**IACPM Answers to question 6, 9, 12**

**QUESTION 6**

# Sustainability disclosure

Introduction:

In the synthetic securitisation market specifically, securitisations are very relevant to support SMEs/corporates transformation during the transition phase towards a more resilient economy, and to finance all sustainability-related investment initiatives.

It is therefore important that the framework

* does not only consider strictly "sustainable", "green" or “taxonomy-aligned” loans (like labelled green bonds or social bonds), but also
* promote lending to companies which are in the transition phase either via the **underlying assets**, or via the **use-of-proceeds**, as well as by **sustainability-linked lending**, a significant part of the ESG synthetic securitisation market at the moment.

**Question 6.1.** Are there sufficiently clear parameters to assess the environmental performance of assets other than auto loans or mortgages?

Yes, for all asset classes

Yes, but only for some asset classes (please specify) **No**

No opinion

**Question 6.2.** Should publishing information on the environmental performance of the assets financed by residential loans and auto loans and leases be mandatory?

Yes, the information is currently available

**No**

No opinion

*For synthetic on balance-sheet securitisations:*The responses “yes” would only apply to synthetic securitisations intended to be marketed as sustainable/ESG securitisation, with a transitional period to ensure the availability of information, and with a grandfathering arrangement for existing deals. Otherwise, for non-STS / non-ESG synthetic securitisations, mandatory requirement to publish the environmental performance information should not apply.

We would also note in this regard that on-balance sheet (synthetic) securitisations designated as STS and involving residential loans or auto loans or leases would in any case be subject to additional transparency requirements under Article 26d of SECR relating to environmental performance, including the new technical standards prescribing the content, methodologies and presentation of such disclosure which ESAs are required to develop.

Therefore, we would also recommend caution in this area for the time being – not because we would not support the introduction of environmental performance disclosure requirements, but because there are so many overlapping developments in this area that it would be premature to do so specifically in the securitisation market now. In this regard (and apart from STS considerations noted here above), we would note that synthetic securitisations, like securitisation market more generally, can involve different asset types and different institutions acting as counterparties or investors, with a range of sustainability-related regulatory requirements, standards, taxonomies, industry-led initiatives etc. applied to them.

Therefore, any introduction of further securitisation-specific sustainability reporting may result in duplicative disclosures and reporting, extra costs and regulatory compliance challenges on both sell- and buy-side.

**Question 6.3.** As an investor, do you find the information on environmental performance of assets valuable?

**Yes** No

No opinion

Describe the use you have made of it?

*For synthetic on balance-sheet securitisations:*The information on environmental performance is used by investors for two separate purposes:

* Assess the (positive) **sustainability impact** of the portfolio, and benchmark it to their investment strategy: without impact data, investors will not be able to incorporate securitisations in impact-related funds, generally based on SDG themes and criteria
* Assess **portfolio sensitivity to ESG risks**, run medium/long-term scenarios and benchmark it to investors’ appetite for ESG risks.

Investors in synthetic securitisations acknowledge that **flexibility is required during the transition phase around the format of acceptable securitisation transaction** (combining collateral / use of proceeds or sustainability linked approach) **and the definition of underlying assets.**

This flexibility is especially relevant in the SME space, and notably on transactions supported by the EIF, where developing and increasing the proportion of sustainable lending is especially challenging.

**Question 6.4.** Do you think it is more useful to publish information on environmental performance or on adverse impact and why?

*For synthetic on balance-sheet securitisations:*On synthetic securitisations that are intended to be marketed as sustainable/ESG securitisations, both are important as they have different purposes, as explained in 6.3. hereabove. Positive environmental impact is also as important than negative impact.

However, we would caution against developing overly prescriptive securitisation-specific disclosure requirements. Flexibility will be necessary during the transition period on the type of data that borrowers and originating banks are able to report on, and investors will have to assess if the available information is comprehensive enough to achieve their investment strategy.

