THE INVESTMENT ASSOCIATION
INVESTMENT MATTERS

An EU Framework for Simple, Transaprent and Standard Securitisation

The Investment Association's Response to the European Commission's Consultation Document

The Investment Association represents UK investment managers. We have over 200 members who manage more than £5 trillion for clients around the world. Our aim is to make investment better for clients so that they achieve their financial goals; better for companies so that they get the capital they need to grow; and better for the economy so that everyone prospers. Ultimately much of what they manage belongs to the man in the street through their savings, insurance products and pensions.

We welcome the opportunity to respond to the European Commission's consultation document on an EU framework for simple, transparent and standard securitisations.

The Investment Association is supportive of the European Commission's efforts to expand the securitisation market through developing a Simple, Transparent and Standard (STS) framework. Whilst a global approach to simple, transparent and standardised securitisation should remain the ultimate goal, we welcome the development of a European framework, which should provide greater legal clarity for investors and encourage the development of the European securitisation market by facilitating cross-border investment.

It is important that the Commission reflects the progress made by the EBA and BCBS-IOSCO following the feedback that they have received from market participants on its framework for STS securitisations. This would help ensure that the STS framework criteria are practical, effective and internationally consistent. This would also ensure that the capital treatment of STS securitisation creates a level playing field between bank and non-bank investors.

Qualifying instruments

The Investment Association believes that for the EU STS framework to be successful in allowing the securitisation market to function as an effective financing mechanism for some non-banks as well as banks, it should include:

- high-quality non-senior tranches in the pool qualifying securitisations;
- non-actively managed collateralised loan obligations (CLOs); and
- synthetic securitisations where a true sale securitisation is either uneconomic or not possible due to contractual limitations.

In all circumstances, qualifying securitisations should have lower capital requirements than non-qualifying securitisations.

It is imperative that the discussion on simple, standard and transparent securitisations does not result in non-qualifying securitisations becoming 'non-eligible' securitisations, thereby precluding the abiiility for investors with the appetite for these instruments based on their risk-return profiles from investing in them.

The Investment Association is keen to emphasise that a securitisation should be deemed qualifying or not at the transaction level, not at the tranche level. If a securitisation is qualifying, then all exposures to it, including all classes of note, are qualifying. To avoid cliff effects, securitisations that are considered qualifying at issuance should not retroactively be deemd non-qualifying during the life of the transaction.

Other proposed changes

The Investment Association is a company limited by guarantee registered in England and Wales. Registered number 04343737. Registered office as above.

In addition, The Investment Association believes the following changes are required to promote investment in securitisations:

Short Term Securitisations

- Differing qualifying criteria should be developed for Asset-Backed Commercial Paper (ABCP), given that they differ from long-term securitisations in terms of the heterogeneous nature of the underlying assets, the use of liquidity support facilities from the sponsor, and commercial sensisitives on the disclosure of information on the underlying assets.

Risk Retention Requirements

- The onus for verifying risk retention requirements should be transferred from investors to originators as investors currently have no obvious means to reliably control the behaviour of originators over the life of the transaction.

Transparency and Disclosure

- There should be greater disclosure in the transaction documentation required by the CRA Delegated Regulation, including:
  - loan level data; and
  - any claims on assets that lie outside the securitisation and may affect it.
- There should be greater standardisation of securitisation transactions' documentation including prospectuses and investor reports. These disclosure standards should take into account the different underlying assets and should not be overly prescriptive.
- There should be a requirement that cash flow models and qualitative disclosures regarding breaches and triggers be made available to investors.
- Work should be done to standardise definitions of key concepts and risk factors, as there is often no homogeneous definition of the main factors characterising the risk profile of securitised assets.
- Credit rating agencies should publish both capped and uncapped credit ratings, in order to improve clarity for investors.
- A central, free-to-access electronic repository for all documentation relating to securitisation instruments should be developed.

