



EBA Consultation Paper on the Draft Regulatory Technical Standards on homogeneity of the underlying exposures in securitisation

This document provides the response of the Dutch Securitisation Association (“DSA”) on the EBA Consultation Paper dated 15 December 2017.

We welcome the opportunity to commend on this Consultation Paper.

DSA Background

The Dutch Securitisation Association was established in 2012 as representative body of the Dutch securitisation industry. Our membership includes issuers of securitisations both from the insurance and banking industry, and we are operating in close cooperation with the Dutch investor community.

Our purpose is to create a healthy and well-functioning Dutch securitisation market. We try to achieve this i.a. by providing a standard for documentation and reporting of Dutch RMBS and Consumer ABS transactions, promoting (in close cooperation with PCS) further standardisation and improvements in transparency, and active involvement in consultations about future regulation of the securitisation market.

Against this background, we would like to commend, on behalf of all Dutch issuers joined in the DSA, on the EBA Consultation Paper on the draft RTS on Homogeneity (individual DSA members may also provide their own comments).

Our comments

Q1: Do you agree with the focus of the RTS, general approach and underlying assumptions on which the RTS are based? Does the proposed approach provide sufficient clarity and certainty on the interpretation and application of the criterion of homogeneity?

Recital 27 provides as examples of homogenous pools “residential mortgages” or “corporate exposures”. We appreciate that EBA wants to refine this further (a combined pool of Dutch and Italian residential mortgages would not be regarded as homogenous by most investors, while individually these pools might qualify as homogeneous, subject to other criteria), but the approach taken in the consultation may lead to unnecessarily fragmented pools with insufficient diversification.

Q2: Do you agree with the assessment of the homogeneity of underlying exposures based on criteria specified under (a) to (d)? Should other criteria be added or should any of the criteria be disregarded?

We do agree with the criteria (a) to (d). As regards (d) we note that, apart from the relevance for certain asset categories, some criteria (jurisdiction, governing law) are far more relevant overall than others (type of obligor, type of credit facility). Also, the determination which risk factors are relevant or not creates a lot of uncertainty and lack of clarity.

Q3: Are there any impediments or practical implications of the criteria as defined? Are there any important and severe unintended consequences of the application of the criteria?

Apart from the comments on Q2, we fear that the fragmentation created by the risk factors will lead to smaller pools which will not be securitised because of lack of economics of scale. This defeats the purpose of the whole STS exercise.

Q4: Do you agree that when considering the relevance of the risk factors, the asset category, type of securitisation (non-ABPC or ABCP), and specific characteristics of the pool of exposures, should be taken into account? Should other elements be considered as important determinants of the relevance of the individual risk factors?

*We do agree that there should be a clear differentiation between ABCP and non-ABCP given the different structural support elements of both types of structures.
The most relevant risk factors should be equally applicable for all non-ABCP asset categories and pool specifics.*

Q5: Do you agree that the same set of criteria should be applied to non-ABCP and ABCP securitisation? Or do you instead consider that additional differentiation should be made between criteria applicable to non-ABCP and ABCP securitisation, and if so, which criteria? *For Trade Receivable transactions, which form the core of ABCP programmes, (c), asset category classification, should be sufficient, since (d), risk factors, would only offer one, hardly relevant, risk factor, i.e. industry of the seller, for consideration.*

Q6: Do you agree with providing a list of asset categories in the RTS? Do you agree with the asset categories listed? Should other asset categories be included or some categories be merged? For example, should separate asset categories of project finance, object finance, commodities finance, leasing receivables, dealer floor plan finance, corporate trade receivables, retail trade receivables, credit facilities to SMEs and credit facilities to corporates, be included? Please substantiate your reasoning.
We do agree with the list of asset categories. No further mergers are needed. Any missing categories (Project Finance, Whole Business Securitisation) are currently not relevant for the Dutch/European market and will not classify as STS.

Q7: Do you agree with the definitions of the asset categories provided? For example, do you consider that the asset category of credit facilities to SMEs and corporates should be further specified and for the SMEs should refer to the definition provided in the Commission Recommendation 2003/361/EC, or should other reference be used (for example to Art. 501 of the CRR)? Please substantiate your reasoning.
Further specification of the definitions is not needed, as long as criteria (a) and (b) are also applied. It is relevant that assets are originated and serviced according to common standards, not that they comply with a theoretical definition.

Q8: Do you agree with the approach to determination of the homogeneity based on the risk factors, and the distinction between the concept of risk factors to be considered for each asset category, and relevant risk factors to be applied for a particular pool of underlying exposures, as proposed? Are there any impediments or practical implications of the risk factors as defined? Are there any important and severe unintended consequences of the application of the risk factors?
*We refer to our answers on Q2 and Q3.
We also note that in Art. 1 states that exposures “shall be deemed to be homogenous where they have similar risk profiles and cash flow characteristics”. If (g), type of repayment or amortisation, would be included as a risk factor, cash flow characteristics should be deleted from this general description (so leaving just “similar risk profiles”).
Including “similar cash flow characteristics” as a pre-condition for homogeneity implies that none of the asset classes as defined will be homogenous, since in all categories there will be a mix of amortising, revolving etc. exposures.*

Q9: Do you agree with the distribution of the risk factors that need to be considered for each asset category, as proposed? What other risk factors should be included for consideration for which asset category?
We do agree with the distribution of the risk factors generally. Although not all risk factors have the same weight, in our view, we appreciate that a further refinement or weighting of the factors would make the classification of homogeneity too complicated.

