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Comments on the European Commission's proposals for a

- Regulation laying down common rules on securitisation and creating a European framework for simple, transparent and standardised securitization and amending Directives 2009/65EC, 2009/138/EC, 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012
- Regulation amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms

Proposals should adequately take into account financing needs of the real economy

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Deutsches Aktieninstitut e.V.
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General remarks

Bundesverband der Deutschen Industrie¹, Deutscher Industrie- und Handelskammertag² and Deutsches Aktieninstitut³ welcome the draft proposals of the European Commission for a regulatory framework to promote simple, transparent and standardised securitisations.

Non-financial companies using capital markets for financing growth, innovation and employment have a vital interest in a financial market regulation that addresses systemic risks appropriately and thus ensures that they are provided with financial services in a reliable manner. Asset Backed Securities (ABS) and Asset-Backed Commercial Papers (ABCP) are an important source of funding for the German and European real economy.

Meanwhile, banks will again find it more relevant to use the securitisation market for their funding activities and to release bank's regulatory capital in order to extend credit exposures for SMEs. However, securitisation goes well beyond releasing banks' regulatory capital to provide new scope for lending. For example, auto ABS support the sales of car manufacturers and thus stabilize large parts in the automotive value chain. Moreover, for larger SMEs it is increasingly important to use this kind of funding sources to better diversify their financial basis. More and more SMEs use the market for ABCP for the mobilization of trade receivables. ABCP securitisations are a solid mainstay in the financing mix of German corporates. Finally, securitisation could make an important contribution to the financing of infrastructure in Europe. With a view to close the striking investment gap in Europe, this financing option is of strategic importance. By the use of securitisation small-ticket infrastructure projects could be aggregated thus making them an attractive investment option for institutional investors.

To revitalize the securitisation market in Europe, whose volume has shrunk significantly in the wake of the financial crisis, the European Commission is keen to ensure uniform quality standards and a consistent regulatory treatment. This is strongly welcomed. We have repeatedly called for a removal of the various regulatory impediments that contradict efficient and well-functioning European securitisation markets.

¹ Bundesverband der Deutschen Industrie (BDI) is the umbrella organisation of German Industry and industry-related service providers. It represents 36 industrial sector federations and has 15 regional offices in the German Laender. BDI speaks for more than 100.000 private enterprises – 98 % small and medium sized – employing around 8 million people.

² The Association of German Chambers of Commerce and Industry (Deutscher Industrie- und Handelskammertag e.V. - DIHK) is the umbrella organisation of the 80 German Chambers of Commerce and Industry and represents the collective interest of commercial and industrial businesses in Germany. Its legitimation rests on more than 3.6 million member companies from all sectors, regions and size classes that belong to the Chambers of Commerce and Industry.

³ Deutsches Aktieninstitut represents the entire German economy interested in the capital markets. Its about 200 members are listed corporations, banks, stock exchanges, investors and other important market participants. Deutsches Aktieninstitut keeps offices in Frankfurt am Main, Brussels and in Berlin.

From this angle, the proposals of the Commission are insufficient. We are concerned that the regulatory framework presented by the Commission could fall short of what is necessary to deliver lasting impulses to the European securitisation markets. To meet the self-imposed objectives the draft requires fundamental changes in the following aspects:

- The draft rules for the capital requirements of STS securitisations should better recognize the quality of real sector-based securitisations. The proposals represent a significant deterioration compared to the status quo and in relation to comparable investment alternatives such as covered bonds or other forms of credit transfers.
- We firmly believe that several STS requirements and definitions are impracticable or too vague formulated. As a result many high-quality securitisation transactions will not qualify for the STS regime, although their quality is not questioned. Thus, it is of utmost importance that the STS criteria are clearly formulated in the rule text to avoid legal uncertainty in terms of later unforeseeable interpretation by supervisory authorities.
- The process of regulatory recognition of STS securitisation, the ongoing supervision of compliance with the criteria as well as the sanctioning process in the case of infringement of the regulation provide incalculable uncertainties and risks for originators, investors and corporate service providers. In the absence of third party certification, the framework must at least confer a right to the originator to request from its competent authority a binding confirmation of conformity with regard to the criteria of simplicity and standardisation.

Reviving the market for securitisations is a cornerstone in the strategy of the Commission to build a Capital Markets Union, an objective the undersigned parties fully support. This will only have a real chance, when the shortcomings of the present draft Regulation are eliminated. In the following, we focus on those issues that are of particular importance for the real economy.

