EBA Discussion Paper Draft Report on STS Framework for Synthetic Securitisation Under Art. 45 of Regulation (EU)2017/2402
This document provides the response of the Dutch Securitisation Association ("DSA") on the EBA Discussion Paper dated 24 September 2019.
We welcome the opportunity to commend on this Discussion 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 Discussion Paper Draft Report on STS Framework for Synthetic Securitisation Under Art. 45 of Regulation (EU)2017/2402 (individual DSA members may also provide their own comments).

Our answers on the question

Question 1: Do you have any comments on this introductory section of the Discussion Paper?
The introduction creates the impression that (balance sheet) synthetic securitisations are almost identical to private, bilateral, SRT driven etc. This is indeed to a large extent the reality of the last 10 years. However, synthetic securitisation is only a technique and you could just as well use it for publicly placed funding transactions (see also you analysis in Par. 22)
This is relevant since STS criteria should focus on the (synthetic) securitisation technique; lack of public data and/or SRT considerations should not be mixed in this technical discussion.

Question 2: Do you agree with the analysis on the market developments? Please provide any additional relevant information to complement the analysis.
We do not completely agree with your analysis in Par. 21. Arbitrage synthetics disappeared indeed due to the stigma attached to it, balance sheet synthetics disappeared for a while mainly since for the typical asset classes involved (corporate, SME) the economics did not work in a high spread environment, so the industry focused on auto's and mortgages where the true sale technique is usually applied.
On your analysis in Par. 37 and 41 of the (future) asset classes we also have a slightly different view: Corporate and SME exposures are securitised synthetically in order to cope with the legal issues associated with true sale for these asset classes. And since these asset classes are "RWA-intensive", capital relief is often achievable. However, if (or better: when) residential mortgages become more RWA-intensive there is no reason why true sale should not be applied for RMBS capital relief transactions.

Question 3: Do you agree with the analysis of the historical performance? Please provide any additional relevant information to complement the analysis.
Since (synthetic) securitisation is just a technique, you would expect a comparable performance between pools in synthetic securitisations, true sale securitisations and on balance sheet.
So the slightly better performance of pools in synthetic transactions seem to be correlated with the higher percentage of SRT trades in synthetics, or as you indicate in Par. 57 "core" exposures in pools in synthetic securitisations.

Question 4: Do you agree with the analysis of the rationale for the creation of the STS synthetic instrument? How useful and necessary is synthetic securitisation for the originator and the investor? What are the possible hurdles for further development of the market?
We do generally agree with the analysis. We certainly agree that there is scope for more standardisation is synthetics. This should however not be confused with the even bigger need for standardisation in SRT (Par. 66 does not seem to differentiate between synthetic STS and SRT).
We agree with Par. 75 where it states that an STS framework for synthetics should be adapted to issues around counterparty credit risk and specificities of the credit transfer, but we fail to understand why STS has to be adapted by "different motivations for both originators and investors to engage in the synthetic securitisation". Originators amd investors always have different motivations, also in true sale securitisations.
As concerns the pro's and con's, we note that most of the pro's (except for the increased relevance of the product due to some advantages compared to traditional securitisation) are also valid for true sale securitisation. The con's have been discussed in the public hearing and we subscribe to the general opinion of the industry: STS for true sale also anticipated STC, the players are at least as sophisticated as in true sale, and for cannibalisation: see our answer on Question 6).

Question 5: Do you agree with the assessment of the reasons that could eventually support a preferential capital treatment?
We do not agree with the perceived risks for the banking sector. The incentive for banks to engage in securitisation for capital benefits may indeed be driven by differences in capital requirements. But this should be managed by proper calibration of risk weights in order to create a level playing field between different products. It should not be perceived to be a negative of favorable capital treatment under STS.

Question 6: Please provide any additional relevant information on potential impact of the creation of the STS synthetic securitisation on (STS) traditional securitisation, and any other information to complement the analysis.
As indicated in answers on earlier questions, synthetic and true sale are used for different asset classes. As such, these techniques will not cannibalise each other.

Question 7: Do you agree with the criteria on simplicity? Please provide comments on their technical applicability and relevance for synthetic securitisation.
Criterion 1: Balance sheet securitisation and credit risk mitigation
We agree subject to the following conditions:
- *there should be a practical definition of core lending/business activity, encompassing all activities that are generally undertaken by a credit institution.*
- *the prohibition on double hedging should not disallow the securitisation of exposure that benefit from a (partial) guarantee by a third party, so where (part of) the credit risk is on the guarantor rather than the debtor.*

Criterion 4: Homogeneity
Our view will depend on the criteria to be developed. In any case, we strongly recommend to consider the fact that synthetic transactions make it easier to deal with multi-jurisdictional pools and that, according to your data, 60% of synthetic securitisations contain multi-jurisdictional exposures, while most of them contain exposures outside Europe.

Criterion 11: No defaulted exposures or exposures subject to outstanding issues.
We would like to point to the fact that for traditional securitisations this criterion has proven to be one of the most difficult to meet, especially because of problems in retrieving the required information from existing systems. We fear that for SMEs this problem may be at least as big as for the typical retail clients in traditional securitisations.
Criterion 13 No embedded maturity transformation.
We disagree. Many, if not most, Corporate and SME exposures are underwritten on the basis that they will be refinanced or repaid from the sale of the underlying assets.
And since, as you write, "it is not necessary", we would strongly recommend not to include this criterion.