Q10: Do you agree with the definition of the risk factor related to the governing law, which refers to the governing law for the contractual arrangements with respect to the origination and transfer to SSPE of the underlying exposures, and with respect to the realisation and enforcement of the credit claims? Do you consider the risk factor of the governing law should be further specified, or further limited (e.g. to the realisation and enforcement of the financial collateral arrangements securing the repayment of the credit claims)?
We generally do agree with the definition of governing law.

Q11: Do you consider prepayment characteristics as a relevant risk factor for determining the homogeneity? If yes, based on which concrete aspect of the prepayment characteristics of the underlying exposures should the distinction be made, and for which asset categories this risk factor should be considered and should be most relevant?

Prepayment changes over time, which cannot be captured by an up-front risk factor and prepayment differs per jurisdiction, which is (indirectly) covered by risk factor (i).

Q12: Do you consider seniority on the liquidation of the property or collateral a relevant risk factor for determining the homogeneity? If yes, do you consider the distinction between the credit claims with higher ranking liens on the property or collateral, and credit claims with no higher ranking liens on a different property or different collateral, as appropriate for the purpose of determination of homogeneity?

We do consider pools with predominantly second and lower ranking liens as a different risk category compared to pools with mainly first or equally ranking liens, so this risk factor may be relevant for determining homogeneity.

Q13: Do you agree with the approach to determining the homogeneity for the underlying exposures that all do not fall under any of the asset categories specified in the Article 3?

Yes, we do agree with this approach.

Q14: Do you believe that materiality thresholds should be introduced with respect to the risk (factors i.e. that it should be possible to consider as homogeneous also those pools which, while fully compliant with requirements under Article 1 (a), (b) and (c), are composed to a significant percentage (e.g. min 95% of the nominal value of the underlying exposures at origination), by underlying exposures which share the relevant risk factors (e.g. by 95% of general residential mortgages with properties located in one jurisdiction and 5% of income producing residential mortgages located in that and other jurisdictions)? Please provide the reasoning for possible introduction of such materiality thresholds.

This depends on the relevant risk factor. If we would look at all risk factors proposed by EBA we would suggest indeed a materiality threshold for factors (a) to (g). For (h) Industrial sector of the seller, it is not relevant and for (i) and (j), Jurisdiction/Governing Law, it should not be difficult to select a 100% compliant pool.

Q15: Alternatively, do you see merit in introducing synergies with IRB modelling, enabling the IRB banks to rely on risk management factors validated for modelling purposes, when assessing the similarity of the underwriting standards, or assessing relevant risk factors? Please provide the reasoning and examples for possible introduction of such synergies.

IRB models should follow as much as possible the asset classes, and not the other way around, reason why we would like to limit the fragmentation of asset classes, since IRB models will not be available on a very fragmented scale.

Q16. Which option from the two (the existing proposal as described in this consultation paper, and the alternative option as described in this box) is considered more appropriate and provides more clarity and certainty on the determination of homogeneity? Please substantiate your reasoning.

We would prefer the alternative option, which would allow us, with adequate justification, to put aside certain risk factors.

Both alternatives are problematic to the extent that they require "similar cash flow characteristics" (see also our answer on Q8.).

Q17: Please provide an assessment of the impact of the two proposed options, on your existing securitisation practices and if possible, provide examples of impact on existing transactions.

Of the 13 public transactions in our jurisdiction (the Netherlands) in 2017, 3 might have suffered to meet the requirements anyway under both options. The reasons: either legacy portfolios, where selection options are limited, or transactions of small originators that have to combine different asset types in order to get to the required critical mass.

For the other transactions we assume that the both options might have worked except for the requirement of “similar cash flow characteristics”, which would have been problematic where in most cases amortising and non-amortising exposures were combined in one pool.

Q18. Alternatively, do you believe that a hybrid option, combining the existing proposal and the alternative proposal, would be most appropriate? The hybrid option could envisage that all the risk factors would need to be taken into account in the underwriting, and for those risk factors that are not taken into account in the underwriting, (i) either adequate justification would need to be provided that it is not required for the purpose of the homogeneity, (ii) or if the justification cannot be provided, the risk factor would still need to be taken into account when determining the exposures in the pool (on the top of the requirements related to underwriting, servicing, and asset category). Or, should other hybrid option be envisaged? Please substantiate your reasoning.

This hybrid option potentially offers a solution for our concerns around the different level of relevance/weighting of different risk factors. A limited number of very relevant risk factors (like “jurisdiction”) would be treated as “real” risk factors (as per your option 1) and the other (like “type of repayment/amortisation”) could be taken into account “in the underwriting”. This would provide, in our view, the optimal combination of limiting the risk factors at the pool level (and consequently improving the economies of scale) and still potentially taking into account the whole list of risk factors (and maximize the homogeneity).

Also we would expect this to be the best (or only) way to legitimately combine amortising and non-amortising exposures in one pool. But to avoidance misunderstandings: our preference for this option is not limited to its application to “type of repayment/amortisation”, but also refers to other risk factors.

Q19. What are the advantages, disadvantages and unintended consequences of this alternative option, in particular compared to the existing proposal?

The advantage would be less fragmentation of pools, so better economies of scale, while still safeguarding the use of proper risk factors. A potential disadvantage is that this hybrid option provides less certainty in interpretation (and increases the risk of disputes and penalties based on a perceived wrong interpretation).

Q20. Are there any impediments or practical implications of this alternative option as defined? Are there any important and severe unintended consequences of the application of this option?

The concept of taking the risk factors into account and reflected in the underwriting standards, methods and criteria may need some further clarification and elaboration in the final version of the RTS.