With regard to the latter, we note that investors can refer

* For **risk** assessment, to the EBA report on management and supervision of ESG risk management, which tackles broader than just environmental risk, and proposes several approaches to assess ESG risks (portfolio alignment, risk framework and loan-by-loan exposure methods), and
* For **impact** assessment, to the global indicators framework designed by the UN for the monitoring of the Sustainable Development Goals,

when performing their own ESG due diligence as well as when complying with their SFDR requirements.

**Question 6.5. a)** Do you agree that these asset specific disclosures should become part of a general sustainability disclosures regime as EBA is developing?

**Yes** No

No opinion

*For synthetic on balance-sheet securitisations:*Yes, this will be relevant on securitisations intended to be marketed as sustainable/ESG provided any duplicative disclosures and reporting are avoided and flexibility is maintained during the transition period when availability of relevant data may be more limited.

There should be no difference between mandatory sustainability disclosures on loan portfolios whatever the purpose. However, depending on the asset type and the investment strategy, investors may ask for additional information that is material to them.

**Avoiding additional complexity and leveraging currently existing regulatory frameworks and high-level disclosure standards are critical.**

On transparency requirements, it is important to highlight that

- EU STS (traditional and synthetic) securitisations backed by auto and residential mortgage assets are already required to provide additional disclosure on sustainability and harmonisation of such disclosure will be further made under the new technical standards.

- EU on balance sheet (synthetic) STS framework requires the appointment of an external verification agent to verify that underlying assets comply with the applicable eligibility criteria. Sustainability-related criteria will be part of that verification process.

- Whether or not the deal is an EU STS, securitisations in scope of the EU Securitisation are also required to provide at least quarterly loan-by-loan and investor reporting using very prescriptive templates, which already include certain sustainability-related reporting fields (eg Residential mortgage loan templates requires loan-by-loan disclosure of the Energy Performance Certificate Value).

Therefore, any additional sustainability related transparency should be carefully incorporated into existing reporting and transparency framework avoiding duplication or creation of unnecessary burden, and must be subject to detailed consultation with the industry.

Considerations should also be made to the **extra-territorial effect** of EU regulations for sustainable finance, as many stakeholders operate beyond the boundaries of the European Union and will have to meet multiple ESG-related requirements. For example, EU investors when investing in non-EU securitisations are also required to confirm that they receive sufficient transparency and disclosures on the deal characteristics and its risk profile. However, for the last three years, since SECR became applicable, it remains unclear whether non-EU securitisations in this context are expected to prepare EU style loan/investor reporting. Therefore, the development of EU sustainable securitisation framework will need to be clear with regard to expectations for sustainability-related disclosures on non-EU deals and for EU deals that may also involve non-EU sell-side parties. In this regard, we would emphases that it is very important for the industry to be clear on the scope of application of any new SECR requirements. It should be clearly stated in any legislative proposal if the new requirements are intended to have extra-territorial effect and, if such extra-territorial effect is intended, meaningful time for consultation with the industry is provided by the European Commission and/or other relevant EU regulators.

**Question 6.5. b)** Should ESG disclosures be mandatory for (multiple choice accepted):

Securitisation that complies with the EU green bond standard; **YES**

RMBS; **Yes**

Auto loans/leases ABS; **Yes**

The responses “yes” above are provided on basis that the relevant synthetic securitisation is intended to be marketed as sustainable/ESG securitisation, otherwise mandatory requirement to publish ESG disclosures should not apply.