Regulatory Barriers

- The complexity and heterogeneity of the various regulations and practices by competent authorities may act as barrier for investors. A common and much simplified framework is definitely needed to create the conditions for a more liquid, easier to handle and more standardised high quality securitisation market.
- We are supportive of the EBA's recommendation for a detailed review of the entire regulatory framework for securitisation across all the different regulations and regulatory authorities on a standalone basis and in conjunction with the regulatory framework applicable to other investment products such as covered bonds and whole loan portfolios.
- This could involve reviewing the many regulatory requirements, current and proposed, related to securitisation and actively considering:
  - what risks the requirements are mitigating;
  - whether some requirements overlap or duplicate each other;
  - how effective the requirements have been at mitigating identified risks;
  - any unintended consequences of the requirements; and
  - actions market participants have taken themselves to mitigate the risks identified and whether this now means that the regulatory requirements are redundant.

The Investment Association and its members remain strongly supportive of developing the securitisation market in Europe as well as globally, and would welcome further discussion on any of the points that we raise in our response.

Identification criteria for qualifying securitisation instruments

Question 1:

A) Do the identification criteria need further refinements to reflect developments taking place at EU and international levels? If so, what adjustments need to be made?

The Investment Association supports the identification criteria, which are in line with the Solvency II and LCR provisions. They offer a good basis for identifying simple, transparent and standardised securitisations.

In developing its framework, it is important that the Commission reflects the progress made by the EBA and BCBS-IOSCO following the feedback that they have received from market participants in its framework for STS securitisations. Building upon the criteria developed by the EBA and BCBS-IOSCO would help ensure that the STS framework criteria are practical, effective and internationally consistent. This would also ensure that the capital treatment of STS securitisation creates a level playing field between bank and non-bank investors.

In addition, we believe that the following adjustments should be made to the identification criteria set out by the Commission in its consultation document.

Simplicity Criteria:

- We agree that the underlying exposures should be homogenous. However, there should be no requirement for jurisdictional homogeneity as proposed in the BCBS-IOSCO consultative document. This would not be practical in Europe, where assets in a securitisation may be multi-jurisdictional even within single nations such as the UK (due to differences between English and Scottish mortgage laws).
- In addition, these criteria should not seek to limit or minimise tranching in securitisations to aid simplicity. Tranching gives investors access to different maturity and risk profiles that meet their risk-reward requirements.

Standardisation Criteria:

- We are generally supportive of these criteria. However, we do not agree that synthetic securitisations should be excluded from any framework for simple, transparent and standardised securitisations.
- Our members, as investors in securitisations, acknowledge that synthetic securitisations can introduce undesirable counterparty risks. They are concerned about their ability to able to take control over the underlying assets in enforcement scenarios. This limitation dilutes the investor protection available in synthetic structures relative to those in true sale securitisations.
- However, our members recognise the importance of synthetic securitisations where a true sale securitisation is either uneconomic or not possible due to contractual limitations. Therefore, synthetic securitisations should be included in a framework for STS securitisations subject to adequate safeguards.
- For this to be achieved it is important to draw a distinction between synthetic securitisations where only the asset-side of the securitisation is synthetic and those where both the asset and liability side of the securitisation are synthetic. We believe that the former and not the latter should be considered to be a qualifying securitisation subject to the safeguards set out below at a minimum (in addition to the criteria that qualifying true sale securitisations will have to satisfy).
- Where only the asset side of the securitisation is synthetic, the securitisation should be exposed to two separate asset pools, the funding collateral and the reference collateral.
- Eligibility criteria should be applied to the funding collateral in a qualifying synthetic securitisation, with the aim of ensuring that the bankruptcy-remoteness of the securitisation from the originator is not impaired via the reference collateral (e.g. senior unsecured bonds issued by the originating bank would not be eligible as funding collateral).

- The funding collateral should not consist of instruments with credit risk that is significantly correlated with the credit risk of the reference collateral (e.g. senior unsecured bonds issued by an EU bank used as reference collateral in a securitisation from another EU bank).
- The originator must certify that the:
    - reference collateral will only be securitised once and will not be securitised in a true sale transaction in addition to the synthetic transaction, nor will it be securitised in multiple synthetic transactions;
    - reference collateral is not referenced in any other credit instrument, securitisation or not; and
    - ability of the securitisation to enforce the reference collateral is in no way inferior to that in a corresponding true sales transaction.
- The originator must own the reference collateral over the life of the transaction. In the event of a transferor insolvency, the transaction must enter liquidation.
- The originator must post additional cash collateral in a ring-fenced account to be deposited with the originating bank or held by a counterparty and pledged to the securitising bank.
- Higher risk retention requirements should be imposed to ensure strong alignment on interest between the originator and the investor.
- Originators should use standardised transaction documents and the terms of those documents (including amendments) should be publically available following the conclusion of the transaction.

