May 12, 2015

European Commission
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Re: Comments on Consultation Document: An EU framework for simple, transparent and standardised securitisation

The Structured Finance Industry Group ("**SFIG**")[1] appreciates the opportunity to offer some general comments on, and to respond to certain questions raised by, the February 18, 2015 Consultation Document (the "**Consultation Document**") of the European Commission services (the "**Commission**") that seeks to develop a securitization framework to help restart securitization markets on a more sustainable basis, allow for an efficient and effective risk transfer to a broad range of institutional investors and banks, create funding opportunities via the securitization transactions for banks and non-bank institutions alike, and protect investors and manage systemic risk. SFIG acknowledges the efforts of the Commission that produced the Consultation Document and strongly supports this new initiative to strengthen the global securitization markets.[2]

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[1] SFIG is a member-based, trade industry advocacy group focused on improving and strengthening the broader structured finance and securitization markets. SFIG provides an inclusive network for securitization professionals to collaborate and, as industry leaders, drive necessary changes, be advocates for the securitization community, share best practices and innovative ideas, and educate industry members through conferences and other programs. Members of SFIG represent all sectors of the securitization market including issuers, investors, financial intermediaries, law firms, accounting firms, technology firms, rating agencies, servicers and trustees. More particularly, SFIG membership includes U.S.-, Canada- and Australia-based issuers of and investors in asset-backed securities ("**ABS**") that from time to time participate in the EU securitization markets either as sellers of ABS issued or sponsored by them, or as purchasers of ABS issued or sponsored by EU financial institutions. Further information can be found at www.sfindustry.org.

[2] In addition to the Consultation Document, the following documents (among others) have recently addressed different facets of the regulatory treatment of securitizations: (i) The European Banking Authority's "*EBA Discussion Paper on simple standard and transparent securitisations: Response to the Commission's call for advice of December 2013 related to the merits of, and the potential ways of, promoting a safe and stable securitisation market*" (October 14, 2014), available at http://www.eba.europa.eu/documents/10180/846157/EBA-DP-2014-02+Discussion+Paper+on+simple+standard+and+transparent+securitisations.pdf (the "**EBA Consultation**"); (ii) the Basel Committee on Banking Supervision's "*Basel III Document—Revisions to the Securitisation Framework*"

I. Introduction

We appreciate and support efforts aimed at addressing the factors that may be hindering the full recovery of sustainable securitization markets. More than seven years after the onset of the financial crisis that for many cast an indiscriminately unfavorable light on virtually all forms of securitization, we are encouraged to see that a more thoughtful and nuanced assessment of the value of securitization has evolved among a broad range of regulatory and quasi-regulatory organizations. We are concerned, however, that a consensus seems to have emerged around the idea that the answer to any and all problems afflicting securitization markets today is to be found at the confluence of the three identifying characteristics of simplicity, standardization and comparability ("**STC**"). More problematic, in our view, is the proposition that only STC securitizations (*i.e.*, those that simultaneously share all three STC characteristics) should be considered "high quality" securitizations ("**HQS**") for a variety of regulatory purposes. This view has gained almost axiomatic status,[3] irrespective of the impeccable performance records of thousands of securitization transactions that would be excluded from HQS status under the current proposals because they fail to satisfy one or another of the proposed requirements to achieve the STC status.[4]

As noted above, SFIG believes that the adoption of STC securitization standards could potentially foster the development of sustainable securitization markets and have useful applications for regulatory purposes such as, for example, in connection with the capital treatment of securitization transactions. We also agree with the Commission that a modular approach similar to the one described in the Consultation Document[5] provides the flexibility required to satisfy different regulatory needs. However, we do not believe that an STC framework alone will suffice to help achieve all of the objectives set out by the Commission in the Consultation Document. In particular, objectives such as "allowing for efficient and effective risk transfers to a broad set of

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(December 11, 2014), available at https://www.bis.org/bcbs/publ/d303.pdf (the "**2014 Basel Securitization Framework**"); (iii) the IMF Staff Discussion Note authored by Miguel Segoviano, Bradley Jones, Peter Lindner, and Johannes Blankenheim entitled "*Securitization: The Road Ahead*" available at http://www.imf.org/external/pubs/ft/sdn/2015/sdn1501.pdf (the "**IMF Securitization SDN**"); and (iv) the Basel Committee on Banking Supervision and the Board of the International Organization of Securities Commissions' "*Consultative Document-Criteria for identifying simple, transparent and comparable securitisations* (December 11, 2014), available at http://www.bis.org/bcbs/publ/d304.pdf (the "**BCBS/IOSCO Consultative Document**")

3 In the Consultation Document, for example, the Commission states: "It is important to distinguish between the concept of ***a high quality securitisation – one that is simple, transparent and standardized/comparable in terms of the process by which it is created***, and the underlying credit quality of the assets involved." (Page 5, emphasis added).

