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The New European Framework for ABS Transactions

The Securitisation Regulation and the CRR Amendments

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1. Introduction

Background

Ten years have now passed since securitisation was stigmatised in public perception as being evil and having triggered off the financial crisis that began in 2007 – originally called the "US subprime crisis". In addition to the loss of confidence that occurred, the regulatory reforms aimed at stabilising the financial system under the banner of Basel III were accompanied by measures that nearly brought the European securitisation market to a standstill.

In the meantime, the negative effects of the financial crisis on the real economy led to the realisation that high-quality securitisations and a functioning Asset-Backed Securities market (ABS market) in Europe could

contribute to a better supply of credit to the real economy. It is estimated that up to EUR 150 billion in additional funding could be mobilised for the European economy.[1]

For this reason, measures to revitalise the European securitisation market have recently been initiated. At the end of 2009, the European Central Bank (ECB) responded to the lack of transparency of securitised loans with regard to assets eligible as collateral in the Eurosystem with a consultation on the Loan Level Data Initiative. Accordingly, issuers of ABSs have been required since 2013 to provide, depending on the individual asset class, gradually more and more comprehensive information at the individual loan level (loan-by-loan), in order to increase transparency in the securitisation markets and to improve risk assessment by the market participants concerned. These rules were introduced initially for Residential Mortgage-Backed Securities (RMBSs) and Small and Medium-sized Entities' (SMEs) securitisations, followed by Commercial Mortgage-Backed Securities (CMBSs) and later for consumer loans, auto loan and leasing, as well as credit card receivables.

"Securitisation is believed by many to be at the onset of the financial crisis in the US. While EU securitisations performed well overall, the crisis revealed flaws in the way securitisation is regulated and supervised."

Valdis Dombrovskis
Vice-President of the European Commission

To revive the European securitisation market and make it more attractive, the idea of distinguishing and privileging particularly high-quality securitisations arose. In May 2014 the Bank of England and the ECB[2] published a discussion paper on "qualifying securitisations" and in October of the same year the European Banking Authority (EBA)[3] followed with a discussion paper on "Simple, Standard, Transparent (SST) Securitisations". Finally, in December 2014, the Basel Committee on Banking Supervision (BCBS) – together with the Securities Supervision (Board of the International Organization of Securities Commissions, IOSCO) – as the global standard-setter, also published a similar consultation paper in which the terms "Simple, Transparent and Comparable (STC)" were used.[4]

Securitisations should be considered to be of a particularly high quality if they are as "simple" as possible in terms of the underlying assets and the cash flows resulting from them, if they are highly "transparent" with regard to the information relevant to investors, and if they are largely "standardised" and thus ultimately "comparable" with regard to standardised structures.[5] In an investment campaign for Europe presented in the same year, the European Commission announced a revival of the securitisation markets, with an emphasis on first-rate securitisations, which was intended to avoid the mistakes made prior to the 2008 financial crisis. The establishment of a simple, transparent and standardised securitisation market as an essential component of the Capital Markets Union is intended to support the real economy in creating jobs and returning to sustainable growth. Rules are to be adopted with which to better distinguish simple, transparent and standardised securitisations from complex, non-transparent

[1] Cf. Rapporteur Othmar Karas in debate of the European Parliament on 25.10.2017.
[2] Cf. BoE/EZB: The case for a better functioning securitisation market in the European Union, May 2014.
[3] Cf. EBA: Discussion Paper on simple, standard and transparent securitisations, October 2014.
[4] Cf. BCBS #304: Criteria for identifying simple, transparent and comparable securitisations, December 2014.
[5] Cf. EBA: Discussion Paper on simple standard and transparent securitisations, October 2014 und BCBS #304: Criteria for identifying simple, transparent and comparable securitisations, December 2014.

and high-risk securitisations and to align the supervisory framework with the actual risks.[6]

The ECB's Opinion dated 11 March 2016 on the European Commission's legislative proposals for a new EU Securitisation Framework indicates that, in its view, the proposed arrangements balance the need to revitalise the securitisation market in Europe by making the securitisation framework more attractive for both the issuer and the investor, and the requirement to maintain the supervisory nature of the Framework. Robust STS criteria, a reasonable certification procedure and strict supervision are said to be very important in order to implement a more risk-sensitive treatment of what are called "STS securitisations".[7]

[6] Cf. recitals (2) and (3) of Regulation (EU) 2017/2402 (Securitisation Regulation).
[7] Cf. European Central Bank opinion, 11 March 2016.

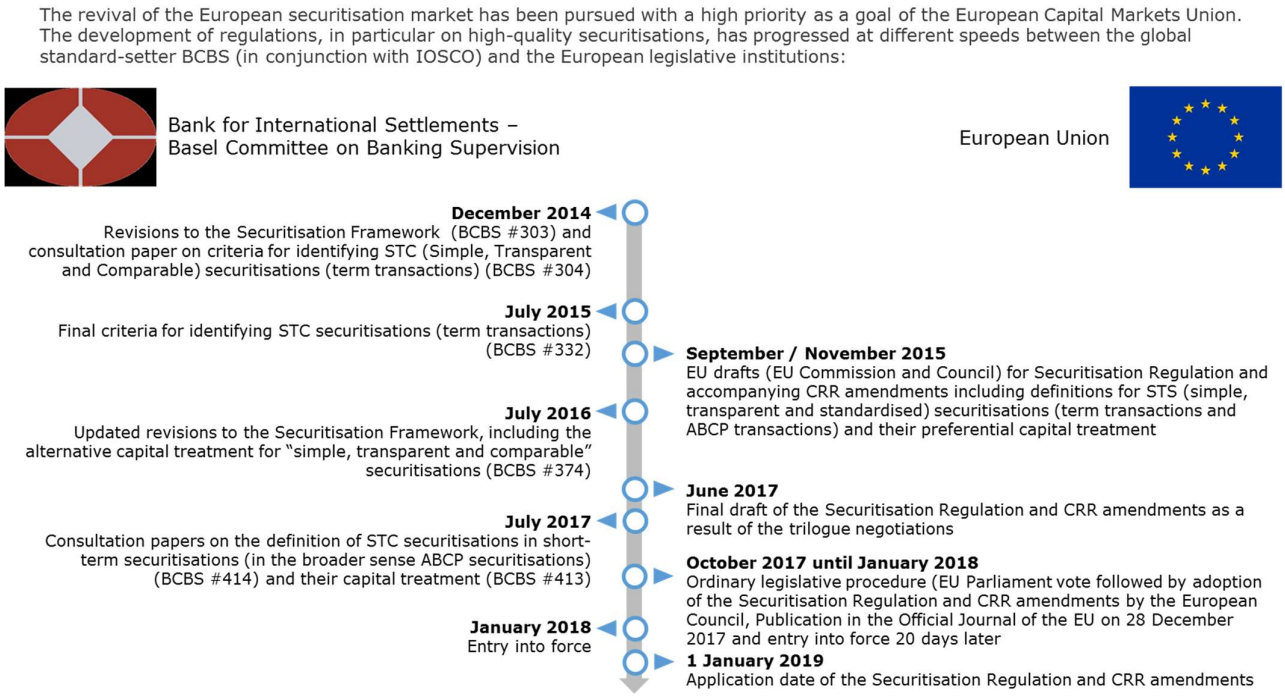


Fig. 1: Comparison of the pace of development of the BCBS and the European legislature

Following the conclusion of months of trilogue negotiations at the end of May 2017 and the compromise painstakingly achieved between the European Parliament, the Council and the Commission, the final proposals for a uniform Securitisation Framework, including the creation of a European framework for simple, transparent and standardised securitisations (the "Securitisation Regulation")[8] and concomitant changes to the relevant sections of Regulation (EU) No 575/2013 (Capital Requirements Regulation, CRR) appeared at the end of June 2017.[9] The final regulations were then published in the EU's Official Journal at the end of December 2017.

Publication in the Official Journal of the EU on 28 December 2017

Key aspects of the new EU Securitisation Framework

The new EU Securitisation Framework creates a general framework for securitisations and addresses a broad target group. The new Securitisation Regulation regulates – and harmonises regardless of the type of investor –

Framework harmonised across sectors

- the definition of securitisations,
- the due diligence requirements,
- the rules concerning risk retention,
- the transparency requirements and
- the framework for STS securitisations, broken down into long-term securitisations (Term Transactions) and short-term securitisations (ABCP securitisations, Asset-Backed Commercial Paper).

[8] Cf. Regulation (EU) 2017/2402 (Securitisation Regulation).
[9] Cf. Regulation (EU) 2017/2401 (CRR Amendments).

Synthetic securitisations excepted for the time being

The newly introduced Securitisation Regulation does not provide for synthetic securitisations to receive STS certification and thus benefit from the advantageous risk weighting. The European Commission is empowered, one year after the date of application of this Regulation, to make an appropriate legislative proposal for synthetic securitisations – on the basis of a report by the EBA in close cooperation with the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA).

In addition to the newly introduced Securitisation Regulation, the new EU Securitisation Framework also includes material changes for CRR users. Accordingly, a separate Regulation amending the CRR contains on the one hand deletions and references to the newly created Securitisation Regulation, and on the other revised calculation approaches with a new hierarchy of methods, in particular taking into account the newly created especially high-quality STS securitisations, to which a preferential treatment is to apply, primarily with regard to their risk weighting.

Effective from 1 January 2019 with transitional provisions until the end of 2019

Both Regulations came into force in January 2018 and are to be applied from 1 January 2019, whereby institutions are required to apply the existing capital requirements for securitisations contained in the currently applicable CRR on a transitional basis until 31 December 2019. In the period between the entry into force and application of the two Regulations, the competent authorities EBA, ESMA and EIOPA are to enact a large number of delegated acts (levels 2 and 3) (in the form of regulatory technical standards, RTSs, and implementing technical standards, ITSs, as well as guidelines and reports) to specify several aspects. Until they are published and applied, several aspects will be regulated temporarily on the basis of existing delegated acts.

Our presentation of the new European regulatory framework is accordingly divided into two parts: first of all, we will provide detailed descriptions of the contents of the new Securitisation Regulation, then we will deal with the CRR amendments and their effects on securitisations, in particular the newly created STS securitisations. We conclude with an appraisal of the introduction of STS securitisations and the implications of the CRR amendments.

2. The newly introduced Securitisation Regulation

2.1. Harmonised Framework for a broad target group

Broad target group

The newly introduced Securitisation Regulation promotes the harmonisation and consequently the standardisation of the European securitisation market. This applies both with regard to the competent authorities of the individual Member States as well as to the market participants (e.g., institutional investors, originators, sponsors, original lenders, and securitisation special purpose entities) for whom there are already securitisation regulations scattered across various sectors (credit institutions, asset managers, and insurance companies) and which are not always consistent. In order to ensure the coherence of the EU legal framework with this Regulation with regard to the rules applicable to securitisations, the CRR, Directive 2009/65/EC (UCITS Directive), Directive 2009/138/EC (Solvency II Directive), Regulation (EC) No 1060/2009 (EU Rating Regulation, amended by Regulation (EU) No 462/2013, CRA 3 Regulation), Directive 2011/61/EU (AIFM Directive) and Regulation (EU) No 648/2012 (EMIR Regulation) have been amended accordingly.