Additional Risk Features:

- It is imperative that risk features are not too rigidly regulated. Such an approach could disincentivise investment and could exclude assets with good performance track records and low historical default experience.
- Prudential rules should define risk factors which are sensitive to underlying risks and require levels of capital appropriately calibrated to cover such risks.

B) What criteria should apply for all qualifying securitisations ('foundation criteria')?

We do not believe it is possible to set out a definitive answer to this question at this stage. However, we propose that, in addition to the points noted in question 1 above:

- The Commission should adopt criteria that are determined in light responses to the EBA and BSCBS-IOSCO consultations
- The EU STS framework should include:
    - high-quality non-senior tranches in the pool qualifying securitisations. Currently, junior tranches are not included in Type 1 securitisations under Solvency II. Yet, high-quality non-senior tranches have been showing much better performance than non-high quality securitisations both from a credit and spread perspective since the financial crisis and there is less evidence of significant deviation of spread volatility performance between high-quality ABS mezzanine tranches and high-quality ABS senior tranches.
    - non-actively managed collateralised loan obligations (CLOs). Loans granted to large corporates and included in CLOs have a similar or better risk profile than SME loans. CLOs have demonstrated higher performances vs Collateralised Debt Obligations (CDOs). Moreover, CLOs downgrades that occurred during the crisis were mainly due to rating agency methodology changes and were not linked to credit performances of the underlying pool of loans.
    - synthetic securitisations where only the asset-side of the securitisation is synthetic.
    - underlying exposures to individuals or undertakings that are not only resident, domiciled or established in the EEA. This would promote expansion of the securitisation market in Europe.

Identification criteria for short-term instruments

Question 2.

A) To what extent should criteria identifying simple, transparent, and standardised short-term securitisation instruments be developed? What criteria would be relevant?

We would welcome the development of STS criteria for short term securitisations. However, in developing these criteria it is important to draw a distinction between the short term tranches of longer-term securitisations and short-term securitisation instruments such as ABCP.

- Short term securitisations that are issued as part of longer-dated securitisations are exposed to the same risks as the longer-term notes in the same structure. Therefore, they should be subject to the same criteria as longer-term securitisations.
- Short term securitisations such as ABCP have unique aspects that would not be consistent with the criteria applicable for longer-term securitisations. ABCP differ from longer-term securitisations in a number of ways including the:
  - heterogeneous nature of the underlying assets;
  - the use liquidity support facilities from the sponsor; and
  - commercial sensitivities on the disclosure of information on the underlying assets.

Using the same criteria for ABCP as for wider securitisations would be simplistic and could impede developments in the ABCP market. In particular, requirements surrounding liquidity metrics, maturity length, and asset homogeneity should not apply.

B) Are there any additional considerations that should be taken into account for short-term securitisations?

No comment

Risk retention requirements for qualifying securitisations

Question 3

A) Are there elements of the current rules on risk retention that should be adjusted for qualifying instruments?

The Investment Association is supportive of risk retention requirements that ensure a proper alignment of interests between the sponsor/originator and the investor.

Risk retention requirements for qualifying securitisations could be lowered. However, this would need to be done following extensive consultation with investors.

B) For qualifying securitisation instruments, should responsibility for verifying risk retention requirements remain with investors (i.e. taking an "indirect approach")? Should the onus only be on originators? If so, how can it be ensured that investors continue to exercise proper due diligence?

We do not believe that responsibility for verifying risk retention requirements should remain with investors. As it currently stands, investors are being held to account for ensuring that originators satisfy the retention requirements, yet they have no obvious means to control the originators actions over the life of the transaction.