4 Each Annex A attached to SFIG's responses to the EBA Consultation and the BCBS/IOSCO Consultative Document sets forth in detail, on the basis of input provided by our membership, specific instances of high quality assets with outstanding performance records which, for one reason or another, would be excluded from HQS treatment under those proposals. These responses are available, respectively, at http://www.sfindustry.org/images/uploads/pdfs/SFIG_Response_to_EBA_Paper_on_Simple_Standard_and_Transparent_Securitizations.pdf and http://www.sfindustry.org/images/uploads/pdfs/SFIG_Response_to_BCBS_IOSCO_Paper_on_Simple_Transparent_and_Comparable_Securitizations.pdf.

5 See pages 6 and 7.

institutional investors as well as banks"[6] and "allowing securitization to function as an effective funding mechanism for some non-banks as well as banks"[7] could be vigorously advanced if securitizations other than STC securitizations are also deemed to be eligible for high quality treatment. Moreover, the focus on the development of sustainable markets only for STC securitizations may inadvertently confine to a lesser rank (and thereby hinder or prevent the development of markets for) all other securitizations funding real economy assets that for one reason or another do not meet that standard.[8] The world economy, as a whole, would benefit from the development of efficient, well-regulated markets for all types of securitizations, including HQS securitizations.

We recognize that the HQS designation should only apply to a select subset of securitization transactions. We believe, however, that the specific features of a securitization transaction that make it eligible for HQS treatment are not the same across all asset classes or regulatory objectives. For example, as explained elsewhere in this letter, the characteristics that identify high quality asset backed commercial paper ("**ABCP**") are different from those that characterize high quality residential mortgage backed securities ("**RMBS**"). Furthermore, a banking regulator seeking to ascertain what is a high-quality asset-backed security ("**ABS**") when held by a bank should undoubtedly focus on features different from those that would lead a securities regulator to conclude that a particular ABS' high quality makes it suitable for unsophisticated investors. Accordingly, the delineation of the criteria identifying an HQS securitization must be a function of the regulatory purpose(s) to be served. Once a particular regulatory objective has been identified, a proposed modular approach would help identify and apply the most relevant criteria for that particular purpose. The relative weight of each module could thus be calibrated appropriately in response to the specific regulatory objectives sought to be achieved.

Finally, we appreciate that the Commission's Consultation Document of necessity pertains directly only to the European securitizations. However, we urge the Commission also to be mindful of the global nature of the securitization markets. A well-functioning European securitization market will likely increase the diversity and supply of high-quality, tradable assets available to investors and financial intermediaries around the globe as well as broaden the overall investor base for securitization products originating from various jurisdictions. Likewise, well-functioning securitization markets in non-European jurisdictions will likely increase the investor base for European securitization products, and provide investors in Europe with a greater supply

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6 Consultation Document, page 5.

7 *Id.*

8 Our concern is echoed in the IMF Securitization SDN, which observes that:

> "A binary two-tier, high/low-quality, classification system at the aggregate level risks creating a fragmented market. Significant "cliff effects" or discontinuities between similar product offerings might result where a slightly lower-quality loan pool attracts drastically lower investor interest if it barely fails to meet the qualifying "high-quality" requirement. Significant pricing and liquidity distortions between tiers may well be exploited by product originators where there is a strong incentive to have deals barely meet the minimum requirement in order to attract the "high-quality" designation."

IMF Securitization SDN, page 20.

and diversity of products to hold. Any regulatory changes made in Europe as a result of this consultation will inevitably have a broad impact on the global financial system, whether intentional or not. Establishing a regulatory framework that has the effect of substantially hindering access in the European securitization markets for securitizations backed by non-European originated assets, irrespective of their quality, is unlikely to hasten the development of the deep and liquid trading venues that is one of the key objectives of the Consultation Document. Such a Euro-centric approach could also create an inappropriately uneven playing field for non-European banks, and may lead to a limiting of access to mature non-EU securitization markets around the globe for EU originators – a result clearly inconsistent with the Consultation Document's objectives.

II. <u>Responses of SFIG's members to certain questions posed in the Consultation Document</u>

Question 1:

A. Do the identification criteria need further refinements to reflect the developments taking place at EU and international levels? If so, what adjustments need to be made?

SFIG Response:

As noted above, we believe that the criteria dictating which securitizations will benefit from a more favorable regulatory treatment should be tailored to reflect the regulatory purpose being pursued and that additional criteria should be considered for identifying other high quality securitizations appropriate to the nature of the assets involved, the investor base accessed and the policy objectives to be achieved. Thus, the criteria to be used to identify securitizations which, when held by banks or other regulated financial entities, are to be entitled to a less onerous regulatory capital treatment should properly focus on characteristics such as the quality of the underlying assets, the robustness of the structure and the availability of sufficient information to allow a bank to assess the credit and other key characteristics of such assets and the securities they back. In addition, factors impacting the liquidity of the security (such as tranche size, listing/registration status and central bank repurchase facility eligibility) would also be relevant to the extent the standard is used in connection with liquidity coverage ratio ("**LCR**") requirements.

