason why synthetic securitisations should necessarily be excluded from the qualifying securitisation category. They are important risk and capital management tools for AFME's bank members and, provided they meet the requirements of simplicity, structural robustness and transparency requirements imposed, a number of our members believe they should be eligible for QS. We note, however, that certain of our investor members have concerns relating to the control investors have over the underlying assets in synthetic securitisations.

**Paragraph 129:** This will be difficult to provide as proposed. In particular, consistent and comparable data will not necessarily be available because underwriting standards change over time. Requiring data over a long period of time means that assets with substantially different underwriting criteria would be compared without a practical way of reflecting the underlying differences in assets.

**Paragraph 130:** This is broadly sensible, although note our comments in respect of synthetic securitisations on paragraph 128. Also, some flexibility will be required in this criterion as concerns structures such as master trusts and originator trusts where the issuer will not necessarily have direct recourse to the underlying obligors.

**Paragraph 131:** Further guidance will be required on the meaning of "homogenous", but this criterion is sensible provided it is intended to refer to relatively high-level homogeneity (e.g. residential mortgages, rather than something as specific as, say, buy-to-let mortgages in the London market). Also, we wonder how an obligor's "volition" to make timely payments can be assessed beyond checking their having entered into a contract to do so (the asset sold into the securitisation). Is this meant to ensure that affordability has been checked?

**Paragraph 132:** This is again a broadly sensible criterion but needs to be addressed more specifically to exclude excessive reliance on market-based refinancing risk. For example, an RMBS is highly unlikely to have a life longer than seven years, but the underlying assets will likely have a WAL of 25-30 years. This is nonetheless acceptable because refinancing of residential mortgages is a normal feature in the life of the product and is highly unlikely to be problematic at a level that would impact the cashflows on the transaction in a material way.

**Paragraph 135:** See our comments on synthetic securitisations in respect of Paragraph 128. This is broadly sensible, but it should be noted that any legal opinion will be subject to customary assumptions and qualifications in respect of these items appropriate for the relevant market. These should not be a barrier to the transaction being a qualifying securitisation.

**Paragraph 144:** While we understand the reason for including this criterion, we question its appropriateness in all circumstances. Firstly, the direction of travel in financial services regulation generally (not just in securitisation) is to reduce undue mechanistic reliance by investors on external credit ratings through transparency - a principle we support. Secondly, a "one-size- fits-all" approach here may not be appropriate: in private transactions (for example) the transaction parties may wish to make their own arrangements for ongoing credit assessment: this may be "independent" or not, and may involve an ECAI or not. It is important to note that recent legislation in the form of Article 8c of the Credit Rating Agency Regulation does not mandate the involvement of at least two ECAIs for all issues of structured finance instruments; it simply requires two ECAIs if the transaction is rated at all. To require two ECAIs in order to qualify as QS seems to us to widen this legislative requirement "by the back door" – at least at the "core" level of any QS definition. Of course it may be sensible at a "modular" level (for example, additional requirements for central bank repo eligibility) for a dual ECAI requirement to apply. There is detail and subtlety here which requires further discussion.

**Paragraph 146:** We are not clear as to the intended meaning of this requirement. If it is a requirement for an audit of the reports from the transaction, we are unsure whether auditing firms would be willing to provide this or what value this would add