**Question 6.6.** Have you issued or invested in a green or sustainable securitisation? If yes, how was the green/sustainability dimension reflected in the securitisation? (multiple choice accepted)

|  |  |  |
| --- | --- | --- |
|  |  | Please describe how the use of proceeds principle is applied **- Examples** |
| Green or sustainable underlying assets | Yes | * **Underlying green assets** can include physical assets and financial assets such as loans and trade receivables. * Green assets can be tangible or intangible, and they can include the share of working capital that can reasonably be attributed to their operation. * Ex: Underlying loans complying with ICMA or LMA standards for sustainable loans * Ex: Mortgages to finance energy-efficient homes, electric vehicle loans/leases, solar panel leases, SME loans to fund environmental projects, etc. |
| Use of proceeds for green/sustainable projects. | Yes | * **Underlying brown assets**, but the use of proceeds raised or the **capital/liquidity relief** generated is applied for green purposes and/or the originator has strong credentials generally * Ex: Referencing an existing SME portfolio (brown), but commit to reinvest a majority of the **proceeds** to taxonomy-aligned investments * Ex: Commit that 25% of the **RWA reduction** will be used to spur new Positive Impact financing over the next three years |
| Green/sustainable collateral AND use of proceeds for green/ sustainable projects | No |  |
| Other (please describe)  Sustainability-linked securitisations | Yes | * **Underlying transitional assets** but the structure of the transaction or the terms of the bonds are more favourable if ESG KPIs related to the issuer and/or the underlying assets are met * Ex: If the Bank can redeploy twice more of the RWA reduction towards positive impact projects after 4 years, the coupon is reduced, creating an **incentive for additional Positive Impact Finance** investment. |

* For the voluntary **Green/Sustainable Securitization Standard**, as for the Green Bond Standard, a common framework is necessary (min % of assets aligned with EU Taxonomy, mandatory third-party validation, grandfathering), to enable investors to include the % aligned with the EU Taxonomy in their GAR (by banks) or in the % of the investment fund aligned (by asset managers).
* For **transactions on assets that are not 100% taxonomy-aligned**, setting a minimum on share of sustainable assets would exclude transactions based on use-of-proceeds and sustainability-linked criteria, and provide limited support and incentive for sustainable economic growth. In these early years, we need more flexibility to ensure more funding/capital is available for developing sustainable economy by the use of securitisations. Therefore, as far as the transaction’s characteristics are fully transparent, and disclosures are proportionate, we recommend that
* for securitisation with a **share of sustainable assets** in the underlying pool, a sliding scale starting with e.g. 30% - 40% and gradually moving to 100%. Long-dated securitisations could in time repurchase/remove non-sustainable assets from the pool and replace them with sustainable ones to achieve higher than 40-50% during the life of the deal. Such a sliding scale would not only account for the limited availability of sustainable collateral, but also stimulate the transition
* for securitisations based on **use of proceeds**, a similar sliding share could be applied, but starting at a higher minimum level (e.g., 50%), on the proceeds used for sustainability purposes - irrespective of whether or not any of the underlying assets are themselves sustainable. A synthetic risk transfer deal where none of the reference obligations are sustainable should nevertheless qualify if a large and growing amount of proceeds are used for sustainable purposes.

The characteristics of the proposed sliding scales are to be subject to the review by the Joint Committee of ESAs's under Article 44 of the SECR which mandates it to report every three years, starting with 1 Jan 2021, on the functioning of the SECR regime. Article 44 should subsequently be amended to expressly mandate the Joint Committee to report on the functioning of the sustainable securitisation framework. Thus, the appropriateness of the sliding scales will be monitored and assessed from time to time.

In summary, we suggest to clearly differentiate between

1. **the qualification of “sustainable securitisation” as per the SECR regulations**, which would apply to the 3 types of transactions (based on the underlying loans, on the use-of-proceeds or on the sustainability-linked incentives embedded in the loans), applicableduring the **transition phase**, with the **sliding shares**, aiming to **promote the transition,** and finance sustainable assets after the transition phase, and
2. **the voluntary « label »** that would only apply to close to **100% taxonomy-aligned** underlying assets, but **without promoting transition.** Such a label can already apply now to transactions on e.g. renewable energy projects or green mortgages, but would **not** help SME and corporates in transition.   
   Securities issued from transactions based on "use-of-proceeds" might qualify for a "green" or "sustainable" bond label, while the label "sustainable securitisations" is restricted to transactions collateralized by taxonomy-aligned assets.