Specific remarks

1. Regulation on a European framework for simple, transparent and standardised securitization (STS-R)

Transparency requirements for originators, sponsors and SSPEs (Art. 5 par. 1 STS-R)

Investors need reliable information on the reference portfolio and the transaction structure to profoundly evaluate the credit risk of the transaction. However, detailed data and information necessary for a substantial evaluation of risk are already provided in advance of new issuances and as part of the current transaction reporting system to interested investors. Transparency requirements on the underlying exposures that go beyond what already exist would be counterproductive.

In order to protect the interests of companies, clarification is needed that data may be provided to third parties only in compliance with data protection rules and taking into account the legitimate interests of the company that are protected by the common obligation of banks in terms of confidentiality of information such as the common banking secrecy. This should apply both for traditional term and replenishment transactions as well as ABCP transactions. In addition, it should be clarified that the compliance with such obligations does not prevent from STS-eligibility.

The required documentation disclosure from ABCP transactions could reveal important business secrets. This would seriously harm the acceptance of those programs among corporates. The use of securitisations for risk and capital management of banks would become more difficult, the potential for new lending would shrink.

It must be ensured that transaction specific documents are only available to the sponsor bank, provided rules on confidentiality are negotiated. In contrast, any information on receivables to investors must be provided on an aggregate and anonymised basis. To safeguard confidentiality, ABCP contracts must be disclosed only on an individual transaction level to investors. The company can and should be responsible only for the information it provides directly to the SSPE and the sponsor. The reports created on this basis are no longer the responsibility of the company. The company should be liable only bilaterally to the sponsor with respect to the accuracy of the data it provides. This must be clarified in Article 5 (par. 1, a, b and c) STS-R) as well as in Art. 13 (par. 8) STS-R respectively.

Non-impairment requirements (Art. 8 par. 7c STS-R)

To bring the securitisation market back on track, suitable quality criteria for the securitised exposures are necessary. These criteria must be based on current and accepted market standards. Only then will the necessary acceptance among market participants be ensured, which gives the securitisation market a new impetus.

In order to fully exploit the economic advantages of securitisations for the financing of the real economy a broader definition of qualifying securitisation is necessary. We are concerned that the non-impairment requirements with regard to term ABS could impede the

political efforts to revive the securitisation market in the EU and to improve the conditions for medium and long-term financing of business.

According to these provisions, loans granted to credit-impaired borrowers shall be excluded from the definition of simple securitisations. However, the definition of impairment is unfortunately not based on accounting rules, unnecessarily too broad, partly unclear and might be difficult to implement. Yet it is completely unclear, for the time being, what “a credit assessment or a credit score indicating that the risk of contractually agreed payments not be made is significantly higher” actually means.

It is important that the definition of “significantly higher risk” is itself simple, objective and transparent and uniform in European countries and does not leave room for interpretation between national competent authorities.

The definition under Article 8 (7) letter a) would prevent companies from benefiting from more favourable funding that have declared insolvency, agreed with their creditors to a debt dismissal or reschedule or had a court grant his creditors a right of enforcement or material damages as a result of a missed payment within three years prior to the date of origination. A credit institution that intends to securitise loans that were originated 5 years ago to free up capital for new loans, for instance, would have to exclude such companies that have experienced one of these mentioned events under 8 Article 8 (7) letter a) 8 years ago, even if such company has a good credit quality in the meantime. The requirement under b), in turn, is typically checked at the time of origination, is part of prudent credit granting and does not need to be required explicitly to keep the requirement simple.

Having said this, we propose to delete Article 8 (7) letter a), b) and c) STS Regulation. Instead, we propose to exclude loans with higher risks based on well-established criteria as follows:

- Receivables qualify for default according to Basel II;
- Receivables that show evidence of impairment requiring specific allowances according to the applicable accounting framework (whether IFRS or national accounting rules);
- Receivables with significant risk based on the delinquency status that are past due more than 30 days.

Residual values (Art. 8 par. 9 STS-R)

According to Article 8 (9), the repayment of the holders of the securitisation positions shall not depend, substantially, on the sale of assets securing the underlying exposures.

The requirement in Article 13 par. 3 of the delegated act is clearer and easier to interpret saying “The repayment of the securitisation positions shall not have been structured to depend, predominantly, on the sale of assets securing the underlying exposures”. We therefore propose that the Regulation adopts the wording in Article 13 par. 3 of delegated regulation 2015/61 on the liquidity coverage requirement.

In addition, it should be clarified that residual values that are fully backed by repurchase obligations or guarantees are not dependent on the sale of assets securing the underlying exposures. In such cases, the risk that the sales price of the asset is less than the calculated value of the asset, the so-called residual value risk, is fully borne by the party that has assumed the repurchase obligation or residual value guarantee. There is no market risk any longer, because the repayment is in such cases dependent on the credit quality of the party that has assumed the repurchase obligation or guarantee.