Date of application and Transitional Provisions

The present Regulation applies to securitisations for which securities are issued for on or after 1 January 2019. However, on the basis of transitional provisions the **term "STS"** may also be used for securities for which securitisations issued prior to the date of application, provided the requirements are met and that they are not securitisation positions arising from ABCP transactions or ABCP programmes. If the securities concerned were issued between 1 January 2011 and 1 January 2019 or before 1 January 2011, but new underlying exposures were added or substituted after 31 December 2014, the **due diligence requirements** set out in the currently applicable CRR, current Solvency II supplement, or supplement to the current AIFM Directive, continue to apply. The **risk retention requirements** applicable to credit institutions and investment firms, insurance and reinsurance companies, and AIFM continue to apply to securities issued before 1 January 2019. For securities issued after 1 January 2019, for which the harmonised rules on risk retention are not yet available in a finalised RTS of the EBA, reference is made to the application of the **RTS on Risk Retention** (Delegated Regulation (EU) No 625/2014) adopted within the framework of the currently applicable CRR.[10] Likewise, originators, sponsors and securitisation special purpose entities (SSPEs) must publish the information to be disclosed for the purpose of transparency with regard to the underlying exposures, after the manner of the existing specifications, until a newly developed RTS is provided (Appendices I to VIII of the Delegated Regulation (EU) 2015/3).

2.2. General provisions applicable to securitisations

General provisions for securitisations

The first part of the Regulation (Articles 1 to 17) contains rules intended to apply across all sectors to all securitisations, including STS securitisations, which have hitherto been scattered and not always coherently regulated in the areas of credit institutions, asset management, and insurers in the CRR, AIFM, Solvency II Directive and the delegated acts (Article 1). The general part contains, in addition to harmonised definitions (Article 2), which are largely adopted from the CRR, in particular rules on the sale of securitisations to retail clients (Article 3) and requirements for SSPEs (Article 4). But requirements for the due diligence duties of institutional

[10] On 15 December 2017, the EBA published a consultation paper (EBA/CP/201/22) on this, which is now in the commentary phase (with a comment period until 15 March 2018). Within the framework of the modalities for holding risks, a synthetic or contingent form of retention is also being discussed.

investors (Article 5), on risk retention (Article 6) and transparency requirements (Article 7), on the fundamental prohibition of re-securitisations (Article 8), on criteria for credit-granting (Article 9) and on regulations on the securitisation repository (Articles 10 - 17) also apply to securitisations in general.

Sale of securitisations to retail clients (Article 3)

- The seller must ensure that the securitisation position is **suitable** for the retail client.
- For retail clients' **financial instrument portfolios** of up to EUR 500 000, **no more than 10 %** may be invested in securitisation positions, whereby an **initial minimum amount of EUR 10 000** is envisaged.
- The retail client, in turn, must provide the seller with **accurate information** about their financial instrument portfolio.

Requirements for securitisation special purpose entities (SSPEs – Article 4)

- SSPEs may **not be located in certain countries** (e.g., high-risk and non-cooperative jurisdictions, countries without multilateral tax agreements).
- In the case of **STS securitisations**, it is even mandatory for the SSPE to be **located in the EU**.

Due diligence requirements for institutional investors (Article 5)

The due diligence requirements have been supplemented on the basis of the current CRR regulations. The existing provisions in the CRR, the delegated act on Solvency II and the delegated regulation on the AIFM Directive will be repealed and replaced by a single article imposing **uniform and streamlined due diligence requirements** for all types of regulated institutional investors doing business in the EU. Based on the definition of institutional investors (cf. Article 2 (12) of the Securitisation Regulation), institutions for occupational retirement provision (IORPs) and management companies for undertakings for collective investment in transferable securities (UCITS) also fall within the scope of the due diligence requirements for investments in securitisation for the first time, which is why we describe in detail below the due diligence requirements and point out changes.

Institutional investors must check whether

- the same sound and well-defined **criteria for credit-granting** (Article 9) were applied to both securitised and non-securitised exposures,
- the requirements for **risk retention** (Article 6) were complied with and
- the **information required** under the transparency requirements (Article 7) has been disclosed.

Furthermore, institutional investors must assess the risks associated with holding a securitisation position by taking into account at least

- the **risk characteristics** of an individual securitisation position and the underlying exposures,

- all **structural features** of the securitisation (including contractual priorities of payment and payment-related triggers, credit and liquidity enhancements, market value triggers and definitions of default), and
- for an STS securitisation, fulfilment of all **requirements for STS securitisations**.

In addition, the institutional investor must

- monitor the **risk profile** of the securitisation position on an ongoing basis, if necessary taking into account aspects such as the nature of the exposure, the percentage of 30, 60 or 90 days overdue loans, default rates, etc. and
- ensure **internal reporting** to the management body for the purpose of governance and adequate risk management.

On request, they shall provide the competent authorities with evidence of their **comprehensive and thorough knowledge** of the securitisation position as well as their **risk management strategy and procedures**.

For **not fully supported ABCP programmes**, the institutional investor must conduct **regular stress tests** with regard to cash flows and collateral values, or alternatively with regard to loss assumptions. For **fully supported ABCP programmes**, they must conduct **regular stress tests** of the sponsor's solvency and liquidity, and must demonstrate to the competent authorities on request that they have full and thorough knowledge of the **sponsor's creditworthiness** and the terms of the **liquidity facility** provided.

Insofar as an institutional investor entrusts another institutional investor with **investment management** – including investment in securitisations – they may also instruct the other institutional investor to ensure compliance with due diligence duties. In this case, sanctions for non-compliance would only be imposed on the managing institutional investor.

Requirements of the newly introduced securitisation regulation regarding the due diligence duties for institutional investors in comparison[11]:

[11] Cf. Deloitte UK: Securitisation investor due diligence - Demystified, 2017.

Art. 5	Changes	CRR equivalent	AIFM RL[12] equivalent
1 (a)	Demands on the criteria for credit-granting of companies correspond to those of credit institutions and investment firms; thorough assessment of the debtor's creditworthiness.	408	52 a)
1 (b)	Extension of the requirements in 1 (a) to originators from third countries outside the EU.	new	new
1 (c)	Continuous risk retention of at least 5 % and notification to institutional investors.	405 (1)	51 (1)
1 (d)	Extension of the requirements in 1 (c) to originators from third countries outside the EU.	new	new
1 (e)	Information required under Article 7	409	52 e) and f)
2	For fully supported ABCP transactions, the institutional investor must check whether the sponsor has verified the requirements under 1 (a).	new	new
3 (a)	None	406 (1) b) and c)	53 (1) b) and c)
3 (b)	None	406 (1) g)	53 (1) g)
3 (c)	Institutional investors may rely on information disclosed regarding compliance with STS requirements, but not without their own due diligence.	new	new
4 (a)	None	406 (2)	53 (2)
4 (b)	In the case of not fully supported ABCP programmes, regular stress tests for loss assumptions if there are insufficient data on cash flows and collateral values.	406 (1)	53 (2)
4 (c)	For fully supported ABCP programmes, regular stress tests of sponsor solvency and liquidity.	new	new
4 (d)	Internal reporting to the institutional investor's management body for the purpose of governance and risk management.	new	53 (4)
4 (e)	On request, proof to competent authorities of comprehensive and thorough knowledge of the securitisation position and written risk management strategies; maintaining records of the due diligence assessment.	406 (1)	53 (1)
4 (f)	For fully supported ABCP programmes, proof to competent authorities on request of knowledge of the sponsor's creditworthiness and the terms and conditions of the liquidity facility made available.	new	new
5	Any sanctions for breaches of the due diligence requirements to be imposed on the Investment Manager, if engaged and instructed by an institutional investor.	new	new

Table 1: Comparison of due diligence obligations of institutional investors

Risk retention (Article 6)

With the adoption of existing risk retention requirements and their harmonisation in the form of the newly created Article 6 of the Securitisation Regulation, a **direct approach** is introduced for the first

[12] Cf. Commission Delegated Regulation (EU) No 231/2013 supplementing the AIFM Directive.

time, which imposes the **retention of a material net economic interest** (**risk retention**) directly on the responsible originators, sponsors or original lenders of a securitisation. This is to be seen as complementary to the indirect approach for institutional investors, who are only permitted to invest in securitisations if the risk retention requirements are met.

Contrary to controversial discussions in which the EU Parliament's rapporteur, Paul Tang, had in the meantime called for an increase in the net material economic interest to 20 % for certain types of retention, the minimum level of the material net share to be held was left at the previously customary 5 %.[13] It has been concluded that the established methods and the incentives they provide are effective and that this is not just a question of the rate of the risk retention.

Ban on cherry picking

The Securitisation Regulation also introduces a new, additional provision prohibiting that assets are transferred to a SSPE which, during their term or for a period of four years incur higher losses than comparable assets that remain in the balance sheet of the originator (**ban on "cherry picking"**).[14] Proven violations of this prohibition – significantly poorer performance of the transferred assets and the intent of the originator – are sanctioned by the competent authority in accordance with Articles 32 and 33 of the Securitisation Regulation (e.g. with fines of at least EUR 5 million). Without prejudice to this, assets with an above-average credit risk profile may be transferred to the SSPE as long as this is clearly communicated to (potential) investors. Specific details are expected in the RTS on the risk retention.

If the originator, sponsor and original lender cannot agree among themselves, it is laid down that the originator is the party who must hold the net material economic interest of at least 5 % of the securitisation.

For risk retention purposes, the definition of originator is limited to the extent that a company established for the sole purpose of securitising exposures or operating exclusively for this purpose is not deemed to be the originator. This is to exclude the possibility that an originator without real substance is founded solely for the purpose of risk retention. Appropriate details are to be expected in future RTSs on risk retention.

As in the past, five variants are planned to fulfil the risk retention.

[13] Cf. Rapporteur Paul Tang in debate of the European Parliament on 25.10.2017.
[14] Corresponding to the earlier national regulation on the random selection of assets to be disposed of BaFin Rundschreiben 4/1997, Reference No. I3-21-3/95.