**Question 6.6.** According to the [Commission proposal for a European green bond](https://ec.europa.eu/info/publications/210706-sustainable-finance-strategy_en#green-bonds) [standard,](https://ec.europa.eu/info/publications/210706-sustainable-finance-strategy_en#green-bonds) a securitisation bond may qualify as EU green bond if the proceeds of the securitisation are used by the issuing special purpose vehicle to purchase the underlying portfolio of Taxonomy-aligned assets. Is there a need to adjust this EuGB approach to better accommodate sustainable securitisations or is there a need for a separate sustainable securitisation standard?

Yes No

No opinion

Auto-loans/leases

Trade receivables

Residential mortgages (RMBS)

SME loans - **Yes**

Corporate loans **- Yes**

Leases

Consumer loans

Credit-card receivables

Other – please specify : Asset based finance (commercial mortgages, project and infrastructure finance, etc): **Yes**

[If so, what should be the requirements for a securitisation standard?] Please explain your answer.  
  
**We don’t see the need to change in EUGBS for securitisation the principle that the underlying loans should be aligned with the EU taxonomy.** A limit might however be set on the assets that lose their status of "taxonomy alignment" due to strengthening of the Technical Screening Criteria over time, as long as these assets do not significant harm any sustainability objective.

It is important that this standard operates like the other bonds or loans standards from ICMA or LMA, remains voluntary, and that careful consideration is given as to how any "label" would interplay with:

- obtaining (or not) any regulatory benefit;

- existing regulatory benefit that EU STS-designated securitisations already have.

We should not end up in a maze of labels and regulatory treatments, like STS but without sustainable label, STS with sustainable label, not STS but with sustainable label, not STS without sustainable label; etc

**Such a EU label would mainly be relevant for public transactions**, but less for private transactions, because junior private credit investors will use their own internal framework to assess the ESG risk and the sustainability impact of the loan pools.

Harmonisation will however be very helpful, but in these early years, the markets are likely to continue to be fragmented. Therefore, without flexibility for receiving regulatory benefit that will promote sustainable securitisations, a one-size-fits-all label will likely to achieve the opposite effect and could be detrimental to the development of sustainable securitisation market.

For all these reasons, any sustainability-related securitisation framework needs to work alongside other sustainability-related frameworks avoiding duplication and ensuring that any securitisation-specific changes do not lead to unnecessary burdens and increased costs of doing a securitisation, which will inevitably further hinder the development of wider securitisation issuer- and investor-base.

**QUESTION 9**

# Assessment of non-neutrality correction factors impact

**Question 9.1 a)** In your view, is the capital impact of the current levels of the (p) factor proportionate, having regard to the relative riskiness of each of the tranches in the waterfall, and adequate to capture securitisations’ agency and modelling risks?

Yes **No**

No opinion

*For synthetic on balance-sheet securitisations:*P factor and RW floors were originally introduced to create a **non-neutrality effect** in capital vs the underlying pool, and account for the agency and modelling risks specific to securitisation transactions. These risks were, between others, at the source of the collapse of US sub-prime residential mortgages securitisations during the 2007-2008 global financial crisis.

However, these risks are very different in synthetic on balance-sheet securitisations and have been materially mitigated since 2008 :

1. **Agency risk** is the operational risk arising from the multiple relationships between the agents of a securitisation structure, and related information asymetries.
   * + However, in synthetic on balance-sheet securitisations aiming at risk transfer, banks are retaining the senior tranche. For this retained tranche, there is **no asymmetry of information** as the seller, the servicer and the buyer are the same institution: the originating bank
     + These transactions are also mostly private and not externally rated: they rarely bear the rating agency risk

Therefore, **there is a specific rationale to reduce the non-neutrality effect created to account for agency risk in originators’ retained tranches of synthetic on-balance-sheet transactions.**

1. **Modelling risk**, as articulated in 2012 and 2014 BCBS papers justifying non—neutrality in the securitisation framework (\*) arises from the layering of models and assumptions made on the underlying pool and on transaction structural features to estimate the loss distribution which serves to define the waterfall of tranche.