In contrast, in developing criteria used to identify securitizations intended to be sold to retail investors, it would be appropriate to emphasize the quality of the disclosure in the offering document provided to investors and the scope of the fiduciary or other duties owed to investors by the dealers or other entities participating in the offering, in addition to the quality of the underlying assets and the liquidity of the securities. For example, strict compliance with Prospectus Directive requirements in the case of a securitization entitled to "qualifying" treatment (and thus a lower risk weighting) under the 2014 Basel Securitization Framework would be as marginally relevant as central bank repurchase facility eligibility would be in the case of a security sold to retail investors. Any set of standards that would simultaneously apply to the risk capital treatment of assets held by regulated financial entities as well as to disclosure considerations applicable to a broad range of investors (including non-professional retail investors) would likely be unduly restrictive as applied to financial institutions, since it would unnecessarily discourage financial institutions from holding otherwise high quality securitizations merely these securitizations were not marketed in compliance with rules designed for the protection of a category of investor that does not include regulated financial institutions.

We also believe that, once the relevant criteria have been identified for a particular asset class, investor base and regulatory purpose, such criteria should be adopted as uniformly as practicable across jurisdictions. Of course, even identical standards enacted in the same language in different jurisdictions can be (and almost inevitably often are) interpreted and applied differently from jurisdiction to jurisdiction. The lack of uniform implementation is easily compounded when the standards are of necessity translated into different languages and enacted in countries with different legal systems and traditions. For this reason, we strongly recommend the adoption of a system of substituted compliance (at least, initially, among jurisdictions which, like Australia, Canada, the U.K. and the U.S., have mature and internationally-focused securitization markets), such that determinations made on the basis of the interpretative guidance in one jurisdiction does not need to be re-evaluated by investors or regulated entities in other jurisdictions.

Subject to the foregoing, we believe that there are certain high-level principles that should apply to the selection of criteria used to determine which securitizations are entitled to HQS treatment for a particular regulatory purpose. Such criteria should be characterized by:

- Being (a) inclusive of assets and transactions from all jurisdictions with a substantial securitization experience (the "eligible jurisdictions"), and (b) jurisdictionally neutral (*i.e.*, without showing preference for certain eligible jurisdictions over others);
- Being susceptible to application on a globally-consistent basis;
- Being flexible enough to allow for the future addition of new asset classes of structures; and
- Not being defined by reference to any particular regulatory regime (the specifics of which are more properly added as "top-up" modules that help custom-tailor HQS for the specific regulatory objectives of particular regulators around the globe).

B. What criteria should apply for all qualifying securitisations ('foundation criteria')?

SFIG Response:

We agree that a modular approach, of a nature similar to that described on pages 6 and 7 of the Consultation Document, would make it easier to implement across jurisdictions, transaction types and regulatory agencies (even within the same jurisdiction) a new regime in which securitizations meeting specified characteristics will be singled out for a special (presumably, more favorable) treatment for a variety of regulatory purposes. For this approach to be most beneficial, we believe that the highest degree of flexibility should be allowed and that, therefore, an *a priori* determination of which modules should be required in all instances may be premature.

Question 2:

A. To what extent should criteria identifying simple, transparent, and standardised short-term securitisation instruments be developed? What criteria would be relevant?

SFIG Response:

Short-term securitization instruments, such as ABCP, are safe and important investments for money market funds, banks, insurance companies, pension plans and other institutional investors, who view ABCP as cash equivalents. Further, ABCP programs provide an important source of funding for the real economy. For example, they provide financing for trade receivables originated by credit institutions, for shorter-term loans and leases, and for receivables originated by finance companies. Consequently we view it as essential that the Commission develop criteria identifying ABCP that qualifies as HQS.

In developing any criteria for short-term securitizations such as ABCP, it is important to differentiate between arbitrage conduits on the one hand and multi-seller ABCP conduits on the other, including considerations such as:

- commercial paper ("**CP**") issued by arbitrage conduits proved to be illiquid at the height of the global financial crisis, due to over-reliance on asset sale proceeds to refinance issued CP; and

- CP issued by multi-seller ABCP conduits is typically reliant on liquidity provided by the bank/sponsor. The credit quality of the liquidity provider and disclosure requirements relating to the liquidity provider can therefore be critical to multi-seller ABCP conduits. We would not recommend that the criteria developed for ABCP include ABCP issued by arbitrage conduits; rather we would limit the criteria to multi-seller ABCP conduits supported by bank liquidity and credit facilities (referred to as "**Multi-Seller ABCP**").

