

Brussels, 15 March 2018

Leaseurope & Eurofinas response to the EBA consultation paper on its draft Regulatory Technical Standards (RTS) on homogeneity of underlying exposures in securitisation

Eurofinas and Leaseurope, the voices of consumer credit and leasing providers at European level, welcome the opportunity to respond to the European Banking Authority (EBA) consultation on homogeneity of underlying exposures in securitisation.

General Comments:

Leaseurope and Eurofinas support the introduction of a new European label for high quality securitisations in Europe, the so-called Simple, Transparent and Standardised (STS) securitisations. We believe that the long-term impact of the new regime can be positive. We welcome the EBA’s efforts to provide more clarity regarding the new securitisation framework in Europe. We would also like to take this opportunity to commend the EBA’s excellent work on the RTS on risk retention, which we believe provides positive clarifications on the level 1 text.

Regarding the EBA proposal to define a set of criteria according to which the underlying exposures are deemed homogeneous, we welcome the proposed non-exhaustive list of asset categories, which accurately reflects current market practices. However, we are concerned by the introduction of the concept of relevant risk factors for determining the homogeneity of a specific pool of the underlying exposures. We think that the introduction of the concept of relevant risk factors, which has to be applied by the originator, could hamper the development of the STS market in Europe. If not further clarified, there is considerable risk that the originator’s interpretation may be challenged afterwards by supervisory authorities.

In order to safeguard this important financing tool for the real economy, we propose a set of amendments to the EBA proposal.

Leaseurope and Eurofinas proposed amendments:

Amendment 1: Article 1(a)

European Banking Authority	Proposal
<i>the underlying exposures have been underwritten according to similar underwriting standards, methods and criteria;</i>	<i>the underlying exposures have been underwritten according to equivalent underwriting standards, methods and criteria;</i>

Justification

We believe that the term *similar* could be problematic as it could imply that underwriting standards would have to be identical which in practice is not the case. For instance, in cases where a portfolio is composed by both retail and commercial debtors the procedures are not identical but provide equivalent results and solid assessments of the credit quality of an individual debtor be it a retail customer or commercial customer or entrepreneur.

Amendment 2: Article 1(d)

European Banking Authority	Proposal
<p>the underlying exposures take into account the relevant risk factors from among those that need to be considered for each asset category in accordance with Article 3, and at least one.</p> <p><i>A risk factor shall be deemed to be relevant where, taking into account the asset category, the type of securitisation and the specific characteristics of the particular pool of underlying exposures, it results in all of the underlying exposures exhibiting similar risk profiles and cash flow characteristics within the respective asset category, enabling the investor to assess the underlying risks on the basis of common methodologies and parameters.</i></p>	<p>the underlying exposure meets at least one of the risk factors that need to be considered for each asset category in accordance with Article 3.</p> <p><i>For risk factors that need to be considered for each asset category in accordance with Article 3 and which are not met by the underlying exposure, the originator, sponsor or SSPE shall disclose, that and why, taking into account the asset category, the type of securitisation and the specific characteristics of the particular pool of underlying exposures, in its unfettered determination they are not required to assess the underlying risk profiles and cash flow characteristics within the respective asset category on the basis of common methodologies and parameters.</i></p>

Justification

We think that the proposed approach to introduce relevant risk factors for compliance with the requirement of homogeneity do not provide sufficient clarity and certainty for originators to determine whether they comply with the homogeneity criteria.

We understand that determining whether or not a certain risk factor is relevant for a specific transaction is open to interpretation. Therefore, we are concerned that a supervisory authority may have a different interpretation than the originator on whether a certain risk factor should have been relevant.

For originators, sponsors and SSPE, the approach taken by the relevant supervisory authority would be unpredictable. Therefore, an originator will have to comply with all risk factors to be

considered even if not relevant, to avoid the risk of being sanctioned due to a different interpretation of the relevance of a risk factor by the supervisory authority.

Given that it would be very difficult to comply with all risk factors to be considered, we believe that it would make almost impossible to have a securitisation being classified as simple, transparent and standardised in Europe.

To avoid this, we propose that the RTS should precisely clarify, that the originator's, sponsor's or SSPE's determination of relevance is a discretionary determination that, if properly disclosed to investors, is not subject to a reassessment and cannot be overlooked by the competent authority.

Responses to the EBA Questions:

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?

We do not agree with the focus of the draft RTS and its general approach. We think that the proposed approach does not provide sufficient clarity and certainty for the interpretation and application of the criterion of homogeneity. In particular, the link between the homogeneity criteria set out in Article 1 of the draft RTS and the relevant risk factors set out in Article 3 remain unclear.

In addition, we believe that a pool that could be considered homogeneous does not automatically imply it is less risky. In fact, we think that a more granular pool of high quality assets would be less risky than an homogeneous pool of lower quality assets. A pool consisting of only one type of debtor is not necessarily less risky than a pool consisting of various types of debtors. Usually, the granularity of the portfolio reduces the impact of a single risk component on the overall performance of the transaction.

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 disagree with the assessment of the homogeneity of underlying exposures based on the criteria under (a) to (d). In particular, the concept of relevant risk factors is unclear and does not provide sufficient guidance for their application.

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?

