**AFME RESPONSE TO EU COMMISSION SECURITISATION CONSULTATION (CMU GREENPAPER) - Additional information in response to Question 15B**
**Points for clarification in the Delegated Act on Liquidity Coverage Ratio**

| ***Text in Article 13 (with wording under question highlighted in red)*** | ***AFME Points for clarification*** |
|---|---|
| 2. The securitisation position and the exposures underlying the position shall meet all of the following requirements: | |
| (c) The underlying exposures have been acquired by the SSPE within the meaning of Article 4(1)(66) of Regulation (EU) No 575/2013 in a manner that is enforceable against any third party and are beyond the reach of the seller (originator, sponsor or original lender) and its creditors including in the event of the seller's insolvency. | Article 4(1)(66) of the CRR defines 'securitisation special purpose entity' or 'SSPE' to mean "a corporation trust or other entity, other than an institution, organised for carrying out a securitisation or securitisations, the activities of which are limited to those appropriate to accomplishing that obligation, the structure of which is intended to isolate the obligations of the SSPE from those of the originator institution, and in which the holders of the beneficial interests have the right to pledge or exchange those interests without restriction".<br><br>Aspects of this definition are unclear and/or appear overly restrictive in an LCR context. For example, the definition appears to assume that the originator is an "institution" as defined in the CRR (being a credit institution or investment firm), whereas the LCR provisions expressly provide for a broader range of originator entities (see article 13(13)). Moreover, the reference to freely transferrable interests appears to assume that the entity acquiring the securitised assets is a traditional issuing entity. As a result, the definition does not clearly provide sufficient flexibility for master trust structures where the entity acquiring the assets is a trustee which holds the assets on trust for certain beneficiaries and the ability of such beneficiaries to transfer their trust interest will typically be restricted.<br>It is our understanding that the SSPE concept was previously used primarily for the |

| | |
|---|---|
| | purposes of the operational conditions for traditional securitisations. It is not clear that it is appropriate for use in a LCR context. |
| (d) The transfer of the underlying exposures to the SSPE may not be subject to any severe clawback provisions in the jurisdiction where the seller (originator, sponsor or original lender) is incorporated. This includes but is not limited to provisions under which the sale of the underlying exposures can be invalidated by the liquidator of the seller (originator, sponsor or original lender) solely on the basis that it was concluded within a certain period before the declaration of the seller's insolvency or provisions where the SSPE can prevent such invalidation only if it can prove that it was not aware of the insolvency of the seller at the time of sale. | See above for our concerns regarding the reference to SSPE in this requirement. |
| (g) the securitisation position is backed by a pool of homogeneous underlying exposures, which all belong to only one of the following subcategories, or by a pool of homogeneous underlying exposures which combines residential loans referred to in points (i) and (ii): | |
| (i) **residential loans secured with a first-ranking mortgage granted to individuals for the acquisition of their main residence**, provided that one of the two following conditions is met:<br>- the loans in the pool meet on average the loan-to-value requirement laid down in point (i) of Article 129(1)(d) of Regulation (EU) No 575/2013;<br>- the national law of the Member State where the loans were originated provides for a loan-to-income limit on the amount that an obligor may borrow in a residential loan, and that Member State has notified this law to the Commission and EBA. The loan-to-income limit is calculated on the gross annual income | AFME seeks to obtain confirmation that first-ranking mortgages granted to individuals for the finance (rather than **acquisition**, e.g. in case of refinancing of an existing mortgage) of their main residence satisfy the condition. We consider that this should be acceptable on the basis that it seems most sensible to test the acquisition purpose portion of this test with respect to the original purpose of the loan (rather than requiring re-testing of the purpose upon any refinancing) but it would be helpful to receive confirmation in this regard.<br>AFME also seeks to obtain confirmation that first-ranking mortgages granted to individuals in respect of any property to be owner occupied (as opposed to buy-to-let) would satisfy the condition. We consider that mortgage loans in respect of, e.g., second homes should be acceptable given that they are not occupied by persons other than the owner and are a residence of an owner, however, once again it would be helpful to receive confirmation in this regard. |