We recommend that the onus should only be on originators of a securitisation to verify their risk retention requirement. This should be:

- done at the launch of the transaction;
- be a requirement of listing the security; and

- should be disclosed throughout the life of the transaction in quarterly investor reports in a comparable manner.

This will not only align Europe with the US, but it will facilitate effective due diligence by regulated investors such as AIFs and UCITs fund managers.

To ensure compliance with the risk retention requirement throughout the life of the transaction, originators should be required to retain credit risk of the securitised assets in the form of restricted notes. This is irrespective of whether they are retaining a vertical or horizontal interest or a combination of the two. These restricted notes would only pay a coupon to the originator in the event that they continue to be the beneficial recipient of the interest. If the originator sells on their holdings then the coupon payment would stop. As a result these notes would only have value if the originator is holding them and confer no economic benefit to a potential purchaser.

However, we note that this would not be as effective in ensuring compliance for securitisations issued by non-bank originators. Further consideration should be given to which counterparty would be best place to fulfil this obligation.

Compliance with criteria for qualifying securitisation

Question 4

A) How can proper implementation and enforcement of EU criteria for qualifying instruments be ensured?

The Investment Association is opposed to a purely self–certification process as it may give rise to conflicts of interests and would not give sufficient confidence to investors.
We appreciate that originators/sponsors are the best placed to attest that the securitisation is in compliance with the STS criteria as they would be the most familiar with the underlying assets, the servicing requirements and the portfolios structural characteristics.

Therefore, we propose that all originators/sponsors/original lenders should be required to state whether or not the securitsation is a STS as part of the listing process. Alternatively, certification for qualifying securitisations could be provided by an independent private entity. In the event that a securitisation is stated to be compliant with the STS criteria, this could be independently verified by a third party.

The third party could be:

- a regulator – therefore creating a framework similar to that for regulated covered bonds;
- a non-profit certification provider at European level that built upon existing national initiatives such as True Sale International in Germany and the Dutch Securitisation Association; or
- an independent auditor.

It is important to note that whatever method of certification is ultimately introduced, investors will continue to perform the necessary due diligence prior to investing in the instrument.

B) How could the procedures be defined in terms of scope and process?

No comment

C) To what extent should risk features be part of this compliance monitoring?

Risk features should not be part of the compliance monitoriyng, provided that they are not included in the qualifying criteria under the principle based approach.

Elements for a harmonised EU securitisation structure

Question 5

A) What impact could further standardisation in the structuring process have on the development of EU securitisation markets?

In principle, The Investment Association is supportive of a harmonised EU securitisation structure.

From an investor perspective, further standardisation in the structuring process would be beneficial as it would simplify the risk analysis and would allow consideration of a wider range of products with marginal additional cost for the resources to required assess the products. In addition, standardisation of securitisation structures would help enhance the secondary market for these instruments by providing confidence to a wider range of investors.

We note that there may be a number of risks that are common across securitisation issuance types, and the use of structuring techniques to mitigate those risks (such as inclusion of triggers within liability payment priorities), which could be readily standardised. However, the legal form of special purpose vehicles used in securitisation depends upon specific national contractual, property and insolvency laws – particularly in relation to the legal position of the underlying assets and transfer of legal rights. Therefore, any efforts to develop a harmonised EU securitisation structure would need to take into account the differences in contractual, property and insolvency law across the EU.

Given the possible difficulties harmonising different EU member state laws, we propose that a harmonised EU securitisation structure could be modelled upon the *Soceitas Europea* (SE). This would create a supra-national structure that would promote cross-border investment without impacting the current national securitisations regimes.

Any efforts to develop an SE equivalent vehicle for securitisations should be part of the Commission’s longer term agenda and should be done as an independent work stream separate from the work that is currently being undertaken to develop a framework for an EU framework for STS securitisations.

B) Would a harmonised and/or optional EU-wide initiative provide more legal clarity and comparability for investors? What would be the benefits of such an initiative for originators?

See response to question 5A above.

C) If pursued, what aspects should be covered by this initiative (e.g. the legal form of securitisation vehicles; the modalities to transfer assets; the rights and subordination rules for noteholders)?