Multi Seller ABCP is unique in that it is supported by a dynamic portfolio of receivables and other financial assets that may have diverse characteristics but in all cases are structured to a very high credit standard (typically to a AA or better level). The portfolio of a Multi-Seller ABCP conduit changes daily and can include assets with fixed or floating interest rates, or that are non-interest bearing as well as assets from many jurisdictions and in multiple currencies. Multi-Seller ABCP conduits do not generally disclose the precise assets that comprise the portfolio at any time but rather disclose the credit and investment guidelines that the bank sponsor employs in arranging the conduit's investments on its behalf as its agent. The bank sponsor, however, has at least the same level of information that investors in term ABS have. In fact, the bank sponsor normally has more information about the underlying sellers and assets than a typical term investor because the bank sponsor views the credit exposure it assumes under its liquidity facilities as akin to a direct investment in such seller and its assets. Further the bank regulators share that view by including the assets of the Multi-Seller ABCP conduit as assets of the bank sponsor in its regulatory capital, leverage and liquidity coverage calculations. The high credit quality of the underlying seller transactions as well as the deep understanding of the underlying sellers and their assets obtained by the bank sponsor both serve to protect the investors in the Multi-Seller ABCP itself. These factors permit the bank sponsor to write liquidity facilities that remove practically all, if not all, risk associated with the underlying sellers and assets from the ABCP issued. As a result, although Multi-Seller ABCP sits within the family of ABS investments for many investors, it really retains a credit profile more similar to covered bonds issued by the bank sponsor than to traditional ABS.

We therefore view the following criteria as the most relevant for determining Multi-Seller ABCP that constitutes HQS:

a. Multi-Seller ABCP that enjoys bank sponsor provided liquidity in an amount at least equal to 100% of all outstanding ABCP and that is available at all times for the full amount of the facility with no funding conditions other than the absence of insolvency events relating to the ABCP issuer (referred to as "non-asset tested liquidity") should constitute HQS so long as the ABCP issuer is designed to be bankruptcy remote.

b. Multi-Seller ABCP that enjoys bank sponsor provided liquidity in an amount at least equal to 100% of all outstanding ABCP but with availability that is subject to reduction in respect of underlying asset quality (referred to as "asset tested liquidity") should constitute HQS if the ABCP issuer is designed to be bankruptcy remote and if the following additional criteria are satisfied:

i. the bank sponsor covers all of the following risks, either through the liquidity facility or through other direct obligations to the ABCP issuer for the benefit of the ABCP investors:

1. all interest rate risk associated with assets maturing on dates other than the ABCP and with the ABCP accruing interest at a rate different from the assets;

2. all currency exchange risk associated with assets denominated in currencies other than the ABCP;

3. all risk that the ABCP issuer has a valid ownership or security interest in its assets, free from other claims;

4. all bankruptcy risk of the asset seller to the ABCP issuer; and

5. all fraud, mistake and other risk that the assets are not as reported by the seller/servicer.

ii. any reduction in the amount available under the liquidity facility is not greater than the amount of defaulted underlying assets that exceed the first loss protection provided by the relevant seller;

iii. the first loss protection for each customer transaction must be structured to the equivalent of at least a single A level as determined by the bank sponsor; and

iv. the bank sponsor provides program wide credit enhancement, which is not subject to reduction based on asset credit quality, in an amount at least equal to the largest single transaction in the conduit that is not supported by non-asset tested liquidity.

B. Are there any additional considerations that should be taken into account for short-term securitisations?

SFIG Response:

Privately negotiated bank customer securitization transactions that meet HQS criteria, whether funded through ABCP conduits or directly by banks, should be eligible for the same favorable regulatory treatment as if they were funded in term securitization markets. While most of the criteria that would comprise a well-structured HQS framework would be equally applicable to securitization transactions funded in the short-term markets or directly by banks, some accommodations should be made for bank customer securitization transactions funded by ABCP conduits or banks given the privately negotiated nature of these transactions.

An important consideration in developing HQS criteria is that the banks providing ABCP conduit and bank customer market financing transactions are typically relationship lenders to their customers and that these transactions are directly negotiated between the banks and their customers. As such, banks in these transactions have visibility into and significant control over facility terms and enjoy extensive and direct access, for diligence purposes, to vital information concerning both the underlying assets as well as the creditworthiness of the underlying obligors and servicing capabilities of their customers themselves. In many such transactions, subject to standards of reasonableness, the bank may request whatever information it needs or wants with respect to such issues. In contrast to the term securitization markets, however, the form such information takes may vary significantly from transaction to transaction. Any criteria developed for information disclosure for HQS should leave banks funding these transactions the flexibility to dictate the form in which this information is presented to investors, provided that, under the relevant transaction documents, the bank has the right to receive the information required in the criteria.