| | |
|---|---|
| of the obligor, taking into account the tax obligations and other commitments of the obligor and the risk of changes in the interest rates over the term of the loan. For each residential loan in the pool, the percentage of the obligor's gross income that may be spent to service the loan, including interest, principal and fee payments, does not exceed 45%; | Furthermore, with regard to the phrase "**first- ranking**" the question is whether Article 13(2)(g)(i) would cover the usual legal language in securitisation documentation (i.e. first and sequentially lower rank) with regard to the existing transactions? |
| (iii) commercial loans, leases and credit facilities to undertakings established in a **Member State** to finance capital expenditures or business operations **other than the acquisition or development of commercial real estate**, provided that at least 80 % of the borrowers in the pool in terms of portfolio balance are small and medium-sized enterprises at the time of issuance of the securitisation, and none of the borrowers is an institution as defined in Article 4(1)(3) of Regulation (EU) No 575/2013; | **"Member State"**: AFME and its members ask for confirmation as to whether the applicability of the LCR rules extends to the EEA. There seems to be uncertainty as to whether "Member State" refers to countries in the EU or whether it applies to the EEA.<br><br>**"Other than the acquisition or development of commercial real estate":** it should be clear that when a SME is purchasing or building a property to conduct its own business in (e.g. a butcher purchasing a shop which effectively is a commercial real estate), a loan for such purpose should not be the reason to exclude the SME securitisation from Level 2B. We understand that CMBS's are to be excluded, but the current text is too wide unless an explanation is provided. |
| (iv) auto **loans and leases** to borrowers or lessees established or resident in a Member State. For these purposes, they **shall include** loans or leases for the financing of motor vehicles or trailers as defined in points (11) and (12) of Article 3 of Directive 2007/46/EC of the European Parliament and of the Council, agricultural or forestry tractors as referred to in Directive 2003/37/EC of the European Parliament and of the Council, motorcycles or motor tricycles as defined in points (b) and (c) of Article 1(2) of Directive 2002/24/EC of the European Parliament and of the Council or tracked vehicles as referred to in point (c) of Article 2(2) of Directive 2007/46/EC. Such loans or leases **may include** ancillary insurance and service products or additional vehicle parts, | **"loans and leases":** In the UK consumer automotive finance market it is usually the case that financing to consumers is structured as hire purchase or conditions sale contracts (rather than loans). While we are of the view that these are intended to fall within Article 13(2)(g)(iv), it would be helpful if the European Commission could provide confirmation of this;<br><br>Also finance companies and banks offer personal contract plans (PCPs) which are hire purchase contracts but allow customers to return the vehicle at the end of term in satisfaction of their final payment - thus leaving residual value risk with the finance company. The final payment is always set by the finance company at a level that creates an incentive for the customer to purchase the vehicle but they are not required to. It would be helpful to receive confirmation from the European Commission that PCPs are indeed loan or lease products for the "financing of motor vehicles" within Art 13(2)(g)(iv). Of course, it would need to be considered on a case by case basis |

| | |
|---|---|
| and in the case of leases, the residual value of leased vehicles. **All loans and leases in the pool shall be secured with a first-ranking charge or security over the vehicle or an appropriate guarantee in favour of the SSPE, such as a retention of title provision;** | whether the other criteria, including Art 13(3), are satisfied.<br><br>Article 13(2)(g)(iv) refers to "auto loans and leases to borrowers and lessees established or resident in a Member State….[which] **shall include** loans or leases for the financing of motor vehicles or trailers…Such loans and leases **may include** ancillary insurance and service products or additional vehicle parts. "<br><br>It is fairly clear from the wording of Article 13(2)(g)(iv) that a fully amortising lease (finance lease) with or without an ancillary maintenance contract would fall within this provision, especially given the "may include" language.<br><br>However, where there is a true operating lease (ie, the full value of the vehicle is not amortised under the lease and therefore there is really no expectation that the lessee will seek to acquire the vehicle at the end of the term), the issue is less clear. On the one hand, it is possible to read "shall include loans or leasing for the financing of motor vehicles" as an non-exhaustive requirement and could therefore be construed to mean that other types of loans or leases can be included within this provision. On the other hand, the use of "shall" in this part of the text contrasts with the use of "may" later in the text and therefore may alternatively suggest that Article 13(2)(g)(iv) requires that such loans and leases must be for the financing of vehicles as opposed to rental.<br><br>It would be helpful if this could be clarified although it is not clear why, if the other criteria in Article 13 are satisfied, portfolios involving operating leases should not be permitted to be Level 2B securitisations. It should also be borne in mind that, to achieve sufficient deal size (which generally promotes liquidity), finance and operating leases may be included in the same portfolio. The potential restrictions in Article 13(2)(g)(iv) could mean this is not viable if the entire securitisation would then fall outside Article (g)(iv) and therefore attract a higher haircut or, at worst, not be eligible at a Level 2B securitisation. |

**"All loans and leases in the pool shall be secured with a first-ranking charge or security over the vehicle or an appropriate guarantee in favour of the SSPE, such as a retention of title provision":** Drafting of Article 13 (2) (g) (iv) could be interpreted in a way that excludes large portions of the auto loan origination in some Member States. This is because the taking of security is by no means standard practice in auto lending - for sound and prudent reasons. For example, in the UK, some lenders will exclude security over the vehicle from the auto loans they provide to high credit quality borrowers because in the UK borrowers have a legal right, in some circumstances, to terminate auto loans which have security over the vehicle. From high credit quality borrowers this risk can be greater than the credit risk itself, thus it is commercially sensible and prudent to offer loans which do not take security over the vehicle to these borrowers. Taking security in some Member States can also be expensive and impractical: this is the case in Italy, for example, where the asset depreciation suffered in the time required to legally enforce the security makes the security of very little practical value. In France, retention of title rather than security is used to protect lenders. In Norway, the security used by auto lenders falls away after five years, so a securitised pool would evolve over time into a combination of secured and unsecured loans, depending on the date of origination of each auto loan. Lastly, leases are typically not secured by a charge.