In addition to the points made in 5A above, it is important to note the underlying assets in different securitisations will have specific features and risk factors. For example, there are significant differences in the quality requirements for collateral in CLOs, RMBS and auto lease ABS. Therefore, these should be considered on an individual basis.

From this perspective standardisation could be envisaged at underlying asset level, and for each underlying asset class the following points could be considered in the standardisation process:

- a common set of collateral quality tests.
- a common waterfall structure with a common set of structural tests (OC tests, delinquency triggers, etc.); and
- minimum monitoring disclosures/reporting should be defined.

D) If created, should this structure act as a necessary condition within the eligibility criteria for qualifying securitisations?

No.

The legal form of special purpose vehicles used in securitisation depends upon specific national contractual, property and insolvency laws – particularly in relation to the legal position of the underlying assets and transfer of legal rights. Given the possible difficulties in harmonising different EU member state laws, we do not believe that this structure should act as a condition within the eligibility criteria for qualifying securitisations.

Such a requirement would slow down the development of an EU STS securitisations framework, and would limit the ability of originators/sponsors to issue different securitisations that meet their risk transfer needs. This would act as a barrier to the revival and further development of this market.

Standardisation, transparency and information disclosure

Question 6:

A) For qualifying securitisations, what is the right balance between investors receiving the optimal amount and quality of information (in terms of comparability, reliability, and timeliness), and streamlining disclosure obligations for issuers/originators?

We do not believe that any of the existing disclosure requirements set out in the Commission Delegated Regulation (EU) 2015/3 (the CRA Delegated Regulation) should be streamlined or limited. Disclosure is key to ensuring investor understanding of a transaction.

We are supportive of the disclosure requirements set out in that they require issuers to disclose the relevant documents relating to a transaction including:

- The final offering document,
- Asset sale agreement,
- the servicing, back-up servicing, administration and cash management agreements;
- the trust deed, security deed, agency agreement, account bank agreement, guaranteed investment contract,
- incorporated terms or master trust framework or master definitions agreement;
- any relevant inter-creditor agreements, swap documentation, subordinated loan agreements, start-up loan agreements and liquidity facility agreements; etc.

In addition to this, issuers should be required to disclose information on the underlying assets including:

- loan level data and meaningful historical data and risk factors (LTVs, ratings, etc.); and
- any claims on these assets that lie outside the securitisation and may affect it.

All transaction documents as required by the CRA Delegated Regulation should be made publically available and at no cost to the investor or prospective investors either on the issuer's website or on a central database at national level at once the initial offering is concluded.

Prospectuses should be made available to investors at least 5 working days before the transaction is priced.

B) What areas would benefit from further standardisation and transparency, and how can the existing disclosure obligations be improved?

Transaction documents and investor reports

- We welcome greater standardisation of transaction documentation, including prospectuses, investor reports, and key transaction terms, and would support the development of a global set of disclosure standards for securitisation transactions.
- Standarisation requirements should not be overly prescriptive. Instead they could take the form of standardised templates or guidelines on what is expected.
- This should include a requirement for qualitative disclosures, such as those on underwriting and servicing procedures, to be complemented with the reporting of defaults, delinquencies, arrears and other risk metrics, such as forbearance and prepayment rates.
- All triggers affecting the cash flow waterfall, payment profile or priority of payments of the securitisation should be clearly and fully disclosed both in transaction documentation and in investor reports.
- Information in the investor report should clearly identify the breach status, the ability for the breach to be reversed and the consequences of the breach. As noted above, this information should be provided in a tabular format to ease understanding.
- Originators or sponsors should be required to provide details on all the triggers (including non-financial triggers) in a tabular format, and the status of components and their respective trigger levels. This would help avoid any ambiguity surrounding non-financial triggers.
- There are no homogeneous definitions of the main factors characterising the risk profile of securitised assets. For example, the definitions for defaulted assets, delinquencies, or loan to value differ between jurisdictions. This often leads to significant difficulties comparing transactions.
- Key transaction terms may differ from jurisdiction to jurisdictions based on different legal systems; we would however expect that transaction documentation, investor reports and key transaction terms be consistent, at a minimum at the national level.