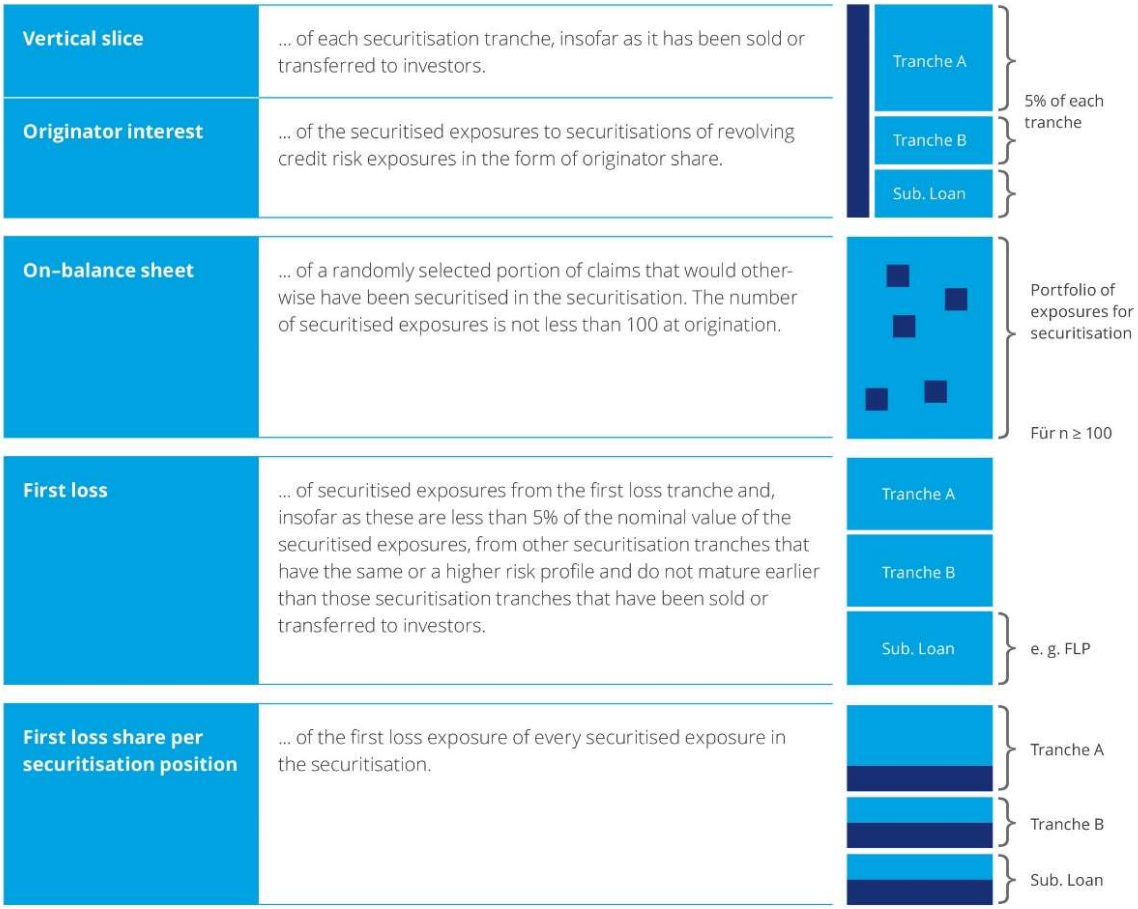


Fig. 2: Variants of risk retention

Six months after the entry into force of the Securitisation Regulation, the EBA, in cooperation with ESMA and EIOPA, will publish **RTSs to specify the risk retention requirements** – in particular the modalities of the five forms of risk retention, including compliance by synthetic or contingent form of retention, the measurement of the amount of the risk retention, the prohibition on hedging or sale of the investment held, the conditions for risk retention on a consolidated basis and the conditions for exemption of certain index-based transactions – thus replacing the RTS currently valid under the CRR. The comment phase for the consultation paper already published ends on 15 March 2018.[15]

[15] On 15 December 2017, the EBA published a consultation paper (EBA/CP/201/22) with a comment period until 15 March 2018. Within the framework of the modalities for holding risks, a synthetic or contingent form of retention is also being discussed.

In addition, Article 6 of the Securitisation Regulation also contains some completely new regulations, which we summarise in the following table:[16]

Art. 6	Changes	CRR equivalent	AIFM RL[17] equivalent
1	Direct approach; the originator holds the risk retention if the originator, sponsor or original lender could not agree among themselves.	405 (1)	51 (1)
2	No cherry picking allowed.	new	new
3 (a-e)	None	405 (1)	51 (1)
4	The fact that the risk retention can be met on a consolidated basis is new to AIFM.	405 (2)	new
5 (a-e)	National development banks are also included in the list of exceptions.	405 (3)	51 (2)
6	The fact that transactions based on a clear, transparent and accessible index are exempted from risk retention is new to AIFM.	405 (4)	new
7 (a-e)	Six months after the entry into force of the Securitisation Regulation, the EBA, in cooperation with ESMA and EIOPA, will publish RTSs specifying the risk retention requirements.	new	new

Table 2: Comparison of risk retention requirements

Transparency requirements (Article 7)

The existing rules on **disclosure to investors** and competent authorities will also be harmonised. The transparency requirements of the new Article 7 of the Securitisation Regulation are much more detailed than the general disclosure requirements of Article 409 CRR and are very similar to the requirements of Article 8 (b) of the CRA 3 Regulation and its attendant delegated Regulation (EU) 2015/3 (CRA 3-RTS).

The following must be disclosed to investors and the competent authorities and, on request, to potential investors

- Data on the **underlying exposures** at the **individual loan level** (quarterly or, in the case of ABCP, monthly),
- **Transaction documents** and **other contracts** in connection with the transaction (e.g. also servicing contracts),
- **STS notification**,
- **Investor reports** (quarterly or, in the case of ABCP, monthly) and
- **Insider information** in connection with the securitisation, pursuant to the Market Abuse Regulation and
- other **important events** and significant changes.

Either the originator, the sponsor or the SSPE is responsible for fulfilling the information duties. In the case of public transactions for which a prospectus has been prepared in accordance with Directive 2003/71/EC (Prospectus

[16] Cf. Deloitte UK: Securitisation investor due diligence - Demystified, 2017.
[17] Cf. Commission Delegated Regulation (EU) No 231/2013 supplementing the AIFM Directive.

Directive), the competent party shall make the information available in a **securitisation repository registered** with ESMA or, if there is no securitisation repository, on a **website**. Unlike the draft regulations in June 2017, the Securitisation Regulation now published no longer provides for information to be disclosed on a website for private transactions for which no prospectus is prepared.

Following the entry into force of this Regulation, ESMA, in cooperation with the EBA and EIOPA, has one year to produce a RTS and an ITS setting out the information to be provided and standardised templates for this information and the format thereof. Pending the presentation of updated RTSs, the information required under Appendices I to VIII of CRA 3-RTS is to be made available either in a securitisation repository or on a website. ESMA already published a consultation paper on 19 December 2017 which defines RTSs and ITSs for both the transparency requirements and the data requirements for the securitisation repository.[18]

Fundamental ban on re-securitisation (Article 8)

Fundamental ban on re-securitisations, with exceptions

While there are some **exceptions**, the ban on re-securitisations is likewise new.

Fully supported ABCP programmes are therefore not considered as re-securitisations, provided that no included ABCP transaction constitutes a re-securitisation and the credit enhancement does not create a second layer of tranching at programme level (Article 8 (4)).

The ban on re-securitisations does not apply to securitisations whose securities were issued before 1 January 2019 (Article 8 (1a)).

In addition to the **exceptions to the ban on re-securitisation for legitimate purposes** already provided for in the Securitisation Regulation (such as facilitating liquidation, ensuring the viability of an institution or preservation of investor interests in the event of distressed positions), further exceptions for legitimate purposes that safeguard the financial stability and interests of investors may be worked out by ESMA in close cooperation with the EBA as needed and subsequently presented in the form of an RTS (Article 8 (3) and (5)).

Criteria for credit-granting (Article 9)

Criteria for credit-granting

A further innovation is the inclusion of the criteria for credit-granting in the general securitisation framework.

In this context, it is particularly important to note that no loans for **residential properties** granted after the entry into force of Directive 2014/17/EU (Mortgage Credit Directive, MCD) in March 2016 may be securitised, insofar as the information provided by the loan applicant may possibly not have been verified by the lender, as is the case with self-certified mortgages (e.g. due to lack of proof of income for the self-employed).

[18] Cf. Consultation paper ESMA33-128-107.

For trade receivables that were not originated in the form of a loan, the criteria for credit-granting do not have to be met.

Securitisation repository (Articles 10 – 17)

Introduction of a new securitisation repository

A major innovation of the harmonised European securitisation framework is the **introduction of a securitisation repository** in which all the necessary data for securitisation are centrally collected, supervised and made available.

The securitisation repository must be a **legal entity established in the EU** in order to be approved and registered by **ESMA**, in line with the EMIR requirements for trade repositories.

The securitisation repository's **data** will be made available **online** on **ESMA's website**. Competent authorities, institutions and (potential) investors receive direct and free **access to the data** through ESMA.

Within one year of the taking effect of the Securitisation Regulation, ESMA is to develop a technical execution procedure and produce RTSs and ITSs on the registration process. Furthermore, in cooperation with the EBA and EIOPA it will provide RTSs on the details of the securitisations, standardised templates, the necessary operational standards and information and access modalities for each stakeholder group.

Improved knowledge levels should be taken into account through regular exchange of information and data reconciliations between ESMA and the relevant competent authorities.

2.3. Requirements for STS securitisations (Articles 18 – 28)

STS securitisations

In order for securitisations to contribute to the financing of the European real economy, it is necessary to restore confidence in the securitisation market and to identify and differentiate especially high-quality securitisations. A uniform and coherent understanding of STS requirements throughout the Union and cross-border common approaches must be ensured so as to avoid creating potential barriers for investors that could undermine the necessary confidence.

While high-quality STS securitisations according to its inherent lower risk profile are adequately supported with lower own funds requirements, they are nevertheless not completely risk-free, and STS certification does not say anything about the quality of the underlying assets of a securitisation. However, the STS criteria should be understood as an indicator that a prudent investor acting with due care is able to adequately analyse the risks associated with securitisation. Starting with the different structural characteristics of **long-term (Term Transactions)** and **short-term securitisations (ABCP programmes and ABCP transactions)**, Chapter 4 of the Securitisation Regulation contains two sections with STS requirements (Articles 19 – 22 and 23 – 26), which are intended to take into account the particularities of each type of securitisation. Furthermore, **requirements for the STS notification** to ESMA (Article 27) and regulations for **checking the fulfilment of the STS requirements by third parties** (Article 28) are specified.

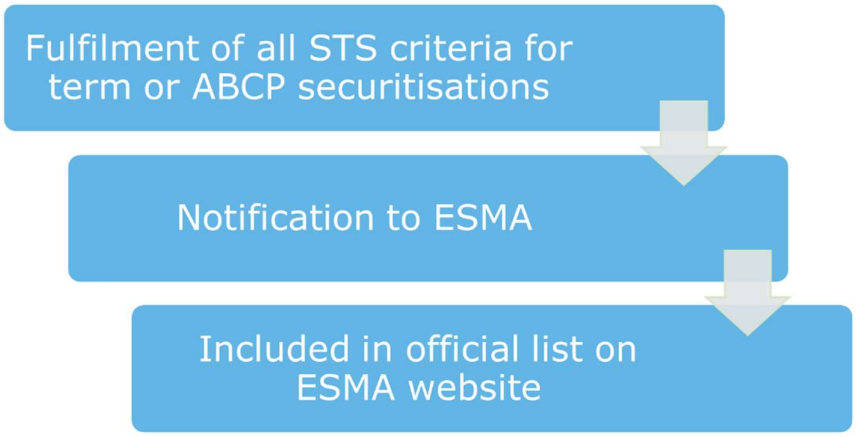


Fig. 3: Use of the STS designation

A basic prerequisite for a STS securitisation is that the originator, sponsor and SSPE are established in the EU.