In the light of the above, AFME and its members would like to obtain guidance on the following points:

(i) In respect of the UK, is it correct to consider that a guarantee provided to the SSPE by the originator/servicer to pass on all proceeds received in relation to the auto loans acquired by the SSPE according to Clause 2(c) (whether or not the underlying loans themselves have security over the vehicle) would satisfy this condition?

(ii) In respect of the Member States where it is common not to take security over vehicles (e.g. Italy) is it the intention to exclude all such collateral from being usable in LCR eligible securitisations?

In respect of Member States where the legal constructions of security over movable objects provide a security interest for a limited period of time only is it correct to interpret that provided all loans are secured at the time of having been acquired by the SSPE (and any subsequent change in this respect is only as a result of the legal

| | |
|---|---|
| | construction of the security interest) that this would satisfy this condition? This would for example be a very relevant question for Norway which, we understand, will be subject to the Delegated Act once CRD IV is incorporated into the EEA Agreement, which discussion and legal process is progressing on. |
| (j) At the time of issuance of the securitisation or when incorporated in the pool of underlying exposures at any time after issuance, the underlying exposures do not include exposures to credit-impaired obligors (or where applicable, credit impaired guarantors), where a credit-impaired obligor (or credit-impaired guarantor) is a borrower (or guarantor) who:<br><br>(i) has declared bankruptcy, agreed with his creditors to a debt dismissal or reschedule or had a court grant his creditors a right of enforcement or material damages as a result of a missed payment within three years prior to the date of origination;<br><br>(ii) is on an official registry of persons with adverse credit history;<br><br>(iii) has a credit assessment by an ECAI or has a credit score indicating a significant risk that contractually agreed payments will not be made compared to the average obligor for this type of loans in the relevant jurisdiction. | There is some uncertainty with respect to when this requirement should be tested (i.e. at the time issuance/establishment of the securitisation or when securities are issued under a structure) and which assets it should be applied to (just new assets being added at the relevant time or across all new and existing assets). That said, it is our understanding that this requirement (like the requirement in sub-paragraph (k)) is intended to restrict arrangements involving assets which are non-performing at the time that such assets are securitised/transferred to the securitisation vehicle. As a result, it is our understanding that this requirement should be interpreted to require testing at the time that new exposures are added to the securitisation (whether that is just upon the issuance/establishment of the securitisation structure in the case of a static pool transaction or upon the issuance/establishment of the securitisation and upon any new assets being added after that time in the case of a revolving pool transaction) and that the test should be applied in respect of new exposures only. Applying a different interpretation would effectively restrict revolving pool transactions, including master trusts, from being eligible. |
| (k) at the time of issuance of the securitisation or when incorporated in the pool of underlying exposures at any time after issuance, the underlying exposures do not include **exposures in default** within the meaning of Article 178(1) of Regulation (EU) No 575/2013 | Like the restriction on credit impaired obligors in sub-paragraph (j) (see above), there is some uncertainty with respect to when this requirement should be tested and which assets it should be applied to. We consider that this requirement should be interpreted in a manner consistent with sub-paragraph (j) and as described above and it would be helpful if this was confirmed.<br><br>In addition, questions arise under this requirement as a result of the term “exposures in default” being defined by reference to article 178(1) of the CRR, which refers to obligors that are past due more than 90 days on any material credit obligation. This runs the risk of excluding *most credit-card securitisations as well as consumer loans and much auto issuance. The IT systems of credit card originators will usually not recognize defaults at 90 days and will typically only exclude receivables in respect of charged off accounts.* |

| | |
|---|---|
| 13. **The originator** of the exposures underlying the securitisation shall be an institution as defined in Article 4(3) of Regulation (EU) No 575/2013 or an undertaking whose principal activity is to pursue one or more of the activities listed in points 2 to 12 and point 15 of Annex I to Directive 2013/36/EU. | **"The originator"** Article 13(13) of the LCR Delegated Regulation provides that the originator of the exposures underlying the securitisation must be either (i) a credit institution or an investment firm or (ii) an undertaking whose principal activity is one of the activities set out in Annex 1 of Directive 2013/36/EU. Art 13(13) of the LCR Delegated Regulations does not operate to exclude operating leases as underlying collateral for Level 2B securitisations. However, because an originator may not necessarily need to be authorised in an EU jurisdiction to enter into operating leases, it may be the case that assets generated by some originators are effectively excluded from Level2B securitisation treatment as a result. Therefore, it is possible that, even before considering whether operational lease assets meet the requirements of Article 13 discussed below, the assets will not be eligible because the originator does not fulfill the originator requirements under Article 13(13).<br><br>In the absence of any possibility of extending Art 13(13) to expressly cover entities involved in operating leasing perhaps some guidance could be given on the "principal activity" requirement or, alternatively, this could be altered to simply refer to "an undertaking involved (whether as a principal activity or otherwise) in one of the activities set out in Annex 1…". |