Cash flow models

- The Investment Association would welcome further disclosures regarding cash flow waterfall models.
- Originators or sponsors should make available to investors the liability cash flow model and information on the cash flow provisions allowing appropriate modelling of the securitisation cash flow waterfall.
- Where a liability cash flow model is provided, issuers should also publish the model's code for inspection. This is to ensure that the cash flow model accurately reflects the prospectus, and vice versa.
- This information should be provided both before pricing of the securitisation and on an ongoing basis.
- The Investment Association notes that the Bank of England's eligible collateral framework, which includes a requirement surrounding the disclosure of a liabilities waterfall model, has been in place since 1st December 2011, since this time there have been more than 80 issues without any apparent problems or legal disputes.

C) To what extent should disclosure requirements be adjusted – especially for loan-level data – to reflect differences and specificities across asset classes, while still preserving adequate transparency for investors to be able to make their own credit assessments?

Disclosure standards should take into account the different underlying assets. Different templates and guidelines should be developed to reflect these differences.

Question 7:

A) What alternatives to credit ratings could be used, in order to mitigate the impact of the country ceilings employed in rating methodologies and to allow investors to make their own assessments of creditworthiness?

Investors will typically undertake their own credit analysis on the portfolio of underlying assets prior to making their investment decisions. Clear, concise and accessible transaction level information, as well as initial and on-going data is critical in supporting investors in making their own assessment. In addition to this, investors will take into consideration the economic conditions in a country as this will have an impact on the underlying portfolio. Investors will then typically benchmark this analysis against external credit ratings. To further assist investors in their credit analysis we would recommend the:

- publication of both the capped and uncapped ratings.
- development of an "expected loss" approach as currently developed in the US.
- publication of cash flow waterfall models.

We note that more recently the EU legislation has placed significant emphasis on reducing reliance on external credit ratings. However unless changes to EU legislation, such as Solvency II that determines the capital that insurers have to hold against an investment on external credit ratings, are made to allow for the use of uncapped ratings it would be difficult to mitigate the impact of country ceilings employed in rating methodologies. This would be difficult to achieve as if un-capped ratings were permitted for use in securitisations, the same should apply for all other asset classes.

B) Would the publication by credit rating agencies of uncapped ratings (for securitisation instruments subject to sovereign ceilings) improve clarity for investors?

The Investment Association is supportive of publication of both capped and uncapped ratings published, which would allow investors to get the clearest possible understanding of the transaction.

Rating agencies routinely produce and sometimes publish underlying ratings in other contexts, such as the BCA (Baseline Credit Assessment) at Moody's and the SPUR (S&P Underlying Rating) at S&P.

<u>Secondary markets, infrastructures and ancillary services</u>

Question 8:

A) For qualifying securitisations, is there a need to further develop market infrastructure?

The Investment Association would welcome a central, free-to-access electronic repository for all documentation relating to securitisation instruments, in order to provide greater access to information for investors. This could be modelled on the European Data Warehouse.

B) What should be done to support ancillary services? Should the swaps collateralisation requirements be adjusted for securitisation vehicles issuing qualifying securitisation instruments?

Currently, both sides of the swap have to post collateral, making the instrument extremely expensive.

The Investment Association believes that SPVs should not be required to post any collateral.

C) What else could be done to support the functioning of the secondary market?

In general, efforts to make the securitisation market more attractive to investors will have a positive effect for secondary markets, by increasing the number of primary issuances and hopefully therefore increasing market liquidity. In addition, a reduction in capital requirements for qualifying securitisations would allow banks to take on more inventory, with a benefit to liquidity.

A more liquid secondary market would limit cases of balance sheet volatility and thus increase the attractiveness of securitisation. Price volatility could also be reduced via the implementation of an effective market making platform, or via a 'last resort buyer' with specific programs, such as the asset purchase program in the US, or the program on European Covered Bonds.

Prudential treatment for banks and investment firms

Question 9:

With regard to the capital requirements for banks and investment firms, do you think that the existing provisions in the Capital Requirements Regulation adequately reflect the risks attached to securitised instruments?