Synthetic securitisations (Art. 8 STS-R)

The proposal only allows “true sale” securitisation to become STS. We advocate that the regulatory framework also includes synthetic securitisations. Synthetic securitisation transactions are an important capital management tool for banks (not only with respect to SME portfolios) as they help banks to release regulatory capital and therefore provide them with the opportunity to grant new loans to bank customers.

In our view, the equal treatment of synthetic securitisations and true sale securitisations would support the development of a market for SME securitisations. This applies in particular against the background that banks in Germany employ almost predominantly synthetic securitisations to securitise SME loans, in particular, smaller credit institutions like savings banks and cooperative banks in Germany.

There are two motivations involved here: First, the credit institutes have no great interest to reduce their balance sheets. Second, their contracts with borrowers often contain clauses that explicitly exclude the sale of loans, and borrowers value that their bank remains their single point of contact concerning the loan contract. In addition, synthetic securitisations of SMEs are generally easier to handle than true sale securitisations that are technically and legally much more complex. Synthetic securitisations allow a wider range of SME financing instruments and address a central current problem of corporate financing by banks: the creation of new scope for lending through capital relief, which becomes increasingly important in view of the more stringent regulatory requirements (CRD IV). In this respect, synthetic securitisation is clearly superior. As loans are neither sold nor assigned in the case of synthetic securitisation, this class of financing instruments clearly meets the needs and interests of SMEs and should be included as qualifying securitisations.

Unfortunately, the draft proposal excludes synthetic securitisations. It is argued that synthetic securitisations are more complex than true sale securitisations and include significant amount of counterparty risk. However, synthetic securitisations of plain vanilla (real economy) balance sheet assets such as SME loans (as opposed to synthetic CDOs) are generally structured in a simple and transparent way. Often the transaction and associated documentation actually are less complex than a true sale transaction for both issuer and investor as it does not involve the sale of assets.

Requirements relating to standardisation (Art 9 par. 5 STS-R)

From the company's perspective, it is quite understandable that a violation of the agreed portfolio criteria triggers a termination event. However, the value of the underlying exposures

held by the SSPE is completely intransparent and not controllable by the company. We therefore suggest to delete this provision.

According to Art. 9 par. 5 d, a failure to generate sufficient new underlying exposures that meet the predetermined credit quality triggers for early amortisation or termination events. This is hard to comprehend. ABCP transactions often do not entail an obligation for the originator to sale the receivables. Moreover, in cyclical industries this is not always possible. However, this does not say anything about the quality of the receivables.

Requirements relating to transparency (Art. 10 STS-R)

Historic default and loss performance (Art. 10 par. 1)

According to Article 10 (1), the originator, sponsor, and SSPE shall provide access to data on historic default and loss performance covering a period no shorter than seven years for non-retail exposures and five years for retail exposures. We regard this loss history partly as too long. Thus, exceptions should be allowed on the request of the originator after the approval of the competent authority.

Confidence level of 95 % (Art. 10 par. 2)

According to Art. 10 (2), a sample of the underlying exposures shall be subject to external verification prior to issuance of the securities with a confidence level of 95 %. We are concerned that an external asset audit is very costly for firms. For example, large customer portfolios often include several thousand claims that must be checked by the auditor. We therefore suggest an upper limit for the sample size (max. 100 receivables) to maintain efficiency. Ultimately, the introduction of fee-based audits makes the ABCP transaction, particularly for smaller companies, economically unattractive. This is in sharp contrast to the original intention to facilitate SME financing.

Joint liability (Art. 10 par. 4 STS-R)

According to Article 10 (4), the originator, sponsor and SSPE shall be jointly responsible for compliance with Article 5 STS-R and shall make all information required by Article 5 (1a) available to potential investors before pricing.

The joint liability entails unacceptable liability risks for the real economy originator that is a significant obstacle for developing an efficient STS securitisation market. The company has no control over information that other originators provide and that are created by the sponsor or a third party at program level. Moreover, the company does not have the expertise to bindingly define the requested features to assure compliance with the STS criteria. Companies as originators should never be liable to third parties for complying with the respective criteria.

In case of multiple originators (like in multi-seller ABCP conduits) originators should only be liable for their own pool information (and not for others), nor should they be reliable for

consolidated information provided by the sponsor or features of the program documentation. Only the sponsor should be the relevant party to make available information to the investors of the ABCP program. The originator or the SSPE cannot fulfil this.