Even though the objective is to identify simple, transparent and standardised securitisations, the STS criteria are in themselves extensive and complex. While some criteria are clearly defined, others leave wide scope for interpretation. In its opinion of 11 March 2016, the ECB also sees a need for clarification on a number of points – which the EBA, ESMA and EIOPA intend to address with the aid of the development of RTSs in order to ensure legal certainty and efficiency.

Differing structural characteristics of long-term and short-term securitisations lead to differing requirements for STS securitisations.

Term Transactions

An overview of the individual requirements in terms of simplicity,[19] standardisation and transparency for long-term transactions may be derived from in the following Figure.

[19] To clarify which of the underlying exposures are considered homogenous, the EBA published, on 15 December 2017, a consultation paper (EBA/CP/2017/21) covering both long-term transactions and ABCP securitisations.

Simplicity (Article 20)	Standardisation (Article 21)	Transparency (Article 22)
1. **Legal "True Sale"** and transfer of underlying exposures **2. + 3.** Definition of severe clawback provisions **4.** **True sale requirements in case that the seller is not the original lender** **5.** Transfer of underlying exposures after closing (trigger events) **6.** Underlying exposures are not encumbered **7.** Exposures meet clearly defined eligibility criteria **8.** **Homogenous pool of exposures** **9.** **No securitisations in the pool** **10.** Exposures are originated in accordance with underwriting standards that are no less stringent than for non-securitised exposures; any changes shall be disclosed **11.** Underlying exposures do not include any defaults at the time of transfer (Art. 178 (1) CRR) **12.** Debtors/guarantors have already made at least one payment at the time of the transfer **13.** Repayments shall not depend predominantly on the sale of exposures **14.** EBA is working with ESMA and EIOPA to prepare draft regulatory technical standards to clarify the term "homogeneous"	**1.** **Risk retention** requirements (Art. 6) are fulfilled **2.** **Interest rate and currency risks** are mitigated; measures taken to that effect are disclosed. The SSPE shall not enter into derivative contracts and shall ensure that the pool of underlying exposures does not include derivatives **3.** Interest payments are based on **generally used market interest rates** **4.** Provisions in an **enforcement event** (e.g. no reverse waterfall repayments) **5.** **Mandatory trigger events** relating to the performance of the underlying assets leading to non-sequential priority of payments **6.** Provisions **for terminating the revolving period** **7.** **Transaction documentation clearly specify** the responsibilities of all involved parties **8.** The **servicer** shall have the expertise in servicing exposures of a similar nature to those securitised **9.** The **transaction documentation** sets out clear and consistent terms, definitions and remedies and actions relating to delinquencies and defaults of debtors **10.** **Clear provisions** for conflict resolution and clearly defined voting rights	**1.** Access to **historical performance and default rates** for exposures covering a period no shorter than five years **2.** A sample of the underlying exposures shall be subject to **external verification prior to issuance** **3.** Originator/sponsor provides a **liability cash flow model** to potential investors before the pricing of the securitisation and afterwards upon request Investors shall be provided with that model on an ongoing basis **4.** For **RMBS, auto or lease transactions** the originator, sponsor and SSPE shall publish data on the environmental performance relating to the underlying assets. **5.** Prior to pricing the originator and sponsor are responsible for providing **all information required by Art. 7**

Fig. 4: Overview of the STS criteria for long-term transactions

ABCP Securitisations

STS criteria related to ABCP securitisations must be met at both **transaction level** (Article 24) and **programme level** (Article 26). Moreover, further requirements are defined for the **sponsor** (Article 25).

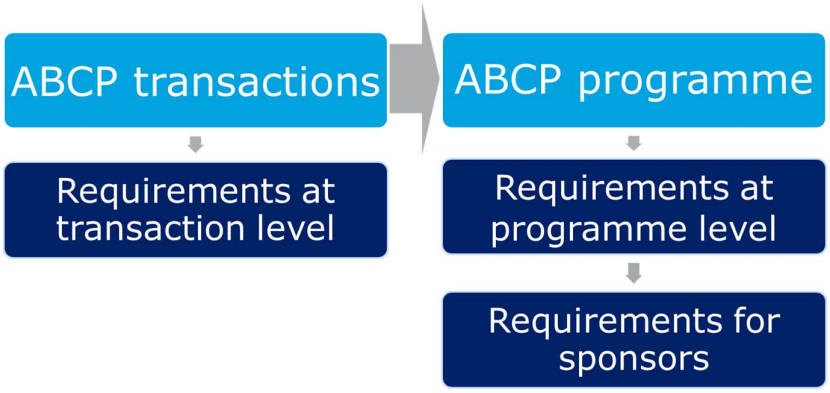


Fig. 5: Special Features of ABCP Securitisations

The requirements at transaction level are derived from the criteria for long-term transactions (particularly with regard to simplicity and homogeneity).

However, there is no explicit differentiation between the simplicity, standardisation and transparency criteria. In addition to the criteria for long-term transactions, Article 24 et seq. contain among other things the following special features for ABCP transactions, which take into account the special characteristics of this type of securitisation:

Additional requirements at transaction level (Article 24)

1.
Homogeneity of the pool: Pool of underlying exposures shall be homogeneous in terms of asset type.

2.
Introduction of a remaining weighted average life, that shall not exceed 1 year.

3.
None of the underlying exposures shall have a residual maturity of longer than 3 years except for pools of auto loans, auto leases and equipment lease transactions, which shall have a remaining exposure weighted average life of not more than 3 and a half years and none of the underlying exposures shall have a residual maturity of more than 6 years).

4.
Pool shall not include exposures of debtors who have been declared insolvent within 3 years prior or have undergone a debt restructuring process.

5.
Pool shall not include loans secured by residential or commercial mortgages.

6.
If the sponsor does not have access to the data that he has to make available, he can obtain the data from the seller (Period covered by data: at least 5 years, for short-term receivables at least 3 years).

EBA, in cooperation with ESMA and EIOPA, will issue guidelines and recommendations for the harmonised interpretation of the concept of "homogeneous".

Fig. 6: Overview of additional requirements at transaction level

With regard to ABCP programmes, the **requirements** set out below are placed **on the sponsor** of the ABCP programme, and further **requirements at the programme level** going beyond requirements at transaction level are to be fulfilled.

Requirements of the sponsor (Article 25) e.g.

- Shall be a **regulated credit institution** under Directive 2013/36/EU (Capital Requirements Directive, CRD IV).
- **Covers all** liquidity, credit and dilution **risks and** all necessary **costs**.
- **Demonstration to its competent authority** that its **solvency and liquidity** are not jeopardized even in extreme stress situations in the market.
- Compliance with **due diligence requirements**.
- Verify, that the seller meets the requirements of Art. 265 (2) of Regulation (EU) Nr. 575/2013 (Additional own funds requirements for securitisations of revolving exposures with early amortisation provisions)
- **Satisfy** the risk **retention requirement** in accordance with Art. 4.
- The sponsor is **responsible for compliance with Art. 7** and for making information available to potential investors.

Requirements at programme level (Article 26) e.g.

- General **reference to Article 24 (1) – (8) and (12) – (20).**
- A maximum of 5 % of the total amount may temporarily infringe Article 24 (9) to (11) without affecting the STS status of the ABCP programme.
- The remaining **weighted average life** of the underlying exposures shall not be more than 2 years.
- **Ban on re-securitisation**
- Issued securities shall not include clauses that have an affect on their final maturity, where such options or clauses may be exercised at the discretion of the seller, sponsor or SSPE.
- The **documents shall clearly state**:
  - the responsibilities of the **trustee**,
  - the contractual obligations, duties and responsibilities of the sponsor,
  - **processes and responsibilities** necessary to ensure that a default or insolvency of the servicer does not result in a termination, as well as
  - processes in case the liquidity facility shall be drawn down.
- The **servicer** shall have **experience** in servicing similar exposures.

Fig. 7: Overview of the requirements of the sponsor and at the programme level

STS notification and support from a third party (Articles 27 and 28)

STS notification

The **originator and sponsor are jointly** responsible for **notifying** the fulfilment of the STS criteria and the explanations thereof to ESMA or, in the case of ABCP securitisations, only the **sponsor** (for ABCP programmes and the ABCP transactions contained therein). **ESMA** publishes a list of all notified securitisations on its website.

Authorisation of a Third Party

After lengthy negotiations, it was agreed that **third parties authorised** under the Securitisation Regulation may assist in verifying compliance with the STS criteria, but this may not affect the liability and legal obligations of the originator, sponsor or the SSPE or the due diligence requirements of institutional investors. The **assistance of an authorised third party** shall be indicated in the **STS notification**, stating its name, place of establishment and the name of the competent authority that authorised it.

The **authorisation of such a third** party is subject to a number of **conditions**, including the following

- in relation to the **remuneration** of the third party service: only non-discriminatory, cost-based and result-independent fees;
- **neither a regulated entity** (credit institution, insurance company, investment firm) nor a **credit rating agency**;
- the **independence of the third party** is ensured (no advisory, audit or equivalent services by the third party within the framework of the securitisation) and there are **no conflicts of interest**;
- presence of **adequate professional qualifications**.

Neither the publication of the STS notification nor the declaration of a third party shall be understood as a guarantee that the STS requirements are actually met. Joint responsibility for their fulfilment lies exclusively with the originators, sponsors and SSPEs.