No Comment

Question 10:

If changes to EU bank capital requirements were made, do you think that the recent BCBS recommendations on the review of the securitisation framework constitute a good baseline? What would be the potential impacts on EU securitisation markets?

The revised securitsation framework published by the BCSB in December 2014 sought to address a number of shortcomings that were identified during the crisis such as:

- mechanistic reliance on external ratings;
- risk weights that were too low for hugely related securitisation exposures;
- risk weights that were too high for low rated senior securitisation exposures; and
- cliff effects in capital requirements.

Many of these shortcomings will be addressed once the revised securitisation framework has been implemented into European legislation.

If these changes are supplemented by:

- BCBS-IOSCO criteria for the identification of simple, transparent and comparable securitisations, and
- EBA criteria for simple, standard and transparent securitisations;

we believe that the Commission will have developed a framework to identify securitisations with improved risk profiles that will warrant different capital treatments for those that do not meet these criteria.

Question 11:

How should rules on capital requirements for securitisation exposures differentiate between qualifying securitisations and other securitisation instruments?

The European Commission should seek to establish a single definition of securitisation and a single definition of qualifying securitisation. This definition should ideally be harmonised with those used at a global level.

Under such harmonised definitions a securitisation should be deemed qualifying or not at the transaction level not at the tranche level. If a securitisation is qualifying, then all exposures to it, including all classes of notes, are qualifying.

All exposures to a qualifying securitisation should have lower capital requirements than otherwise equivalent exposures to a non-qualifying securitisation.

To avoid cliff effects, securitisations that are considered qualifying at issuance should not retroactively be deemed non-qualifying during the life of the transaction.

Question 12:

Given the particular circumstances of the EU market, could there be merit in advancing work at the EU level alongside international work?

Ultimately a global framework would provide the most benefit to the securitisation market. Nonetheless, The Investment Association supports the work being done at an EU-level to expand the securitisation market and make it more attractive to investors.

The Commission should seek to ensure that any work that is advanced at EU level:

- reflects the feedback received to the proposals put forward by the EBA and the BCBS-IOSCO joint taskforce;
- closely monitors developments at an international level and ensures regulatory consistency that creates a level playing field for bank and non-bank investors, and limits the possibility for regulatory arbitrage.
- creates a uniform approach to criteria, definitions and terminology that can be adopted across different regulations but is flexible enough to deal with differences between different securitised assets that are originated and listed in capital markets across the EU.

Prudential treatment for non-bank investors

Question 13:

Are there wider structural barriers preventing long-term institutional investors from participating in this market? If so, how should these be tackled?

As mentioned above, there are a number of regulatory barriers that act as barriers to long-term institutional investors participating in this market. In addition to this, securitisations still suffer a reputational stigma following the financial crisis.

The work that is currently being done both at international and EU level will be instrumental in overcoming these barriers.

Question 14:

A) For insurers investing in qualifying securitised products, how could the regulatory treatment of securitisation be refined to improve risk sensitivity? For example, should capital requirements increase less sharply with duration?

The Investment Association welcomed the changes to Solvency II that recognised that high quality securitisations should be identified and given a specific capital treatment. However, we note that:

- the current capital charges remain too high and do not reflect their default performance during the financial crisis. For example, a 5-year AA securitisation will still have a capital charge of over 15%. This should be compared to a total actual accumulative default rate during the crisis (2007 to 2013) of only 0.14%.
- with regards to mortgage loans, a different approach should apply if an insurer holds the mortgage loans directly as compared to investing in a RMBS. While in the case of mortgage loans Solvency II appropriately recognises that the real risk is counterparty default risk, in the case of RMS the capital charge is based on the historical price volatility. This leads to the anomaly that a 10y residential mortgage loan portfolio with eg 100% LTV ratio is charged at 3%, while a 10y AAA RMBS is charged at 21.5%.

In light of this, The Investment Association recommends that:

- capital charges for STS should be aligned to capital charges between those for covered bonds and corporate bonds with a similar rating and similar duration.
- capital charges for high quality securitisations should be capped at the level of the charge for directly holding a similar pool of assets.

B) Should there be specific treatment for investments in non-senior tranches of qualifying securitisation transactions versus non-qualifying transactions.