An exception with regard to the transparency requirements should be envisaged in Article 5 for where publication would breach Union or national law governing the protection of confidentiality, data protection or would result in a violation of the banking secrecy. Otherwise, it may be in many cases impossible to fulfil the transparency requirements. Thus, it is important that in such cases the requirements need only be fulfilled on an anonymised or aggregated basis.

Partial STS (Art. 11 STS-R)

According to Article 11, ABCP securitizations shall be considered “STS”, where the ABCP program complies with the requirements in Article 13 of the STS regulation and all transactions within that ABCP program fulfil the requirements in Article 12. This implies that a securitisation position on transaction level (e.g. a liquidity line) cannot be considered “STS” if the respective program in its entirety does not comply with the STS criteria.

We suggest to delete Article 11. To give sponsors the necessary flexibility to allow for a small number of transactions that fall out of the STS scope Article 13 (1) should include a threshold of 30 % to allow for non-STS-transactions.

Lifetime of underlying (Art. 12 STS-R)

According to Article 12, transactions within an ABCP program shall have a remaining weighted average life of no more than two years and none shall have a residual maturity of longer than three years.

We are concerned that several types of loans and leases in the automotive and in the machinery and equipment sector do not meet this restrictive criterion, thus reducing the scope of STS lease and loan financing for SMEs. The typical structure for such ABCP programs for the real economy are so-called “multi-seller-programs”. Investors are exposed to various different pools from different sellers and industries that distinguish fully supported multi-seller ABCP programs from traditional securitisations. Moreover, the sponsoring bank provides liquidity facilities to the program. We therefore advocate STS criteria that take specifically into account the double layer of protection of the investment position (liquidity guarantees plus underlying assets). Therefore, the limitation of the residual maturity should be deleted.

STS notification and due diligence (Art. 14 STS-R)

Companies of the real sector must not be obliged to report to ESMA. Instead, the sponsor should inform the competent authority. Alternatively, the originator should be allowed to outsource its reporting obligations to the sponsor (similar to EMIR). To protect the confidentiality of the company’s financing activities, bilateral transactions shall not be published in contrast to a public ABCP program. The funding strategy of a company must be fully respected as a confidential business secret. Single ABCP transactions that meet the STS criteria should not be published.

Regulatory recognition, compliance and sanctioning (Art. 15 ff. STS-R)

The process of STS classification is not sufficiently clear to induce originators and investors to engage in STS securitisations. The current draft stipulates a self-classification of the originator. At the same time, restrictive requirements to the STS segment are inappropriate, and originators are confronted with considerable sanctions in case of infringement of the Regulation. Although simple at face value, we are sceptical that a self-certification by originators could restore the level of trust necessary to create new dynamics in the European securitisation market. An appropriate legal framework that supports the objective of the regulation must ensure clarity and certainty for all market participants.

The implementation and enforcement of EU criteria for qualifying securitisation instruments could be done by means of a binding assessment by the competent authority in the jurisdiction of the originator. As an alternative, a well-defined certification process could also be done by a private institution that has relevant market experience and market proximity, a clear track record in the development of market standards and close contact with the market, the regulatory authorities and the legislator.

In Germany True Sale International (TSI) pursues that concept, which has long proved its value in German industry. TSI's task is, among other things, to develop quality standards for German securitisations and to implement them by means of a certification process. For the past three years, Prime Collateralised Securities (PCS) has had a similar function at the European level.

In addition, the framework should confer the right on the originator to request from its competent authority a legally binding confirmation of conformity that the securitisation is conform to certain or all criteria of simplicity and standardisation. This is necessary due to the envisaged dissuasive sanctions and the fact that the full liability shall remain with the originator. Thus, the originator needs certainty whether he complies with the STS-criteria or not. In return, the competent authority of the originator or sponsor should be empowered to grant such confirmation of conformity. Such confirmation should be legally valid throughout the European Union and should not be challengeable by any other supervisory authority and overruled by ESMA or the Joint Committees of the European Supervisory Authorities in order to warrant the necessary level of legal certainty for originators. This is necessary, because there are many competent authorities in the European Union for credit institutions, insurance undertakings and money market funds that can have different opinions on the STS-compliance of certain securitisations.

2. Regulation on prudential requirements for credit institutions and investment firms (CRR-R)

Maximum risk weights for STS ABCP (Art. 243 par. 1a CRR-R)

According to Article 243 (1a), positions in an ABCP program shall qualify as STS securitisation when the risk of exposures under the Standardised Approach shall not be higher than 100 % for any non-retail exposure.