Question 4:

A. ***How can proper implementation and enforcement of EU criteria for qualifying instruments be ensured?***

SFIG Response:

To the extent that the HQS designation is to be used by banking and other regulators for purposes of determining the risk capital (and, possibly, liquidity) requirements applicable to financial entities under their supervision, our members strongly believe that each regulated entity should be responsible for the determination of whether or not a particular transaction in which they hold an interest or to which they have an exposure meets the HQS standard on the same basis, and to the same extent, as they are responsible for all other capital requirement or LCR determinations. This approach would be consistent with the way in which such risk capital and liquidity determinations are currently made for all other assets.[9]

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[9] Should one or more third-party "credentialing" agencies be designated in connection with the determination of compliance with the HQS criteria (as discussed in more detail in the text below), we would propose that each regulated financial institution be free to decide whether it will evaluate solely for itself a transaction's compliance with the standard or if it will also take into account the determination of a third party credentialing agency. However, in either case, the ultimate responsibility for the determination of whether a given securitization meets the HQS standard and the consequences thereof should nevertheless rest with the regulated entity alone.

Alternatively, if the HQS designation is intended also to be used in connection with marketing of ABS (whether to a particular type of investor or in general), we believe that the best approach for determining how the designation is to be administered will be different. Our members believe that, although there are a number of different considerations to take into account, the best approach in this circumstance would be to allow the originator or sponsor of the securitization to make an assessment of the status of the securitization within the HQS criteria and to include its conclusion in the related offering document (perhaps along with a brief analysis of each criterion and why it believes the relevant securitization meets such criterion). Originators and sponsors are the parties more familiar with the assets being securitized, the structural characteristics of the transaction, any special servicing needs, etc. It is, therefore, appropriate to make them responsible for making HQS-compliance determinations in the first instance. We recognize that an originator's or sponsor's assertion as to compliance of its securitization with the HQS standard may be perceived as biased by the originator's or sponsor's inherent interest in the success of the offering; however, we believe that such concerns can be mitigated by regulatory safeguards such as the imposition of penalties or other economic consequences on originators or sponsors found to have marketed securities based on incorrect or inconsistent assessments of HQS compliance.[10]

Any alternative approach to the administration of the HQS standard in this context would require the involvement of a credentialing third party (whether a governmental body or a private sector entity) to review the securitization and provide its conclusion as to whether (or not) the criteria have been met. To implement such a system, a complex regulatory structure would need to be put in place to address issues such as:

- The degree of regulatory deference (if any) to which such judgmental determinations by the credentialing agency will be entitled;

- The consequences of, and ultimate responsibility for, "errors" made in connection with such judgmental determinations (to the extent that the credentialing agency's determinations are not final and binding for all purposes);

- How post-closing amendments to the transaction documents or structure would be handled; if the credentialing agency would be charged with ongoing surveillance and monitoring of all transactions designated as meeting the HQS criteria across the globe, the volume of work could quickly become enormous, necessitating significant resources and cost;

- If more than one credentialing agency is to exist, how to resolve potential conflicts if differing judgmental determinations are made (or, if the determination of only one such agency is deemed sufficient, how to avoid "credential shopping" concerns among multiple providers where an originator or sponsor selects the credentialing agency it believes will provide the most favorable response);

[10] Temporarily or permanently depriving an originator or sponsor, or the individuals associated with the faulty determination, from the ability to make future offerings of HQS compliant ABS is one of example of the economic consequences that could be considered.

- If only one global (or national) credentialing agency is established, how to handle the multiple concerns arising from its monopolistic position; and

- The level of oversight (if any) to whom such credentialing agency or agencies would be subject.

Furthermore, we are very concerned that the implementation of a credentialing agency system could lead to a reprise of many of the undesirable practices exposed by the 2008 financial crisis, such as:

- The potential for overreliance by investors (including banks and other regulated entities seeking favorable capital treatment for their investments in securitizations) on such credentialing agency for the evaluation of a transaction's compliance with the HQS regulatory criteria;

- The creation of incentives for any private sector credentialing agencies to increase volume or market share by accommodating the demands or perceived business needs of their customers; and

- Most importantly, the potential for devolving responsibility for the consequences of an inadvertent, negligent or even fraudulent application of the HQS standards to one or more entities that will likely have limited liability.