A securitisation should be deemed qualifying or not at the transaction level, not at the tranche level. If a securitisation is qualifying, then all exposures to it, including all classes of note, are qualifying. If not, then no exposure to it, including none of the classes of note, should be considered qualifying.

In addition, it worth noting that the BSCB-IOSCO proposals considered if changes could be made to the voting rights afforded to junior noteholders for simple, transparent and comparable securitisations. We do not support any approach that seeks to affect the voting rights of junior tranches.

Voting rights are a factor that is considered actively when purchasing/pricing different securitisation tranches. Limiting the voting rights of junior noteholders would act as a disincentive to investors interested in investing in the junior tranches of a transaction as they would not only be taking first loss (relative to the senior tranches) but the protections afforded to them by the ability to vote on material changes would be taken away. This may negatively impact the marketability of these tranches in the transactions and consequently the revival of the securitisation market.

Question 15:
A) How could the institutional investor base for EU securitisation be expanded?

We believe that the above suggestions, including:

- the establishment of a framework for simple, transparent and standardised securitisations;
- the reduction of capital charges for qualifying securitisations;
- the standardisation and harmonisation, where possible, of securitisation frameworks; and
- increased transparency and disclosure to investors both during the issuance process and on an ongoing basis;

Will broaden the institutional investor base by making securitisations more attractive for investors, and making it easier for them to invest cross-border.

B) To support qualifying securitisations, are adjustments needed to other EU regulatory frameworks (e.g. UCITS, AIFMD)? If yes, please specify.

The Investment Association recommends that a holistic, in depth review of the entire web of regulatory frameworks for securitisations and other investment products both within the EU and globally. This should include:

- developing a standardised approach to definitions and terminology for securitisations, including STS and non-STS, that can be used across the broad range of regulations,
- amendments to the risk retention requirements to place the onus on the originator or sponsor rather than the investor, coupled with consistent disclosure of compliance with these requirements; and
- harmonising due diligence requirements for investors under the UCITS and AIFMD frameworks.

Question 16:
A) What additional steps could be taken to specifically develop SME securitisation?

We welcome the Commission's Green Paper on the Capital Markets Union, which focuses, amongst other issues, on improving financing for SMEs via the development of an integrated capital markets union.

In order to develop the market for SME securitisations:

- Focus should be placed on improving the availability of key performance metrics while complying with national confidentiality laws. This would significantly increase transparency and decrease concerns about information asymmetry between originators and investors.
- In the long term, efforts to harmonise relevant insolvency, tax and company law across Europe will encourage cross-border investment in SMEs.
- Non-actively managed CLOs should be recognised within the STS framework. This would lower the capital requirements for these instruments and encourage more investment.

B) Have there been unaddressed market failures surrounding SME securitisation and how best could these be tackled?

No comment

C) How can further standardisation of loan level information, collection and dissemination, in order to reduce the cost of issuance and investment?

No Comment

D) Would more standardisation of loan level information, collection and dissemination of comparable credit information on SMEs promote further investment in these instruments?

Yes.

<u>Miscellaneous</u>

Question 17:

To what extent would a single EU securitisation instrument applicable to all financial sectors (insurance, asset management, banks) contribute to the development of the EU's securitisation markets? Which issues should be considered in such an instrument?

We do not believe that a single legislative instrument applicable to all financial sectors would be appropriate, given the differences between insurance, asset management, and banks and their different prudential requirements.

However, we encourage that Commission to develop an overarching framework that can be incorporated into various pieces of legislation. This should include:

- Standardised definitions of securitisations including STS and non-STS.
- Standardised prospectuses and investor reports – this should not be overly prescriptive but should provide some guidance on the information that should be provided.
- Standardised retention requirements that ensure that the onus is placed on the originator or sponsor to provide disclosure at issuance and on an ongoing basis.

Question 18:

A. For qualifying securitisations, what else could be done to encourage the further development of sustainable EU securitisation markets?

No comment

B. In relation to the table in Annex 2, are there any other changes to securitisation requirements across the various aspects of EU legislation that would increase their effectiveness or consistency?

No comment.