However, subsequent to those BCBS papers, and **particularly in the EU**, confidence in models has been significantly enhanced by the following initiatives:

* + - BA IRB repair: harmonization of modelling practices (2013)
    - TRIM: deep review of banks’ main internal models by supervisors
    - Model risk management frameworks and capital attributed to model risk
    - Forward-looking yearly stress tests, to complement historical models

**P factors and RW floors have not been amended to reflect these model risk mitigants. The non-neutrality of securitisation risk weights achieved through p factor and RW floors was actually increased in recent years.**STS transactions – simpler and more standardised – and naturally embedding a lower modelling risk, only “benefitted” from a more limited increase. The reduced risk weights associated with STS do not purport to reflect the broader, fundamental, reductions in model risk achieved by EU banks and outlined above.

As indicated by BCBS, modelling risk resides mostly in the senior tranches, i.e. in the ultimate level of the waterfall structure, while junior tranches are only sensitive to genuine credit risk. **The reduction of non-neutrality due to model risk should therefore specifically target a reduction of the RW floor on senior tranches**, which are typically retained by banks.

1. Moreover,
   * the strengthening of the regulatory landscape for securitisations has reduced significantly the agency and model risks which justified the introduction of the p factor after the Global Financial Crisis
   * Many additional safeguards are now in place in regulations to offset any perceived additional risks (e.g. Systematic supervisory review of the SRT assessment process).

**All in, in synthetic on balance-sheet securitisations, the absence of information asymmetry (agency risk) and the mitigation of the model risk specific to retained senior tranches justify for a recalibration of both the p factor and the RW floor.**

Moreover, the finalisation of Basel III will introduce a double layer of conservatism on balance-sheet securitisations on the pools RWA and on the risk-weight of the tranches:

* 1. The first layer of conservatism relates to the calculation of the **RW on retained tranches**: the RW on retained tranches under SEC-IRBA is, in effect, floored based on the output of SEC-SA (or SEC-ERB) calculations, which are more conservatively calibrated than the SEC-IRBA.
  2. The second layer of conservatism results from the application of the SA, which is more conservatively calibrated than the IRBA, to calculate the **RW of the underlying pool**, as an input to SEC-SA: the SA will lead to a higher capital charge without any change in the underlying risk.

The consequences of the output floor on securitisation is again particularly worrying for synthetic securitisations where - by definition - the senior tranche is retained, contrary to traditional true sale securitisations.

It is important that the RWA inflation due to the introduction of IRB input floors and the SA output floors on securitised pools is not further magnified by the non-neutrality of the securitisation risk weight functions. Hence a re-calibration of the SEC-IRBA and SEC-SA formulae should be undertaken.

**By increasing the non-neutrality effect without change in the underlying risks, the finalisation of Basel III will also justify a review of the p factors and RW floors, particularly for on balance-sheet securitisation where senior tranches are retained.**

(\*) BCBS 2012 consultative paper: “*Model risk is arguably more acute for securitisations exposures, because setting capital requirements for securitisation exposures involves multiple layers of modelling exercises and assumptions. […] This* ***layering of models and assumptions*** *can amplify the uncertainty associated with capital estimates. In addition,* ***the uncertainty in capital estimates is higher for highly-rated****, seemingly low-risk tranches and there is an asymmetric nature to the uncertainty*.”

BCBS 2014: “*The objectives of a* ***risk-weight floor*** *are:*

* + - *Mitigate concerns related to incorrect model specifications and error from banks’ estimates of inputs to capital formulas (ie model risk); and*
    - *Reduce the variation in outcomes for similar risks.”*

**Question 9.1 b)** If you would favour reassessing the current (p) factor levels, please explain why and what alternative levels for (p) you would suggest instead.