We see practical implications of the criteria as defined. In particular, regarding the introduction of the new concept of relevant risk factors due to the lack of clarity in the RTS. We think that the lack of clarity introduced by the determination risk factors based on their relevance is a critical unintended consequence that could introduce a significant level of uncertainty in the European securitisation market.

Q4: Do you agree that when considering the relevance of the risk factors, the asset category, type of securitisation (non-ABPC or ABPC), 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 think that the type of securitisation (non-ABCP or ABCP) should not be taken into account when considering the homogeneity of the underlying pool of exposures. However, the asset category and the specific characteristics of the pool of exposures should be taken into account when determining the homogeneity of a pool of exposures.

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?

We believe that the criteria determining the homogeneity of a pool of exposures should not be different for non-ABCP and ABCP transactions as the structure of the refinancing of such pool of exposures does not have an impact on its homogeneity.

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 agree with the asset categories provided in the draft RTS.

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.

We think that further specifications that the already proposed should be avoided.

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 do not agree with the introduction of relevant risk factors for the determination of homogeneity, unless further clarification is introduced in the RTS.

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 disagree with the introduction of the relevant risk factors. Therefore we do not see merit in expanding the list.

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 think that it would be more appropriate to distinguish, for example, between collateral that qualifies as financial collateral under Directive 2002/47/EC and collateral that does not.

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?

We do not consider prepayment characteristics as a relevant and adequate risk factor for determining homogeneity, as they are difficult to predict.

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.

The scope of application of the relevant risk factors and the relationship between the homogeneity criteria set out in Article 1 of the draft RTS and the risk factors set out in Article 3 of the draft RTS is unclear. Furthermore, such materiality thresholds would not be practical as such a distinction is irrelevant for a granular portfolio. We think that the granularity of a portfolio is more important than the composition of the portfolio and such thresholds could prevent a portfolio from being granular.

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.

We see the merit of this approach as we think that it is more appropriate to use an existing and tested model than introducing a new model for risk factors.

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.

None of the options would provide enough certainty for determining homogeneity. We advocate a more practical and easier to apply model that would allow all market participants to arrive at a common and clear understanding as to what homogeneity means.

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.

We think that due to the uncertainty arising from the proposed determination of relevance for risk factors, securitisations originated by leasing and consumer credit providers would not meet the criteria of homogeneity and therefore would not be classified as STS.

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.

We do not believe that a hybrid option, combining the existing proposal and the alternative proposal, would be most appropriate as it is unclear how the risk factors should be taken into account in a hybrid option.

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

Option 2 could be seen as an easier approach compared to the application of the risk factors, however we think it could actually provide less clarity in the determination of homogeneity.

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?

As previously expressed, we think that the alternative option leads to legal uncertainties.

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About us

The membership of our two Federations covers institutions specialised in one or more of the following activities:

- Lending to consumers, for instance via personal loans, credit cards or lease/hire purchase agreements
- Leasing to businesses of all asset types, including machinery and industrial equipment, ICT and others assets
- Motor finance, granted to individuals or businesses, either in the form of loans or leases

The consumer credit, asset finance and leasing markets have developed to respond to business investment and consumption needs as well as to accompany the development of local industrial production and distribution. The types of institutions represented by the Federations include specialised banks, bank-owned subsidiaries, the financing arms of manufacturers as well as other, independently-owned institutions.

Specialised financial services providers across the European Union (EU)/European Economic Area (EEA) encompass a diversity of organisations of different legal nature (i.e. credit institutions, financial institutions) and with various operational characteristics (independent companies, subsidiaries of banks, captive finance companies of manufacturers). All share a very high degree of specialisation and have a very limited mix of business activities compared to traditional mainstream banking organisations.

In 2016, the leasing firms represented through **Leaseurope's membership helped European businesses invest in assets worth more than 334 billion EUR**, reaching 779 billion EUR of outstandings at the end of the year¹. Leasing is used by more European SMEs than any individual category of traditional bank lending taken altogether (around 40% of all European SMEs make use of leasing which is more than any other individual form of lending)² and is also extremely popular amongst larger corporates³. It is also extremely useful to support the public sector (e.g. leasing to schools, hospitals, etc.).

¹ Leaseurope 2016 Annual Statistical Enquiry

² Oxford Economics, *The Use of Leasing Amongst European SMEs*, 2015; Eurostat, *Access to Finance Statistics*, 2011; International Finance Corporation *Leasing in Development: Guidelines for Emerging Economies*, 2009; European Investment Fund *The importance of leasing for SME finance*, 2012; and UEAPME, *UEAPME Newslash*, 2012

³ European Central Bank, *Survey on the Access to Finance of Small and Medium-Sized Enterprises in the Euro Area*, April 2013

In 2016, consumer credit providers that are members of **Eurofinas helped support European consumption by making more than 457 billion EUR goods, services, home improvements and private vehicles available to individuals**, reaching 1.024 trillion EUR of outstandings at the end of the year⁴. Consumer lending is procyclical and is highly positively correlated with households' disposable income⁵. By providing access to finance to individuals and households, consumer credit supports the social and economic well-being of millions of consumers across Europe.

Eurofinas and Leaseurope are entered into the European Transparency Register of Interest Representatives with ID n° 83211441580-56 and 430010622057-05

⁴ Eurofinas 2016 Annual Statistical Enquiry

⁵ Eurofinas, *Consumer Credit, Helping European Households Finance their Tomorrow*, 2015