We regard this criterion as impracticable as the real economy originator will normally not be able to identify the risk weight of his receivables under the Standardised Approach. Moreover, the proposal could preclude the securitisation of corporate exposures with an external rating of B or worse from STS securitisation. In this regard, we refer to a proposal of the Basel Committee for revising the Standardised Approach according which corporate exposures would in future be risk-weighted by reference to corporates's revenue and leverage. As a result, most smaller companies would be excluded from STS securitisations irrespective the risk profile of the company which would counteract the original intention to improve the access to finance for SMEs.

Granularity requirements for ABCP (Art. 243 par. 1b CRR-R)

Pursuing to Article 243 (1), the aggregate exposure value of all exposures to a single obligor at ABCP programme level does not exceed 1 % of the aggregate exposure value of all exposures within ABCP programme at the time the exposures were added to the ABCP program.

In our view, it is technically impossible for the sponsor of an ABCP program to aggregate clients or groups of connected clients over different transactions. Manufacturing companies often have only a few customers and therefore a high (and changing) client concentration. Furthermore, as a rule, they do not have suitable systems or expertise to identify connected companies within the meaning of the Regulation. Moreover, at program level, the aggregation of identical or connected clients is technically impossible. The criterion of Article 243 (2) (b) therefore cannot be achieved. The respective provision should be deleted.

STS-criteria for securitisations other than ABCP programs under Article 243 par. 2 CRR-R

Maximum risk weights of the underlying exposures under the Standardised Approach (Art. 243 par. 2 (c) CRR-R)

There are indications to believe that the requirement might entail that EBA will require the nomination of ECAIs for the determination of risk weights. This is based on the rationale of EBA as expressed in its report of July 2015 stating that:

“When determining the risk weights of exposures for assessing compliance with this criterion, all available credit assessments of ECAIs and export credit agencies may be considered according to the provisions of Part 3 Title II Chapter 2 of the CRR based on the assumption that all corresponding ECAIs and export credit agencies have been nominated for the relevant class of items.”

Although originators often use the assessments of ECAIs in the credit process as additional information it cannot be expected that originators have nominated ECAIs.

The obligation to use the assessment of ECAIs would contradict the political aim to reduce reliance on external ratings and thus the assessment of ECAIs. It would increase again the dependencies on external ratings.

This criterion is very problematic and could preclude the securitisation of corporate exposures, including SME corporate exposures as STS securitisation and should not be adopted. At least it should be warranted that originators would not be obliged to deliver external ratings that they do not use. This is to avoid an increasing dependency from rating agencies and additional undue costs for originators.

Capital requirements for STS securitisations pursuant to SEC-ERBA (Art. 260, 262 CRR-R)

Capital requirements should primarily be based on historical data for qualifying and non-qualifying exposures. Empirical findings suggest that historical losses of these two categories of securitisations differ significantly. This should be adequately reflected in the respective capital requirements which should not be higher than today.

From this angle, we regard the risk weight calibration for STS securitizations as too high vs. other (unsecured) sources of funding. The capital adequacy requirements for STS ABS programs fundamentally differ from the previous requirements for securitisation positions or from the capital requirements for comparable products (covered bonds, corporate bonds). The same applies to the provision of liquidity lines for ABCP programmes.

According to the current proposal, risk weights for non-STs transactions make it unprofitable for investors and sponsor banks to engage in the securitisation market. Even if the transactions are considered as STS-compliant, the risk weights would increase considerably.

The sharp tightening of the capital requirements as it is currently discussed (ERBA table 4) would clearly impede the development of the markets for high quality ABS and ABCP. Especially with regard to STS exposures we advocate a new calibration of the respective risk weights.

Specifically, we advocate for risk weights that properly reflect the low risk profile of STS instruments and are comparable to similar risk positions for corporate lendings. The respective ERBA tables should be adjusted. The IRBA formula pursuant to Article 260 CRR-R should be adjusted to ensure a floor risk weight of no more than 7 %.

Concluding remarks

The overall aim should be to safeguard a proper financing of business to overcome the economic crisis in Europe. To ensure this, bank financing and capital market financing must be intelligently interlinked. Securitisation in its full range of instruments should play a vital role in this respect.

Properly regulated STS securitisation markets can make a valuable contribution to the envisaged Capital Markets Union. However, we are concerned that the regulatory framework proposed by the Commission could fall short of what is necessary to deliver forceful impulses to a lasting rebound to this market segment.

Ensuring a regulatory level playing field vis-à-vis alternative financing forms is a necessary precondition for originators and investors alike to give new impulses to the securitisation market in Europe.

Obviously, the right balance between the regulatory treatment of securitisations and the economic need to promote growth and employment by a smooth financing of companies has not yet been found until now. Ongoing reforms should be optimised with the aim to fully exploit the huge potential of a sustainable high-quality securitisation market to the benefit of the real economy.

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