*For synthetic on balance-sheet securitisations:*We estimated the level of non-neutrality that would apply to STS and non-STS securitisation of various asset classes (corporates, consumer loans, residential mortgages low/medium risk, consumer loans), and for STS/non-STS transactions, by comparing  
- the average RW of the portfolio before securitisation and   
- the aggregated RW of all tranches if they were fully retained by the originating bank.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Multiplication factors** | | Corporate IG | Corporate HY | Residential mortgages low risk | Residential mortgages high risk | Consumer loans |
| STS | SA | 1,5 | 1,88 | 1,75 | 2,39 | 1,5 |
| STS | IRB | 1,6 | 1,3 | 3,99 | 2,14 | 1,8 |
| Non-STS | SA | 2 | 2,51 | 2,24 | 3,19 | 2 |
| Non-STS | IRB | 1,8 | 1,42 | 6,19 | 2,21 | 2,47 |

In synthetic on balance-sheet transactions, the multiplication factor between aggregated RW on all the tranches after securitisation and RW on a loan pool is quite substantial, forcing banks to sell thicker junior tranches and increasing the cost of such transactions before releasing enough capital to re-invest in new loans.

The multiplication factors are of course higher on non-STS than on STS transactions, as p factors are different:

Neutrality  
level

Although theoretical, the examples in attachment 1 illustrate the **RWA inflation** induced by the calibration of the SEC-IRBA and the SEC-SA : if a bank was to sell 80% of all the tranches, the RWA reduction would range between 48% and 73% under SEC-IRBA and between 36% and 60% under SEC-SA.

Based on these examples, we estimated that **a fair target of non-neutrality effect could be estimated at maximum 1.5**, and simulated the level of p factor reduction which would allow to achieve this objective.

* We provide you in *Appendix 3* with an analysis performed on four real life transactions to estimate the level of p factor reduction in SEC-SA which could compensate for the RW difference resulting from the (final) Basel III ‘Output Floor’ pre-securitisation (IRB to SA) and post-securitisation (SEC-IRBA to SEC-SA).   
    
  For these transactions specifically, the attached simulations come out at a **reduction of the p factor by circa 50% :**
* In the ‘SEC-SA’, halving the p-factor can bring down the credit enhancement required to reach RW floor to a more reasonable level (still with 1.5 x UL coverage), which should also support smaller SA banks issuance
* Non-Neutrality of c.150% and c.125% of pre-securitisation capital are achieved for Non-STS and STS examples respectively
* The approach to calibration is conservative as normalising the (final) Basel III Output Floor impact does not give recognition to the senior credit risk retained vs pre-securitisation credit risk.

For memory, adjusting the p-factor in SEC-SA to 0.5 for non-STS and to 0.25 for STS transactions, is aligned with the proposals made in the final report of **CMU High Level Forum** (Annex pages 61-62), and to the proposed amendments to Articles 261, 262, 263 and 264.

* However, **the necessary level of p factor reduction is very dependent of the output floor impact on the retained tranche, and varies according to the specificities of the underlying portfolios**: it is typically less important if the RW under SA is low and much more penalizing otherwise.

As you can see in the example below, calculated for a STS transaction on a corporate pool eligible to the SME supporting factor (\*), dividing the p factor by two only halves the output floor effect on the senior tranche (from +36 to +18); in other words, the transaction would still release much less capital (28 RWA vs 57 RWA under current framework).

With p factor = 0,5 :

Chart, bar chart, waterfall chart

Description automatically generated

With p factor = 0,25 :

Chart, bar chart, waterfall chart

Description automatically generated

Based on the evidences above, we recommend that **p factors are reduced by at least 50% in SEC-SA for both STS and non-STS transactions**, and offer to participate in further discussions on this subject with the regulatory community, so that the final proposal is most efficient to compensate for the impact of the output floor.