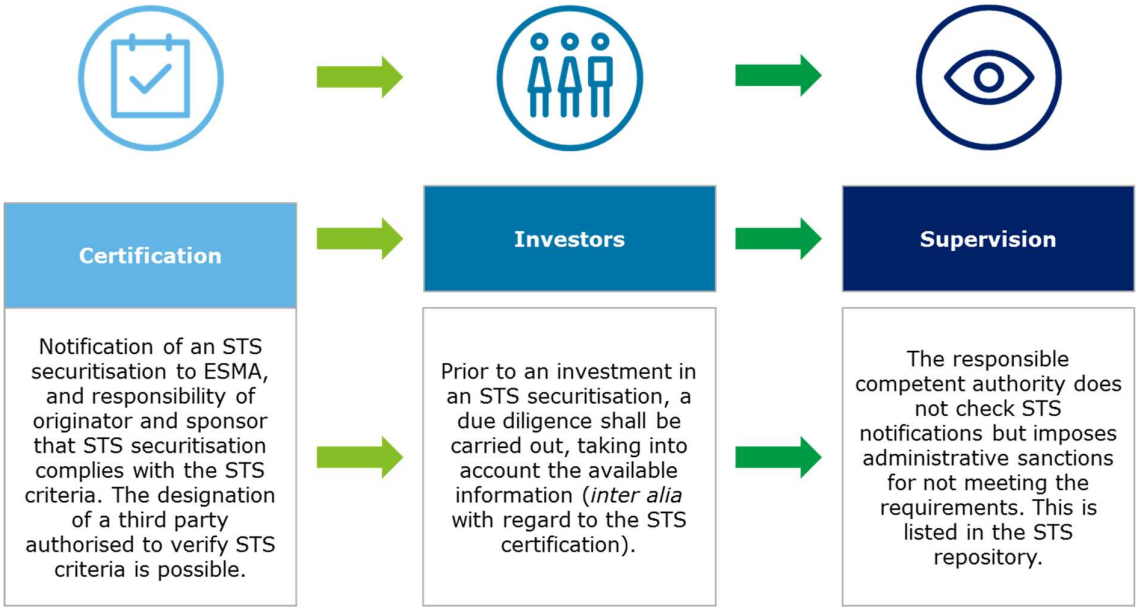


Fig. 8: STS Certification process

Within six months of the entry into force of the Securitisation Regulation, ESMA, together with the EBA and EIOPA, will prepare RTSs and ITSs to specify the information to be transmitted to ESMA and the templates to be used for the transmission of the STS notification.[20]

Furthermore, within six months, ESMA will submit draft RTSs specifying the information to be provided to the competent authorities in the application for the authorisation of a third party.[21]

[20] Cf. Consultation paper ESMA33-128-33.
[21] Cf. Consultation paper ESMA33-128-108.

Supervision (Articles 29 – 37)

Supervision

To monitor compliance with STS criteria and third-party support, EU Member States will, within one year, designate to the European Commission and ESMA competent authorities to which **supervisory, investigatory and sanctioning powers** will be delegated. ESMA shall publish a list of these.

Administrative sanctions and **remedial action** shall be imposed in particular against originators, sponsors, original lenders or SSPEs and third parties who can be shown to have **negligently or intentionally violated** the regulations on risk retention, disclosure requirements, criteria for credit-granting and the various STS criteria and requirements.

3. The new regulatory capital requirements for securitisations

CRR Changes

In accordance with the objectives of the new Securitisation Regulation, amendments to the existing CRR rules for institutions that act as originators, sponsors or investors in securitisation transactions are necessary to take into account the special features of STS securitisations and to eliminate deficiencies (such as mechanistic reliance on external ratings, too low risk weights for highly-rated securitisation tranches and vice versa and also insufficient risk sensitivity) that were revealed during the financial crisis.

In the following, we describe the **changes in regulatory capital requirements** by looking at the new hierarchy of calculation approaches and its exceptions, the new risk weights and other changes, and present the preferential treatment of STS securitisations. We then give an outlook on future regulations for significant risk transfer based on the EBA's discussion paper.

The amendments to the CRR are to be applied from 1 January 2019. Transitional provisions for securitisation positions issued or established before 1 January 2019 provide that the currently applicable capital requirements shall continue to be applied until the end of 2019.

3.1. New hierarchy of calculation approaches

New hierarchy of methods

The Regulation amending the CRR provides for a new hierarchy of methods to be used for calculating the risk-weighted exposure amounts for securitisation positions.

After the manner of the Basel Committee's proposals for revising the securitisation framework[22], the internal ratings-based approach (Securitisation - Internal Ratings-Based Approach, **SEC-IRBA**) is to be at the top of the hierarchy in order to reduce reliance on external ratings. If this approach cannot or is not permitted to be applied, the standardised approach for securitisation (Securitisation - Standardised Approach, **SEC-SA**) should in principle be applied before the approach based on external assessments (Securitisation - External Ratings-Based Approach, **SEC-ERBA**). This hierarchy does not correspond to the Basel Committee's proposals and was laid down in the trilogue negotiations in June 2017, contrary to concerns in this respect, particularly by stakeholders from Germany and the United Kingdom[23]. If no external or inferred rating is available and the SEC-ERBA is therefore not applicable, a risk weighting of 1,250 % is envisaged.

SEC-IRBA

In its computational logic, the **SEC-IRBA** is similar to the Simplified Supervisory Formula Approach (SSFA) and presupposes supervisory approval to use IRBA on the loans underlying the securitisation. The input parameters are K_{IRB} (the capital requirement for the underlying IRBA exposures as if they had not been securitised), the A (Attachment Point) and D (Detachment Point) thresholds, and the regulatory parameter p. By way of a material alteration to the SSFA, the SEC-IRBA contains in addition the tranche maturity (M_T) as an independent variable within the regulatory parameter p. The prerequisite for its application is that the securitised

[22] Cf. Basel III Document - Revisions to the securitisation framework, BCBS d374, July 2016.
[23] Cf. Statement by the United Kingdom and Germany of 28.06.2017.

portfolio is an IRB pool or a mixed pool and that the bank (IRBA institution) can calculate K_{IRB} for at least 95% of the underlying exposures. The competent authorities may prohibit institutions from using the SEC-IRBA in individual cases if the risks of a securitisation with highly complex or high-risk characteristics would not be adequately taken into account (Article 258 (2) CRR).

SEC-SA

If the SEC-IRBA is not used, recourse is normally had next to the SEC-SA. The input parameters of the comparable **SEC-SA**, which is based on the SSFA, are the capital requirement K_A (calculated from K_{SA} and the arrears rates W) and also the threshold values A and D. To simplify, the regulatory parameter p is assumed to be 1 in the standardised approach. The prerequisite for its application is that the capital requirement can be determined only by using the standardised approach, even if the use of the SEC IRBA or the SEC ERBA would be possible for individual underlying receivables. Application is mandatory for re-securitisations, taking into account various adjustments (see below).

SEC-ERBA

Basically, external ratings and thus the **SEC-ERBA** should only be resorted to in third place. When using the SEC-ERBA, a risk weighting table (mapping table) is required to determine the risk weights corresponding to the ratings of recognised rating agencies. The threshold values A and D and also the tranche thickness (T=D-A) and the tranche maturity (M_T) enter into the calculation of the SEC-ERBA. It is assumed that the granularity of the tranches is already taken into account in the rating agencies' ratings, which is why it is not (once again) used as an independent input factor.

The Internal Assessment Approach (**IAA**) is to continue to be used in future for securitisation positions in ABCP programmes or ABCP transactions that have not been assessed externally, to the extent that they fall within the scope of application and the IAA has been approved by the supervisor.

If none of the three calculation approaches is used, the maximum risk weighting of **1,250 %** must be applied.

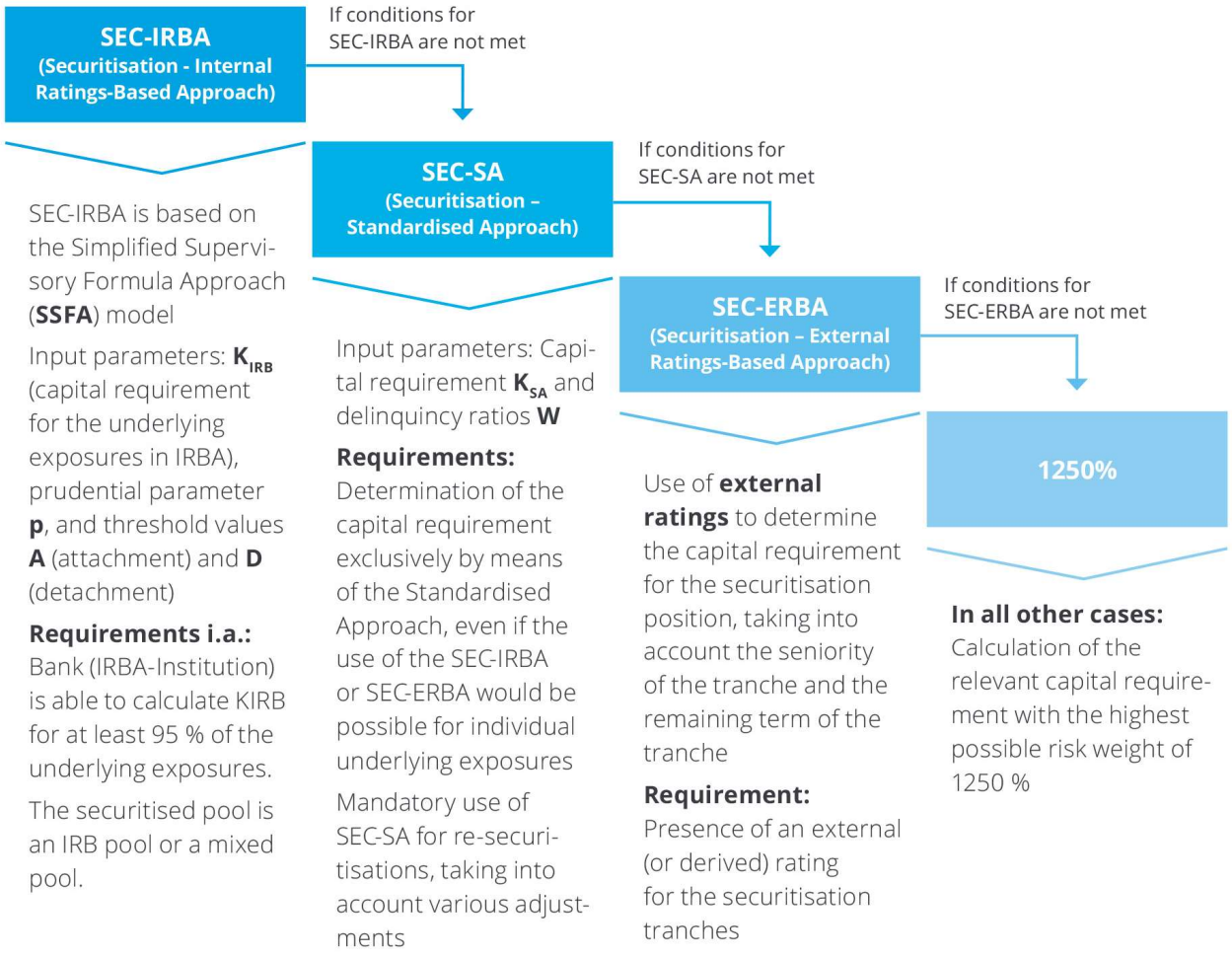


Fig. 9: Hierarchy of new calculation approaches

While the SEC-IRBA and the SEC-SA are based on a **supervisory formula** to determine the risk weight for a securitisation position, the SEC-ERBA has recourse to **risk weight tables** in which **external credit assessment**s are assigned to corresponding risk weights, depending on the rank and maturity of a securitisation position. The rank of a securitisation position in the loss waterfall is thus still a significant risk parameter in all three calculation approaches. For SEC-IRBA and SEC-SA, the capital requirements for the securitised exposures, as if they had not been securitised (K_{IRB} or K_A), are considered to be the main risk drivers, whereby the newly introduced p-factor indicates the extent to which the capital requirements change as a result of securitisation. The calculation of the p-factor also takes into account the effective number of exposures in the pool of underlying exposures (N), the average loss-given-default (LGD) and the tranche maturity (M_T). The type of business (retail or non-retail business), the ranking of the securitisation position (senior or non-senior) and the granularity of the underlying pool of securitised exposures are taken into account in the p-factor via constants defined by the Supervisor. New is thus the inclusion of the maturity in the SEC-IRBA and SEC-ERBA. A risk-weight floor of 15 % applies to all three approaches.