To disregard the lessons of the financial crisis in these respects would be unfortunate. We believe that the adoption of such an approach would ultimately be detrimental to the Commission's objective of advancing the development of sustainable securitization markets.[11]

B. How could the procedures be defined in terms of scope and process?

SFIG Response:

SFIG believes that implementation of the approach advocated in the response to the previous question would not require the adoption of new rules introducing procedures to be followed in connection with a determination of the satisfaction of HQS requirements. To the extent that such determination will be contained in representations made by the relevant parties (*e.g.*, originators or sponsors, in the case of ABS being sold to investors, or regulated financial entities, in the case of ABS held by them) in agreements, disclosure documents or statements contained in regulatory filings, the same rules that currently govern any potential liability in connection therewith would also apply. If desired, modest additions could be made to these rules at the local level to introduce more specific consequences for originators or sponsors found to have materially misstated the position of a given securitization (such as losing the privilege of being able to issue "qualifying" securitizations for a designated period of time, depending on the circumstances). Thus, subject to any such local modifications, the legal regime applicable to the range of activity

[11] The IMF Securitization SDN flags these risks and specifically cautions against the use of "holistic risk labels". See, IMF Securitization SDN, page 20 (listing, as potential risks, in addition to the undue reliance by investors identified in the text, the potential creation of buying or selling pressure, and moral hazard, if the credentialing agency belongs to the official sector).

in which the determination is made will dictate the applicable standard of care to which the party making the determination will be held and the consequences of any failure to meet such standard.

The advantages of this reliance on existing procedures and remedies (as opposed to implementing an entirely new compliance regime) cannot be overemphasized. The jurisdictions in which mature securitization markets currently exist or are re-developing (in addition to Europe, mainly, Australia, Canada, the U.K. and the U.S.) have well-understood answers to claims for breach of representation or warranty or the furnishing of false or misleading information to regulators. That being the case, both compliance and enforcement become easier, less costly and more predictable.

C. To what extent should risk features be part of this compliance monitoring?

SFIG Response:

SFIG wholeheartedly supports the Commission's view that the identification of the criteria characterizing an HQS should not be "intended to provide an opinion on credit or other risks but to make investors' assessments of the risks more straightforward".[12] We believe that the originator/sponsor representation approach that we endorse supports this objective and that, conversely, any credentialing agency approach would have the contrary effect of undermining the Commission's goals. The recent financial crisis reveled that even sophisticated investors are prone to place an undue level of reliance on government-sanctioned third-party pronouncements about the quality of a security, even where prudence and past experience would dictate otherwise.

Question 6:

A. For qualifying securitisations, what is the right balance between investors receiving the optimal amount and quality of information (in terms of comparability, reliability, and timeliness), and streamlining disclosure obligations for issuers/originators?

SFIG Response:

While SFIG supports an appropriate level of disclosure for any securitization that would be considered "qualifying", for the reasons stated above, SFIG does not believe that applying a "one-size-fits-all" approach across the board to all qualifying securitizations (as implied by the question) is the best away to balance investors' need for information and issuers' and sponsors' disclosure burdens. Different types of investors and securitizations will each call for a more tailored approach to finding the right balance. It would be inefficient and probably counterproductive to submit issuers and sponsors of securitizations marketed to institutional, professional investors to the full suite of disclosure requirements that are appropriate in the case of sales to individuals buying the investment for their retirement accounts. Similarly, a securitization backed by wholesale assets (such as "big-ticket" equipment leases or SME loans) will call for disclosure information different from that applicable in the case of a securitization of residential mortgages. As the foregoing examples illustrate, any attempt to impose a uniform

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[12] Consultation Document, page 9.

disclosure regime to all securitizations eligible to qualify as HQS will inevitably be over-inclusive and under-inclusive when applied to different situations.

The same principle should apply to the ongoing reporting obligations of securitizers. While SFIG supports appropriate periodic reporting requirements for qualifying securitizations, the information contained in periodic reports showing the post-issuance performance of a securitization of big ticket equipment leases will differ from that which should be included in the periodic reports for an SME loan-backed transaction. For example, information about lease term and renewals would be more relevant for the former, whereas facility utilization might be a critical metric in the latter. While securitizations backed by both types of underlying assets should be eligible for qualification as HQS (all other relevant criteria being met), to impose on both of them the same information requirements as a pre-requisite to being treated as "qualifying" would not advance the Commission's stated purposes.

B. What areas would benefit from further standardisation and transparency, and how can the existing disclosure obligations be improved?

SFIG Response:

SFIG acknowledges and values the benefits that follow from standardization of transaction features and documentation. Among other things, standardization helps reduce the cost and lead time necessary to bring transactions to market. However, we believe that a rigorous approach that makes standardization an absolute condition to HQS treatment is not advisable. The validity of the principle that standardization of structural elements leads to higher quality (lower investor losses) remains to be established. In fact, many of the subprime RMBS securitizations that resulted in high losses for investors during the financial crisis involved relatively standardized structures. While standardization may be beneficial in facilitating ease of comparison among transactions in the market by investors, the greater importance of securitization as a flexible funding tool for real economy assets cannot be overstated: given the vastly different types of real economy assets that have been (and may in the future be) securitized, any significant level of required standardization would likely serve only to limit the development of new and innovative structures that can facilitate the funding of real economy assets.