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*(\*)Example of a corporate pool eligible to the SME supporting factor, attracting 66 RWA under IRBA and 100 RWA under SA (2.5y-maturity, 0.5% PD, 40% LGD) : the output floor impact before securitisation is +7 on the pool (i.e., the difference between the 73 RWA post SME supporting factor and 66 RWA under IRBA), but the impact on the retained senior tranche after securitisation is +36 (i.e., 45 under SEC-SA minus 9 under SEC-IRBA) in the case of an STS transaction. The STS transaction would have released* ***57 RWA*** *(66 RWA on the underlying portfolio under IRBA minus 9 RWA on the retained senior tranche risk-weighted under SEC-IRBA), but will only release* ***28 RWA*** *with the output floor (73 RWA on the underlying portfolio under SA minus 45 RWA on the retained senior tranche under SEC-SA).*

**Question 9.2** Are current capital floor levels for the most senior tranches of STS and non-STS securitisations proportionate and adequate, taking into account the capital requirements of comparable capital instruments?

Yes **No**

No opinion

Please explain your answer.

*For synthetic on balance-sheet securitisations:*RW floors are now significantly higher than under the previous securitisation regulatory regime (e.g. RW of senior non-STS tranche increased from 7% to 15%).

* + For the reasons explained in point 1 hereabove, we challenge the regulatory position that retaining a senior position on own originated portfolios requires the same capital than acquiring a senior position in a securitisation issued by a third party. We believe that retained senior tranches should benefit from further changes to the preferential STS risk weighted formula.
  + Also, given the excellent performance of EU ABS during and after the GFC and also during the Covid-19 pandemic, it is unclear what evidence there is for these higher RW floors.

To address this issue, we recommend introducing, for originating banks, a **7% RW floor for non-STS senior tranches** treated with SEC-IRBA/SEC-SA/SEC-ERBA and (IAA) as it was in the previous framework (so called SFA formula).

This proposal is also aligned with CMU HLF recommendations, and would ensure a **level playing field between EU and US banks**, whereby the latter still benefit from the Supervisory Formula Approach (SFA) under the IRB approach, which was present in the previous version of the framework in the EU, under the IRBA approach compared to the more conservative SEC-IRBA methodology now being used in the EU.

**Question 9.3** Are there any alternative methods to the (p) factors and the capital floors to capture agency and modelling risk of securitisations that could be regarded as more proportionate?

Please provide evidence to support your responses to the above questions.

*For synthetic on balance-sheet securitisations:*Different alternatives have already been discussed with regulators in the past.

In the interest of time, we recommend using the current framework while reducing the p factors and RW floors as proposed hereabove.

**Question 12**

1. **SRT tests**

**Question 12.1**. Do you agree with the allocation of the LTEL and UL to the tranches for the purposes of the SRT, CRT and PBA tests, as recommended in the EBA report?

Yes **No**

No opinion

Please explain your answer.

*For synthetic on balance-sheet securitisations:***The proposed SRT tests don’t work as expected when applied to real life transactions** that are transferring a significant amount of economic risk. We refer to the examples in *Appendixes 4 and 5* simulated on real life transactions, and approved for significant risk transfer.

**The proposal below assumes that p factor and RW floor will be fundamentally downsized.** Otherwise, we would challenge the appropriateness of introducing complex SRT tests to assess risk transfer significance, when the level of conservatism in the calculation of the RW release – just by itself – can demonstrate that commensurate risk transfer is achieved just because capital can be released despite the multiple layers of conservatism. We refer to our response to question 9 on non-neutrality effect.

Based on this assumption, and would proposed SRT tests anyhow be maintained, **the tests have to be amended**, and we investigated solutions to make these tests work.

**It is also very important that these tests serve only as guidance for supervisors, who should retain the ultimate responsibility of the final SRT decision.**

The new tests as designed seem to be based on the two following key assumptions:

a) issuers will run them to the time call, not the clean-up call and

b) transactions pools are largely composed of bullet amortizing loans with similar maturities,

and hence – in combination - assuming a significant outstanding balance at the time of the UL event. Since the vast majority of SRT transactions do not feature any “positive incentive” for issuers to exercise the time call, the current implication is that issuers must instead run tests to the clean-up call date, resulting in a much more extreme test than intended.