Supervisory formula: p factor

Exceptions to the hierarchy of calculation approaches

Exceptions and deviations from the hierarchy of methods

By way of derogation from the fundamental hierarchy of methods, changes in the hierarchy occur in the following cases in which the SEC IRBA cannot be used, so that the SEC-ERBA may or must be preferred to the SEC-SA.

1. Fundamental elective right (pursuant to Article 254 (3) CRR)

Institutions may, with the approval of the supervisory authority, decide to measure rated securitisation positions or securitisation positions in respect of which an inferred rating may be used in accordance with SEC-ERBA instead of SEC-SA. However, they may not use different approaches in the course of the same year.

2. Special provision for auto ABSs (auto loans and auto leases) and equipment leases (pursuant to Article 254 (2c) CRR)

Institutions must measure rated securitisation positions or securitisation positions in respect of which an inferred rating may be used, backed by pools of auto loans, auto leases and equipment leases in accordance with SEC-ERBA instead of SEC-SA.

3. STS Securitisation position (pursuant to Article 254 (2a) CRR)

If the risk weight for an STS securitisation under the SEC-SA would be higher than 25 %, the SEC-ERBA must be used.

4. Non-STS Securitisation position (pursuant to Article 254 (2b) CRR)

If the risk weight under the SEC-SA would be higher than 25 % or higher than 75 % under SEC-ERBA for positions not qualifying as positions in an STS securitisation, the SEC-ERBA must be applied.

5. Prohibition by competent authorities in individual cases (pursuant to Article 254 (4) CRR)

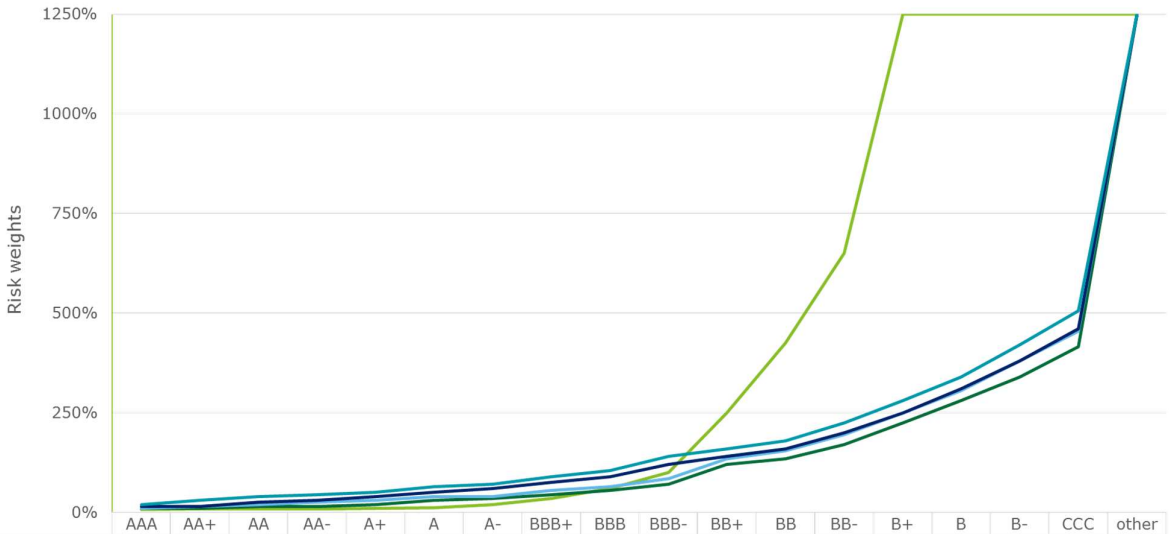
By analogy with the prohibition of the use of the SEC-IRBA in individual cases, the competent authorities may also prohibit institutions, on a case-by-case basis, from applying the SEC-SA if it is not commensurate to the risks posed by the securitisation.

As **re-securitisations** are considered to be more complex and risky, only certain types of re-securitisations are permitted under the Securitisation Regulation. Under Article 254 (6) CRR, these are subject to additional **more conservative regulatory capital calculations**, whereby use of the SEC-SA with the modifications set out in Article 269 CRR (among other things parameter adjustments, increase in the risk-weight floor to 100 %) is mandatory.

Comparison of risk weights and capital requirements (present and after CRR amendments)

The following chart shows the present risk weights for senior granular securitisation positions together with the future risk weights for senior STS and non-STS securitisation positions with a remaining maturity of one and

five years respectively, using the mapping tables for calculating risk weights in the SEC-ERBA.[24]



	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B+	B	B-	CCC	other
current risk weights	7%	8%	8%	8%	10%	12%	20%	35%	60%	100%	250%	425%	650%	1250%	1250%	1250%	1250%	1250%
STS (1 year)	10%	10%	15%	15%	20%	30%	35%	45%	55%	70%	120%	135%	170%	225%	280%	340%	415%	1250%
STS (5 years)	10%	15%	20%	25%	30%	40%	40%	55%	65%	85%	135%	155%	195%	250%	305%	380%	455%	1250%
Non-STS (1 year)	15%	15%	25%	30%	40%	50%	60%	75%	90%	120%	140%	160%	200%	250%	310%	380%	460%	1250%
Non-STS (5 years)	20%	30%	40%	45%	50%	65%	70%	90%	105%	140%	160%	180%	225%	280%	340%	420%	505%	1250%

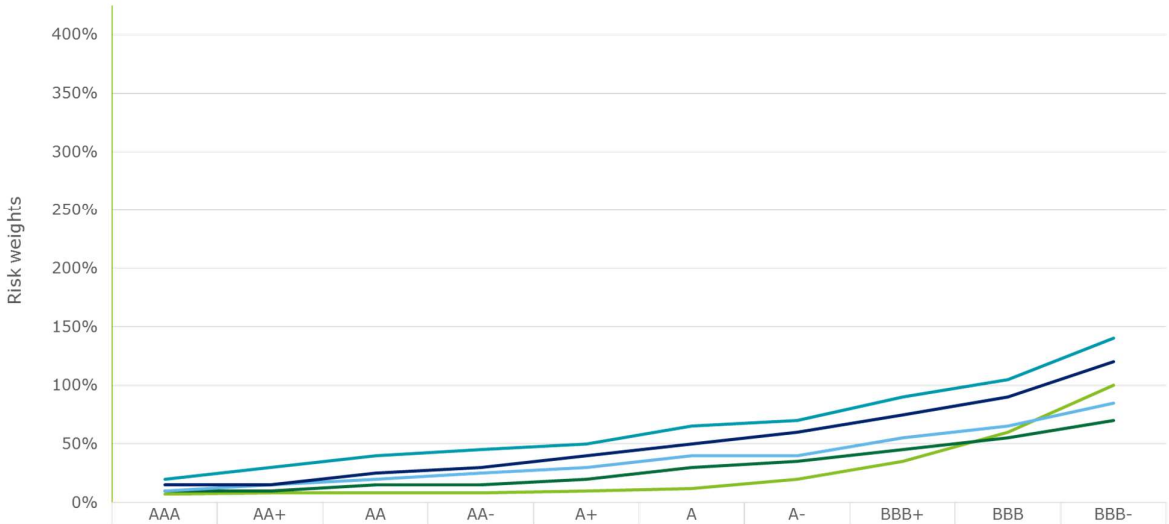
Fig. 10: Comparison of risk weights in the SEC-ERBA

At first glance, a comparison of the present and future regulations reveals two fundamental changes. Firstly, there will be a **differentiation according to the maturity of the securitisation positions** (standardised between one and five years) and secondly, the **credit quality steps will be extended to 17** steps (instead of 11 steps)[25], which means that differentiated risk weights below the maximum risk weight of 1,250 % will be allocated to lower credit quality steps down to CCC- in future.

On the basis of a comparison of current risk weights with future risk weights, it may be seen that a rise in the capital requirements for the upper Investment Grade credit quality steps is to be expected, while capital requirements in the lower Investment Grade and speculative areas will fall significantly.

The following diagram illustrates the increase in risk weights in the upper credit quality steps:

[24] We would like to point out that the risk weights of non-senior tranches would have to be adjusted depending on the respective tranche thickness if one also wanted to compare these with the present risk weights.
[25] Based on EBA technical advice on Qualifying Securitisations, Juni 2015, p. 11, and BCBS Revisions to Securitisation framework, Juli 2016, para. 68 und 117.



	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-
current risk weights	7%	8%	8%	8%	10%	12%	20%	35%	60%	100%
STS (1 year)	10%	10%	15%	15%	20%	30%	35%	45%	55%	70%
STS (5 years)	10%	15%	20%	25%	30%	40%	40%	55%	65%	85%
Non-STS (1 year)	15%	15%	25%	30%	40%	50%	60%	75%	90%	120%
Non-STS (5 years)	20%	30%	40%	45%	50%	65%	70%	90%	105%	140%

Fig. 11: Comparison of risk weights in the SEC-ERBA for the investment grade segment

Based on the new hierarchy of the calculation approaches to be applied and the resulting risk weights, an **increase in the capital requirements for senior securitisation positions with a high credit rating** and **a decrease in the capital requirements for securitisation positions with a lower credit rating** can be expected. Overall, it may be assumed that capital requirements will rise. However, **pro-cyclical effects** may be expected to **weaken**.

Further effects on the level of capital requirements can only be determined on a case-by-case basis. It is quite conceivable that the new hierarchy and the elective right to a general preference of SEC-ERBA over SEC-SA may in some cases lead to lower capital requirements. For some securitisations whose ratings are affected by a high country risk, especially Southern European transactions, the new hierarchy of SEC-SA before SEC-ERBA is likely to have a positive effect, while the hierarchy exception for auto ABSs (SEC-ERBA must be preferred to SEC-SA) appeared necessary.

Due to the collateralisation effect of non-senior securitisation positions on senior positions, the **maximum risk weight to be applied to senior securitisation positions** is limited to the weighted average risk weight to be applied to the securitised positions. This also applies if a higher risk weight would result from an applicable calculation approach (cf. look-through approach in Article 267 CRR).

3.2 Preferential treatment of STS securitisations

Lower capital requirements for STS securitisations

The CRR's current securitisation framework is essentially based on standards originally developed by the Basel Committee on Banking Supervision, which do not distinguish between STS securitisation and other more complex and less transparent transactions. To allow for more risk-sensitive treatment of STS securitisations, the capital requirements for these special securitisation positions have been revised.

In accord with the methodology proposed by the EBA in its report on qualifying securitisations[26], the three new approaches for calculating risk-weighted assets determine that **STS securitisations should be treated in a more risk-sensitive manner under supervisory law** in the three approaches (cf. Articles 260, 262 and 264 CRR). The three approaches have been **recalibrated** for all tranches **to reduce capital requirements** for positions in transactions which are regarded as STS securitisations. Furthermore, the **risk weight floor** for STS securitisations was also **reduced**.