Question 8: Do you agree with the criteria on standardisation? Please provide comments on their technical applicability and relevance for synthetic securitisation.
Criterion 15: Appropriate mitigation of interest rate and currency risks.
We agree with the wording "appropriate mitigation", but not with the interpretation that this implies no currency and interest rate risk at all should be allowed as we read form the "Content of the criterion". Rather we would like to see wording equivalent to what is used in the Guidelines for STS criteria for traditional securitisations ("….it covers a major share of the respective interest-rate or currency risk under relevant scenarios……").
Criterion 22: Reference register.
We note that this requirement will negatively affect the development of public synthetic transactions of Corporate and/or SME exposures, since most obligors would not be prepared to be publicly visible in a reference register.

Question 9: Do you agree with the criteria on transparency? Please provide comments on their technical applicability and relevance for synthetic securitisation.
Criterion 23: Data on historical default and loss performance.
We note that, contrary to retail lending, where extensive data history is available through tthe European Data Warehouse, proxy data for Corporate and SME exposures, if allowed at all, will not be easily available. As a consequence, this condition prohibits relatively new entrants in the market to meet the criterion.
Criterion 24: External verification of the sample.
It looks a bit counterintuitive that for retail exposures the confidence level should be 95% and for corporate 99%. The other way around would better reflect the different complexities of the asset classes.

Question 10: Do you agree with the specific criteria for synthetic securitisation?
Criterion 29: Credit Events
There is some confusion about the use of terminology in the DP between "credit protection agreement", "credit protection contract" and "credit protection arrangements" and especially where derivatives and guarantees are included and not. We assume that the Credit Events of Criterion 29 only cover derivatives, since this would most closely be aligned with the relevant definitions in Chapter 4.
Criterion 30: Credit Protection Payments.
We do generally agree, with the one remark that a 6 months interim payment is market standard for Corporate and SME exposures, but may be refined for other exposures (like residential mortgages).
Criterion 33: Verification Agent.
We agree, but would like to see some clarification of what is exactly expected from the verification of "the accuracy of the final loss amount work out procedure".
Criterion 34 Early termination events.
We notice that priority is given to originator protection over investor protection by disallowing bankruptcy of the originator as a termination event. Although this choice is certainly defendable, it remains to be seen how the market will absorb this deviation form current "widespread market practice".
Criterion 35: Synthetic excess spread.
We understand that this issue is under discussion both in the BCBS and as part of the further work by EBA on SRT. In this respect we would strongly recommend to look at least at some kind of restricted excess spread as contemplated in the 2017 DP on SRT.

Question 11: Do you agree with the criterion 36 on eligible credit protection agreement, counterparties and collateral? Please provide any relevant information on the type of credit protection and different collateral arrangements used in market practice and their pros and cons for the protection of the originator and investor.
No, we do not agree.
Our main concerns, which we share with most of the industry, are:
-the missing option to place a cash deposit with the originator as collateral.
-the exclusion of the possibility of unfunded protection provided by private sector entities (even highly rated, regulated, insurance companies).
Instead we would recommend an approach more in line with the CRM provisions in the CRR.

Question 12: Please provide suggestions for any other specific criteria that should be introduced as part of the STS framework for simple, transparent and standardised securitisation.
We have no additional suggestions for more specific criteria at this moment.

Question 13: Do you see a justification for possible introduction of a differentiated regulatory treatment of STS synthetic securitisation? If yes, what should be the scope of such treatment and how should it be structured - for example only for senior tranche retained by the originator bank, or more limited/wider?
Without differentiation in regulatory treatment, along the lines of true sale STS, we see only limited justification in a STS Framework for Synthetic Securitisations.
Meeting the STS requirements will be a costly exercise, while some of the STS criteria may lead to a reduction in capital efficiency for the originator.
So especially for the retained tranche some kind of compensation by way of lower risk weights will be needed.
And while investors may value STS for more reasons than just lower capital charges, the, admittedly short, history of STS has not demonstrated whether this would have any impact on spreads.
More fundamentally, true sale and synthetic are two different techniques for the same product, securitisation. So while the STS criteria may be differentiated for different techniques, the capital treatment should apply to securitisation as a product and not to individual techniques.

Question 14: What would be the impact if no differentiated regulatory treatment is introduced? In that case, is the introduction of the STS product without preferential treatment relevant for the market?
Based on what we described in our answer on Q13, the impact would be minimal.
STS would be a label and a such replace the PCS label for synthetics.
While PCS labels have been instrumental in the survival of the securitisation product, without the additional regulatory benefit they have not been able to revitalize the market.

Question 15: What would be the impact of potential differentiated regulatory treatment from level playing perspective with regard to third countries where STS framework has not been introduced?
There has never been anything like a global level playing field in securitisation.
We do not want to repeat again all the frustration around regulations dictated by americans, applied in Europe and not in the US.
There is no level playing field for true sale STS. The only country outside the EU that has introduced STC is Japan.

Question 16: Should a separate explicit recommendation be included in the Recommendations section on whether or not such treatment should be introduced?
We would highly appreciate if such a recommendation could be included.