These two assumptions are simply not accurate:

* *Time call*: Running the tests up to the time calls should not have a consequence that an unintended “positive incentive” requires a capital surcharge due to maturity mismatch (cf our response to Q12.2 below)
* *Bullet loans*: SRT structures are used across a variety of asset classes with significantly different maturities and amortization dynamics over time (e.g. corporates, SMEs, autos, consumer, leases, trade finance, residential and commercial mortgages, etc).

The new tests are simply impossible to pass for many real-life deals whilst remaining economically viable. The key issue is the highly conservative application of the UL event in the final year of the transaction: a UL event based on the initial size of the portfolio occurring at the end of the transaction is significantly more adverse than any realistic stress scenario based on observed historical data, making it virtually impossible to structure transactions that pass the tests. By construction, no transaction would – in such scenario – benefit its structural protections such as pro-rata to sequential triggers, as they are usually set levels above the EL.

To make the tests work, various amendments have been considered, focusing on the allocation technique of the UL event, while maintaining EBA’s proposed treatment for expected loss (EL). We excluded some options, like modelling UL on a loan-by-loan basis at the maturity of every securitized exposure, as this may be overly complex for large consumer portfolios with a limited value added.

We simulated the three retained options of UL allocation (see *Appendix 6*) and believe that the option 2 is the most appropriate, i.e. amend UL event loss distribution as per EBA’s proposed ‘back-loaded’ EL vector. Allocating 33.3% of the UL to the first 2/3 and 66.6% to the final 1/3 of transaction life, as determined by clean-up call, meets the EBA’s objective in providing a significant stressed loss scenario to SRT structures (total size unchanged from original proposal) on a consistent basis across banks, which is also relatively simple to model and monitor across banks.

This amendment would make that the tested real life transactions (formerly approved by regulators for Significant Risk Transfer), would pass the tests, while ensuring that  
- Significant stress is applied to test efficacy of structures  
- Implementation and monitoring are simple across banks  
- Structural protections for pro-rata amortization (e.g. triggers to sequential) more likely behave as intended.  
- the approach is more aligned to bank economic modelling of a back-loaded stress.

We also agree with the EBA SRT Report that the proposal to model the lifetime behavior of transactions under stress, at inception, can provide a more dynamic test which better reflects the economics.

We therefore strongly recommend that the current testing methodology proposed in EBA report is reviewed so that the UL event loss distribution is amended as per EBA’s proposed ‘back-loaded’ EL vector.

We also want to warn regulators about the **complexity** of these tests and the underlying modelling techniques, which might not necessarily fit-for-purpose whatever the profile of the underlying portfolio or the structure of the risk sharing transaction, hence the importance to grant **flexibility** to supervisors when they analyse tests outcome to assess significance of risk transfer.

**Question 12.2**. What are your views on the application of Art. 252 of the CRR on maturity mismatches when a time call, or similar optional feature, is expected to happen during the life of the transaction?

*For synthetic on balance-sheet securitisations:*We believe that the EBA is misinterpreting the notion of **positive incentive** provided for in **Article 238** to which Article 252 refers and would be created by the time call.

As clearly stated in Article 238, the notion of “positive incentive” exists when the credit protection arrangement provides for an incentive – like an increase in the premium - at a certain time. On the contrary, the fact that the economics of the transaction deteriorate because of the amortization of the portfolio or the improvement of its credit quality does not constitute a positive incentive since this positive incentive does not exist, for example, if credit quality deteriorates.

We therefore propose that, unless the non-exercise of a time call has an effect on the contractual terms going forward, **the existence of a time call should not be seen as creating a positive incentive to call, regardless of whether the economics of the transaction may have deteriorated since the closing date.** This point should be clarified in CRR.