Preferential risk weighting for STS securitisations	
SEC-IRBA	• The supervisory parameter p is scaled by a factor of 0.5. • $p(STS) = \max[0,3;0,5*(A+B*(1/N)+C*K_{IRB}+D*LGD+E*M_t)]$
SEC-SA	• Reduction of the supervisory parameter p from 1 to 0.5 analogous to the SEC-IRBA
SEC-ERBA	• Recalibration of risk weights to maintain consistency with the new STS calibrations in SEC-IRBA and SEC-SA respectively • Calibration across all rating quality steps and regarding maturity (one and five years) and senior and non-senior tranches
Floor	SEC-IRBA/SEC-SA: Reduction of risk weight floor for senior securitisation positions to 10% SEC-ERBA: Reduction of risk weight floor to 10 % depending on rating, seniority and remaining term: • Securitisations of credit quality step 1 with **short-term ratings** • **Senior tranches** with rating quality steps 1 and 2 for M_T =1 • **Senior tranches** with rating quality step 1 for M_T =5

Fig. 12: Calibrations for STS securitisations

[26] Cf. EBA Report on qualifying securitisation, 7 July 2015.

While the **risk weight floor** for **senior tranches** was **reduced** to 10 %, the floor for non-senior securitisation tranches remains at 15 % in all approaches. In this way, on the basis of analyses by the EBA in its report on qualifying securitisations in July 2015, account is taken of the fact that senior tranches in the context of STS securitisation show a significantly better performance than non-senior qualifying tranches.

Special provision for synthetic SME securitisations

Despite the general exclusion of synthetic securitisations from the STS framework, Article 270 CRR contains a **special provision** which envisages **preferential treatment of the capital requirements for certain synthetic securitisations of exposures to small and medium-sized enterprises**. An **originator** may apply the preferential calibrations of the calculation approaches and thus the preferential risk weights, provided that:

- the **STS criteria** under the Securitisation Regulation are met,
- the retained securitisation positions are **senior** securitisation positions,
- the securitisation is backed by a pool of exposures to undertakings, and at least 70% of these exposures are to small and medium-sized enterprises (**SMEs**),
- a **guarantee** or **counter-guarantee** has been issued by a specific guarantor (including, but not limited to, the central government, the central bank of a Member State, an institutional investor, provided that the guarantee or counter-guarantee is fully collateralised by cash on deposit).

Comparison of risk weights and level of capital requirements for STS and non-STS securitisations

Comparing the capital requirements for STS and non-STS securitisations, the mapping tables for calculating the risk weights in the SEC-ERBA with regard to senior securitisation positions result in a **preferential treatment of a minimum of 5 and a maximum of 55 percentage points**.

Overview and comparison of the new risk weights for senior STS and non-STS securitisation positions[27]:

[27] Based on EBA technical advice on Qualifying Securitisations, Juni 2015, p. 11, and BCBS Revisions to Securitisation framework, Juli 2016, para. 68 und 117.

Credit rating ECAI		STS tranche Senior		Non-STS tranche Senior		Level of preference → difference between STS and non-STS	
		Tranche Maturity		Tranche Maturity		Tranche Maturity	
		1 year	5 years	1 year	5 years	1 year	5 years
1	AAA	10%	10%	15%	20%	5 pps	10 pps
2	AA+	10%	15%	15%	30%	5 pps	15 pps
3	AA	15%	20%	25%	40%	10 pps	20 pps
4	AA-	15%	25%	30%	45%	15 pps	20 pps
5	A+	20%	30%	40%	50%	20 pps	20 pps
6	A	30%	40%	50%	65%	20 pps	25 pps
7	A-	35%	40%	60%	70%	25 pps	30 pps
8	BBB+	45%	55%	75%	90%	30 pps	35 pps
9	BBB	55%	65%	90%	105%	35 pps	40 pps
10	BBB-	70%	85%	120%	140%	50 pps	55 pps
11	BB+	120%	135%	140%	160%	20 pps	25 pps
12	BB	135%	155%	160%	180%	25 pps	25 pps
13	BB-	170%	195%	200%	225%	30 pps	30 pps
14	B+	225%	250%	250%	280%	25 pps	30 pps
15	B	280%	305%	310%	340%	30 pps	35 pps
16	B-	340%	380%	380%	420%	40 pps	40 pps
17	CCC+, CCC, CCC-	415%	455%	460%	505%	45 pps	50 pps
Below CCC-		1250%	1250%	1250%	1250%	0	0

Table 3: Comparison of risk weights for senior STS and non-STS securitisations

For non-senior securitisation positions, the scope of the preferential treatment is significantly higher, with at least 0 and a maximum of 120 percentage points (see Table 1 "Overview and comparison of the new risk weights for non-senior STS and non-STS securitisation positions" in the Appendix).

3.3. Status of the discussion on significant risk transfer

Significant risk transfer under discussion

With regard to the requirements for significant risk transfer (SRT), the new securitisation framework does not contain any material changes, however, on 19 September 2017 the EBA published a **discussion paper** (EBA-DP-2017-03) containing **amendment proposals** in three sub-areas. First of all, the **process for evaluating the SRT** is to be **further standardised**. The EBA would like to standardise further both the notification of the project by the originator and the feedback from the competent authorities. Standards are also to be introduced for all notifications during the term of the transaction.

Furthermore, it is proposed to adopt **uniform precautions** for a number of **structural features** such as excess spread or pro-rata redemptions, which

may jeopardise risk transfer over the lifetime of the securitisation. Such structural features could be assigned to **"safeguards"**, the existence of which is intended to facilitate the assessment and, ceteris paribus, to increase the probability of approval. In addition, for all transactions with special structural features, the EBA is striving for the originator to submit a self-assessment which supports the granting of SRT.

The last pillar of the amendments deals with the identification of certain gaps in the current regulations in Articles 243 and 244 CRR and an extension of the concept of the commensurateness of the risk transfer. One option proposed would be to supplement the purely quantitative tests with a **prescribed minimum size for the first loss tranche** and to tie **commensurability** to a comparison of the equity relief achieved for the originator and the loss risk transferred. The second possibility, more likely to be considered as a medium- or long-term solution, could be the **introduction of a revised test** in the CRR aimed at the observance of both the **significance** and the **commensurateness** of the risk transfer.

Public consultation on the discussion paper closed on 19 December 2017. Even though it seems to be in the realm of the possible that the EBA's proposals will be revised again due to protests from market participants, which are undoubtedly to be expected, some changes or additions in the mechanistic tests of Articles 243 and 244 CRR are very likely. This can be explained alone by the fact that the EBA has been expressly requested, in the mandate extended by Article 244 (6) and Article 245 (6) CRR, to also consider the commensurateness of the risk transfer.

4. Assessment of the planned regulations and changes

The new securitisation regulations affect various areas of a bank and thus lead to increased complexity in terms of data provision, processes and structuring.

Introduction of the Securitisation Regulation

In the context of the introduction of the Securitisation Regulation and the regulations on the newly created especially high-quality STS securitisations, we believe that **early adjustments to lending processes** and the **comprehensive provision of data** are a key success factor for the future ability to place securitisation transactions. We would like to point out that the current **legal uncertainty in connection with the new STS criteria** until the finalisation of the outstanding Level 2 legal acts and the establishment of generally accepted market standards in the context of future structuring of securitisation transactions requires comprehensive analysis. The **establishment of an adequate certification process for STS securitisations** is the kernel of fulfilling the extensive control and reporting requirements.

For the first time, institutional investors in the **IORP** and **UCITS** sectors face new challenges in the form of extensive and detailed **due diligence requirements** for investments in securitisation positions.

Changes in capital requirements

Institutions face numerous challenges with regard to the planned changes in capital requirements.

They must determine the effects on the securitisation positions they hold that result from the **change in the hierarchy of calculation approaches** and the **exceptions** thereto, and weigh up the use of the general **elective right to prefer the SEC-ERBA** to the SEC-SA.

- For this it is advisable to carry out an **analysis of the effects** of the newly calculated risk-weighted assets (RWAs) on the Bank's various divisions (in particular the management of KPIs, portfolio management).
  The required **data** on the new risk drivers must be **identified** at an early stage and **integrated** into systems and processes for the RWA calculation.
- Adjustments to the existing and the introduction of new **calculation methods for determining the capital requirements for securitisation positions** are necessary.

Other types of investors, such as **insurance companies**, must also expect adjustments as a result, so that subsequent to the CRR changes for institutions, **changes in the capital requirements of the Solvency II framework** can also be expected.

Generally speaking, from the institution's point of view, equity capital relief for high-quality securitisations appears desirable and is fundamentally capable of stimulating investment in certain securitisation positions. However, this is only true if the STS classification does not give rise to any difficulties or doubts and that alternative investments available to the institutions do not require a lower level of regulatory capital in comparison.

Effects on capital requirements

In our view, the **overall increase in capital requirements** should justify the **increased effort** involved in analysing and interpreting the STS criteria and the STS certification process in the institutions in order to benefit from the preferential capital adequacy of STS securitisation. Extensively standardised and homogeneous transactions, e.g. in retail business and in the residential property segment, will have an easier time in achieving STS status than more risky and complex transactions. We would like to point out that even the privileged treatment of STS securitisations will lead to higher capital charges in future – compared to the capital requirements of the current CRR regulations (in respect of the highest credit quality steps). The increments in the highest credit quality steps (AAA to BBB+) in the SEC-ERBA (for senior tranches independent of their tranche thickness) range between 2 and 55 percentage points compared to today's regime (see fig. 10). Securitisation positions with a weaker credit rating are subject to a significant reduction in own funds, with reductions of up to 1,025 and 1,000 percentage points respectively regarding a B+ rating in both the STS and the non-STS segments. The exceptions in Article 254 (2a) and (2b) CRR are likely to result in higher capital requirements for certain assessed securitisation positions in the medium and lower rating range due to the mandatory application of SEC-ERBA instead of SEC-SA.

Market developments

Owing to the current restriction on traditional securitisations, many market participants are waiting for the report to be presented by the supervisory authorities on the establishment of **a specific framework for synthetic STS securitisations** and for a legislative proposal possibly to be presented by the European Commission by 2 January 2020. The **special provision in Article 270 CRR** may be regarded as the first response to concerns expressed by market participants regarding the exclusion of synthetic securitisations from the STS framework.

The synthetic securitisations currently on the market are typically fully cash-backed and would qualify as a STS securitisation on the basis of the granular portfolios, according to some market participants. The increase in RWA or the cost of RWA relief, especially for senior tranches, are considered "unattractive" as the risk weight floor would increase from the current 7 % to 15 % without STS certification. Since synthetic securitisations frequently securitise the SME asset class, the costs and the relief effect of securitisations must also be seen in relation to the more favourable risk weighting for investments in infrastructure measures planned within the framework of the Capital Markets Union and the CRR II revision.