In our members' experience, standardization works better when it is the result of an industry-led and market-based process incorporating feedback from, issuers, investors and intermediaries, alike (such as the "RMBS 3.0" project led by SFIG in the United States). Standardization (both with respect to transaction features and documentations requirements) makes possible to more quickly and efficiently bring to market a higher volume of transactions. As such, it is a natural indigenous market development. The more a particular type of transaction is repeated, the higher the number of its features and accompanying documentation that become developed enough to the point where they become standard. However, given the evolutionary nature of many of the securitization markets, few standard features or form documents do or should remain static over time. Markets are always testing further refinements to established transaction features or documentation approaches and any HQS framework should encourage this process.

Effectively imposing standardization on the market (through the form of incentives, such as lower risk capital weightings, only available to "qualifying" securitizations), on the other hand, works entirely differently. First, it requires regulators to (with varying degrees of inevitable arbitrariness and subjectivity) select some of the transaction features or documentation forms at the time available, and fix them as the required standard. Regardless of how well-informed or well-intentioned a process there may be, there cannot be any assurance that the features or forms so selected will in fact be the ones that will best serve the needs of all market participants once they become required elements of the criteria for qualifying as HQS. Second, this type of standardization may curtail innovation and, more concerningly, encourage creative drafting or structuring to circumvent less desirable outcomes or required disclosures.

Accordingly, SFIG urges the Commission strictly to limit any standardization requirements imposed as conditions to HQS status.

C. To what extent should disclosure requirements be adjusted – especially for loan-level data – to reflect differences and specificities across asset classes, while still preserving adequate transparency for investors to be able to make their own credit assessments?

SFIG Response:

Disclosure requirements for securitization transactions should always take into account the asset class to which they will apply. Although it may be easier to identify and formulate disclosure requirements for well-established asset classes (*e.g.*, residential mortgages, auto loans, etc.), it is important to keep in mind that not all well-established classes can be treated the same. For example, while loan level data may be desirable in certain circumstances, it may not be the best disclosure in all cases. We would support requirements for data disclosure that are reflective of the characteristics of the underlying assets (*e.g.*, securitizations backed by highly granular assets may benefit from loan level data, while grouped account data may be more appropriate for pools with lower levels of uniformity).

More importantly, disclosure requirements for HQS should be drafted in such a way that they do not prevent future asset classes developed by the markets from achieving HQS status. In this respect, in addition to the specific disclosure requirements of well-established asset classes referred to above, HQS standards should also include guiding disclosure principles against which the adequacy of the disclosure of new asset classes may be ascertained in the future.

Question 10: If changes to EU bank capital requirements were made, do you think that the recent BCBS recommendations on the review of the securitisation framework constitute a good baseline? What would be the potential impacts on EU securitisation markets?

SFIG Response:

A joint trade group effort, including SFIG, provided significant input during the process that led to the development of the 2014 Basel Securitization Framework and our members' concerns about the final criteria embodied therein are well documented.[13] Given that the 2014 Basel Securtization Framework is the *de facto* starting point for determining bank capital

[13] Comments are available at http://www.sfindustry.org/images/uploads/pdfs/Basel_Securitization_Framework_Comment_Letter.pdf.

requirements for securitization exposures, we believe that it is critical that the shortcomings of that framework be addressed through a globally consistent implementation of an HQS standard based broadly on STC principles as discussed in this response.

Question 11: How should rules on capital requirements for securitisation exposures differentiate between qualifying securitisations and other securitisation instruments?

SFIG Response:

We believe that for the purposes of determining the capital charges applicable to term securitizations held by regulated banks and other financial institutions,[14] the relevant characteristics that determine high quality include:

(i) Approximate neutrality of the legal structure: Any incremental risks that the securitization may add to the risk profile of the underlying assets should be appropriately mitigated by compliance with applicable HQS criteria (for example, with the use of back-up servicers, currency or interest rate swaps, etc.). The objective, in our view, should be that the overall risk exposure inherent in a transaction deemed to be HQS for capital requirements purposes should be as close as possible to what the aggregate risk exposure to the underlying assets would have been.

(ii) Liquidity: For obvious reasons, securitizations for which no liquid market exists should not be entitled to HQS status for capital requirements purposes, even if they entail low or nil risk of loss.

(iii) Credit quality of the underlying assets: Securitizations entitled to preferential treatment for capital regulatory purposes should be inherently likely to retain its value; that would not be the case of underlying assets of dubious credit quality or of a highly volatile nature.