Coming back to the special provision of Article 270 CRR, **preferential treatment of qualified synthetic SME securitisations** (provided, for example, that there is a guarantee promise by an institutional investor within the meaning of the Securitisation Regulation fully backed by cash collateral) would therefore – only – lead to an increase in the risk weight from currently 7 % to 10 % in future. Ultimately, the new rules do indeed result in a higher capital requirement for standard synthetic SME securitisations, but the special provision limits this to an increase of 3 percentage points in the risk weight - for originators mind you.

Other market participants, in particular corporate finance investors, will accordingly have to wait longer for the creation of a specific framework for synthetic STS securitisations and in the meantime accept higher capital requirements or adapt their investment policy, and restructure portfolios.

Against concerns expressed by the market, the Securitisation Regulation includes a clause which provides for a **ban on the securitisation of what are known as Self-Certified Mortgages**, not merely for STS securitisations but for all securitisations. It is still unclear when a residential property loan will be regarded as not verified, i.e. exactly how the legal wording will have to be interpreted (among other things, which information has not been verified by the lender – only proof of income or other information provided by the applicant for the loan). It is also not yet clear what consequences this will have for the securitisation market, what will happen in future with the securitisation transactions backed by such residential properties and whether they will receive follow-up financing.

Since recognition as an STS securitisation requires jurisdiction in an EU Member State, the **Brexit** would automatically result in the classification of UK securitisations as **non-STS securitisations** and would require correspondingly higher regulatory capital for them than for securitisations of equivalent quality among EU Member States. In view of the volume of UK securitisations, this is likely to affect the European securitisation market and force investors to adjust their portfolios, assuming that no compromise is found in the Brexit negotiations.

Economists criticise the many obstacles to the securitisation of trade and lease receivables under **ABCP programmes**, in particular the exclusion of foreign subsidiaries of European companies from classification as an STS securitisation. However, the transparency regulations may also conflict with the trade and business secrets of companies when it comes to originating trade receivables.

Referring to the results of studies conducted by industry representative True Sale International GmbH (TSI)[28], it can be assumed that in some cases the future risk weights of ABCP transactions will require equal or more regulatory capital than an unsecured loan to the selling company, although ABCP transactions have lower loss probabilities than the corresponding companies, due to better internal ratings.

Diametrically opposite to the intended revival of the securitisation market, the criticisms and increasing capital requirements could rather inhibit the ABCP market in its hitherto successful development as a significant component of SME financing in Germany. The negative effects on the attractiveness of ABCP funding for sponsors and companies predominate and the further development remains to be seen.

Outlook and further developments

Both the Securitisation Regulation and the CRR amendments presented leave many questions unanswered.

The supervisory authorities EBA, ESMA and EIOPA have been asked to submit a number of RTSs and ITSs within six to 12 months of the entry into force of the two Regulations in order to clarify these outstanding issues and to develop guidelines on individual aspects and publish reports (for the Securitisation Regulation/CRR amendments a total of 10/2 RTSs, 4/2 ITSs, 2/5 guidelines and 2/3 reports; for an overview, see Tables 2 and 3 in the

[28] Cf. Meissmer: Die Zukunft der ABCP-Finanzierung [The Future of ABCP Financing], in: Die Bank, Issue 9/2017, pp. 6-10.

Appendix).[29] There are no concrete transitional arrangements for all open questions.

The **European Commission** must, no later than three years after the application of the new Securitisation Regulation, submit a **report** on its functioning which shall assess in particular

- Effects of the Securitisation Regulation,
- including the introduction of high-quality STS securitisations,
  - on the European securitisation market and
  - on the contribution of the securitisations to the real economy (above all in respect of SME financing and investment) and also
  - on interrelationships between financial institutions and
  - on the stability of the financial sector.

The further **development of the European securitisation market** depends to a large extent on the results of the European Commission's report and the further legislative proposals based thereon.

[29] Whereby not every RTS or ITS is defined in a separate legal act, but common consultations are often held on related issues.

Appendix

Table 1: Overview and comparison of the new risk weights for non-senior STS and non-STS securitisation positions:

Credit rating ECAI		STS tranche Non-senior		Non-STS tranche Non-senior		Level of preference → difference between STS and non-STS	
		Tranche Maturity		Tranche Maturity		Tranche Maturity	
		1 year	5 years	1 year	5 years	1 year	5 years
1	AAA	15%	40%	15%	70%	0	30 pps
2	AA+	15%	55%	15%	90%	0	35 pps
3	AA	15%	70%	30%	120%	15 pps	50 pps
4	AA-	25%	80%	40%	140%	15 pps	60 pps
5	A+	35%	95%	60%	160%	25 pps	65 pps
6	A	60%	135%	80%	180%	20 pps	45 pps
7	A-	95%	170%	120%	210%	25 pps	40 pps
8	BBB+	150%	225%	170%	260%	20 pps	35 pps
9	BBB	180%	255%	220%	310%	40 pps	55 pps
10	BBB-	270%	345%	330%	420%	60 pps	75 pps
11	BB+	405%	500%	470%	580%	65 pps	80 pps
12	BB	535%	655%	620%	760%	85 pps	105 pps
13	BB-	645%	740%	750%	860%	105 pps	120 pps
14	B+	810%	855%	900%	950%	90 pps	95 pps
15	B	945%	945%	1050%	1050%	105 pps	105 pps
16	B-	1015%	1015%	1130%	1130%	115 pps	115 pps
17	CCC+, CCC, CCC-	1250%	1250%	1250%	1250%	0	0
Below CCC-		1250%	1250%	1250%	1250%	0	0

Table 2: Overview of the need for specification based on the Securitisation Regulation

Provision	Competent Supervisor	Regulatory document	Specification content
Art. 6 (7)	EBA with ESMA and EIOPA	RTS	For more precise specification of the risk-retention requirement
Art. 7 (3)	EBA with ESMA and EIOPA	RTS	To determine the information to be provided by the originator, sponsor and the SSPE to meet their transparency obligations.
Art. 7 (4)	EBA with ESMA and EIOPA	ITS	To establish the format of the information to be determined in accordance with RTS in the form of a standardised template

Art. 8 (5)	ESMA with EBA	RTS	To supplement the list of "legitimate purposes" for the approval of re-securitisations
Art. 10 (7)	ESMA	RTS	Details of the verification of the information provided as to completeness and coherence and of the requirements for the registration application and the simplified application for an extension of registration
Art. 10 (8)	ESMA	ITS	Format for application for and extension of registration
Art. 17 (2)	ESMA with EBA and EIOPA	RTS	Details of securitisation for the securitisation repository (information to be provided for transparency requirements); operational standards for data collection of securitisation repositories, data aggregation and comparison between securitisation repositories; details of the information, modalities and conditions for access to data in securitisation repositories
Art. 17 (3)	ESMA with EBA and EIOPA	ITS	Standardised template for the transmission of information to the securitisation repository
Art. 19 (2)	EBA with ESMA and EIOPA	Guidelines	On the harmonised interpretation and application of the STS requirements (Articles 20-22)
Art. 20 (14)	EBA with ESMA and EIOPA	RTS	Specification of which of the underlying exposures are considered to be homogeneous (based on the characteristic of simplicity)
Art. 23 (3)	EBA with ESMA and EIOPA	Guidelines	On the harmonised interpretation and application of the STS requirements for ABCP securitisations (Articles 24 and 26)
Art. 24 (21)	EBA with ESMA and EIOPA	RTS	Specification of which of the underlying exposures are considered to be homogeneous (based on the requirement at transaction level)
Art. 27 (6)	ESMA with EBA and EIOPA	RTS	Specifying the information to be provided by the originator, sponsor and securitisation special purpose entity for the STS notification
Art. 27 (7)	ESMA with EBA and EIOPA	ITS	To define templates for the information to be transmitted in accordance with the RTSs for the STS notification
Art. 28 (4)	ESMA	RTS	Clarification of the information to be provided to the competent authority when applying for the authorisation of a third party
Art. 31 (2)	ESRB with EBA	Report	On the effects of the securitisation market on financial stability
Art. 36 (8)	ESMA with EBA and EIOPA	RTS	To clarify the general obligation to cooperate, the information to be exchanged and the obligation to inform
Art. 45 (1)	EBA with ESMA and EIOPA	Report	On the possibility of establishing a specific framework for simple, transparent and standardised synthetic securitisations limited to synthetic balance sheet securitisations.
	total	**10 RTS** **4 ITS** **2 guidelines** **2 reports**	

Table 3: Overview of the need for specification based on the regulation amending the CRR

Provision	Competent Supervisor	Regulatory document	Specification content
Art. 244 (6)	EBA	Report	Monitoring the range of supervisory practices with regard to the recognition of the transfer of a significant risk in traditional securitisations
Art. 245 (6)	EBA	Report	Monitoring the range of supervisory practices with regard to the recognition of the transfer of a significant risk in synthetic securitisations
Art. 248 (1) d)	EBA	RTS	Specify what constitutes an appropriately conservative method for calculating the amount of the unused portion of the cash credit facilities
Art. 250 (4)	EBA	Guidelines	What is meant by normal market conditions and when a transaction is structured in such a way that it does not constitute loan support.
Art. 254 (8)	EBA	Report and guidelines	Effects of the hierarchy of approaches on capital requirements and the range of supervisory practices
Art. 255 (8)	EBA	Guidelines	On appropriate methods how KIRB for the dilution risk and KIRB for the credit risk can be aggregated if these risks are not dealt with in an aggregated form in a securitisation
Art. 255 (9)	EBA	RTS	To further specify the conditions under which institutions may calculate KIRB for the pools of underlying securitisation exposures in accordance with sub-section 4 (purchased exposures)
Art. 257 (4)	EBA	Guidelines	Monitoring of the various approaches to determining the maturity of a tranche
Art. 270a (2)	EBA	ITS	To facilitate convergence of supervisory practice on the application of the additional risk weight, including measures to be taken in the event of a breach of due diligence and risk management obligations.
Art. 270e	EBA	ITS	To assign the credit quality steps in an objective and consistent manner to the relevant credit assessments of all ECAIs.
Art. 337	EBA	Guidelines	On the use of input PD and LGD estimates when determining risk weights
	total	**2 RTS** **2 ITS** **5 guidelines** **3 reports**	

Selected publications

Deloitte White Paper

No. 66: **Fundamental Review of the Trading Book – Der Sensitivity Based Approach**
(by Monika Bi, Christian Seiwald & Thorsten Wächter)

No. 67: **Deloitte Global Risk Management Survey – Wesentliche Ergebnisse der 9. Auflage**
(by Michael Cluse & Jörg Engels)

No. 68: **Capital Floors – Kapitaluntergrenzen für interne Modelle und Ratings**
(by Michael Cluse, Tatjana Heine & Christian Seiwald)

No. 69: **BCBS 279 – Auswirkungen des neuen Standardansatzes auf das Counterparty Credit Risk Exposure**
(by Kurt Blecha & Mario Schlener)

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(by Sascha Bakry, Michael Cluse, Dr Gil Opher and Wilhelm Wolfgarten)

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