Once the foregoing criteria are satisfied, the capital treatment of the HQS securitization should be much closer to the capital treatment that a direct exposure to the underlying assets would have received. In many cases, the securitization structure may add benefits that should offset a perceived great risk, for example if the securitization made the resulting assets more liquid than they would have been in non-securitized format.

Question 12: Given the particular circumstances of the EU markets, could there be merit in advancing work at the EU level alongside international work?

SFIG Response:

SFIG strongly believes that when developing the different standards that characterize high quality securitizations for different regulatory purposes, a coordinated, global approach is of the essence. A dissimilar capital treatment of securitization exposures among major jurisdictions

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[14] As explained in our response to Question 2 above, ABCP conduit and bank lenders have strong visibility into and control over the simplicity, quality, transparency and comparability of their short term securitization exposures, thus making the three characteristics listed in the text irrelevant to a determination of HQS status.

would have a detrimental impact on the global securitization markets and, more generally, on the financial markets. Disparate treatment of securitizations in different jurisdictions will encourage global institutions to engage in regulatory arbitrage and non-economic decision-making by, for example, incentivizing activity (such as the creation of certain types of assets or booking exposures to certain types of asset pools) in the jurisdictions with the most favorable capital regime, rather than in the jurisdiction where the business needs most warrant such activity. In addition, differing regulatory treatment of high-quality securitizations across borders could lead to further fragmentation of the securitization markets by effectively closing the doors to, or making more costly and thereby discouraging, simultaneous offerings of high-quality securitizations in multiple jurisdictions.[15] Accordingly, we urge the Commission to coordinate its efforts so as to ensure that the end result is not a patchwork of regimes in which each securitization market can effectively only be tapped by using jurisdiction-specific disclosure packages or complying with jurisdiction-specific regulatory requirements.

Question 16:

A. *What additional steps could be taken to specifically develop SME securitisation?*

SFIG Response:

We welcome the Commission's interest in extending the benefits of securitization to SME loans. By making scarce cash available to fund new loans to deserving SMEs, securitization can significantly expand the credit opportunities available to this important sector of the real economy.

In the U.S., where SMEs are sometimes referred to as "middle market companies", there is a large and robust securitization market for loans to this particular sector, the "Middle Market CLOs". Middle Market CLOs serve as a critical source of funding to private companies who are core to the real economy through the production of goods and services and the creation of jobs. Middle Market CLOs are an established channel of market-based funding from institutional investors to the middle market companies which have traditionally relied primarily on loans (as opposed other funding sources) to support and grow their business.

As the experience in the U.S. shows, the securitization of SME loans shares some important similarities with the securitization of larger corporate loans. In both cases, the ability of the originator to make informed choices of what additional exposures are added to a pool during a "revolving period" (within clearly defined eligibility criteria) should be permitted. Accordingly, a limited amount of active management should not absolutely preclude SME securitizations from achieving HQS status.

In addition, SME loans are increasingly being originated in "marketplace" platforms by internet-based originators. This is a new and developing area that will directly benefit the real

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15 As the Commission is aware, in Australia, Canada, the U.S. and the U.K., it is not uncommon to structure a single securitization of high-quality financial assets as a public offering in one jurisdiction and a private placement in one or more other jurisdictions. This approach allows securitizers to efficiently take advantage of the conditions and demand levels prevailing in different markets and have access to funding in different currencies without having to incur the additional cost and possible impracticality of separate stand-alone offerings in each jurisdiction involved.

economy, so any HQS framework needs to take into account a safe way in which these types of loans can be securitized.

III. Conclusions

In summary, our responses to the Consultation Document include, among others, the following key recommendations:

- The development of sustainable securitization markets in Europe would benefit from the adoption of standards governing favorable treatment for STC securitization transactions for specific regulatory purposes.

- Limiting the universe of securitization transactions entitled to HQS regulatory treatment only to those that satisfy one single set of STC criteria would unduly curtail the potential that securitization has to help the funding needs of the real economy.

- Any regulatory efforts to adopt HQS standards (including in respect of STC securitizations) should be coordinated on a global basis to avoid fragmentation of the markets and preclude opportunities for regulatory arbitrage.

- Compliance determinations regarding qualification of particular transactions with any HQS standard should be the responsibility of the originators or sponsors that market the transactions or the financial institutions that seek favorable regulatory treatment for their holdings, subject in each case to applicable penalties under applicable laws and regulation for mistaken or fraudulent determinations.

We greatly appreciate your consideration of our members' comments and would welcome the opportunity to discuss with the Commission the concerns expressed herein and how our member may contribute to the more successful development of the HQS securitization criteria. Please do not hesitate to contact the undersigned at +1 (202) 524-6301 should you have any questions in connection with this letter.

Very truly yours,

Richard Johns

Richard A. Johns
Executive Director