SUBMITTED VIA

www.eba.eu

European Banking Authority
Tour Europlaza
20 avenue André Prothin
CS 30154
92927 Paris La Défense CEDEX
France

Re: EBA Consultation Paper of 30 June 2021 on the revised Draft Regulatory Technical Standards Specifying the Requirements for Originators, Sponsors, Original Lenders and Servicers Relating to Risk Retention

On behalf of The Loan Market Association (the "**LMA**"), we welcome the opportunity to comment on the revised draft technical standards (the **Draft RTS**) relating to the risk retention requirements under Regulation (EU) 2017/2402 (the **Securitisation Regulation**). The continuing engagement of the European Banking Authority (**EBA**) with market participants on issues related to risk retention is greatly appreciated.

The LMA was established in 1996 and is headquartered in London. Our key objective is improving liquidity, efficiency and transparency in the primary and secondary syndicated loan markets in Europe, the Middle East and Africa ("**EMEA**"). By establishing sound, widely accepted market practice, we seek to promote the syndicated loan as one of the key debt products available to borrowers across the region. Our membership has grown steadily and currently stands at over 777 organisations covering 69 countries, comprising commercial and investment banks, institutional investors, law firms, service providers, rating agencies and regulatory and governmental bodies. The LMA's overall mission is to act as the authoritative voice of the EMEA loan market vis à vis lenders, borrowers, regulators and other interested parties.

A syndicated loan is a financing offered by a group of lenders – collectively referred to as a syndicate – each of which funds a portion of a loan or credit line made under a facility agreement with a borrower. The borrower under a syndicated loan may be a corporate or corporate group, a smaller listed company or a private unlisted company. Where the syndicated loan is financing real estate, infrastructure or other assets the borrower may instead be a corporate established for the purpose of owning and/or operating the relevant assets.

During its history the LMA has played a key role in developing standard form documentation for documenting syndicated loans and forms of documentation and practices for secondary market trading in syndicated loans. Our work has contributed to widening and deepening the syndicated loan market in EMEA, reducing barriers to accessing capital, and increasing liquidity of assets for investors.

General observations

Our representations in respect to the Consultation Paper are limited to managed collateralised loan obligations ("**CLOs**") as opposed to other securitisations, in the hope that we can engage in productive dialogue with EBA in relation to that asset class. The LMA would be pleased to provide additional information on the CLO market following the closure of this consultation.

Our view is that the Securitisation Regulation[1] ("**Sec Reg**") should be amended so that it is possible for managed CLOs to achieve simple, transparent and standardised ("**STS**") status, and for investors therein to benefit from the regulatory capital treatment associated therewith. Amending the STS criteria to permit the inclusion of some or all CLO structures would, in our view, help increase the volume of STS transactions and support the recovery of the EU securitisation market and the wider EU economy in the post-COVID-19 era by providing essential funding to EU corporates.

Securitisations of syndicated loans, such as European CLO transactions which generally comprise portfolios of 30-60 loans to large corporates have proven resilient throughout both the global financial crisis and the recent market disruption resulting from the global pandemic. In September 2021 Standard & Poor's published its 2020 Annual Global Leveraged Loan CLO Default and Rating Transition Study, which considered annual default rates of CLOs for the period from 2001 to the end of 2020. As set out in the study:

(i) in each year during that period the annual default rate of CLOs was a fraction of the annual default rate of investment grade corporate debt; and

(ii) in no year during that period has the annual default rate of CLOs exceeded 0.5% and in the year 2020, the global annual default rate for the security was 0.02%.

It is also worth noting that the resilience of European CLO transactions is further exemplified by the fact that since the establishment of the European CLO 2.0 in the post global financial crisis period, not one of these securities has defaulted[2]. Furthermore, despite the credit deterioration seen subsequent to the beginning of the Covid-19 pandemic, only one CLO 1.0 tranche defaulted in 2020, reduced from three the previous year.

We would be happy to provide data in support of this and would be happy to arrange a time to discuss the CLO market and the operation of CLOs in more detail.

Answers to EBA Questions in the Consultation Paper

Question 1: Do you agree with the provisions in this Article 9 with respect to the application of the retention options on the NPE securitisations, and the "net value" regime of the NPE securitisations? Are the retention options specified under Articles 4 to 8 sufficiently clear using the net value regime? Are there any other aspects of NPE securitisation and the net value regime that should be clarified in the RTS?

No response. CLOs generally do not include NPE assets.

Question 2: Do you agree with the provisions with respect to the synthetic excess spread [Article 10]? Are there any aspects relating to the synthetic excess spread being considered in the measurement of the material net economic interest that should be clarified in these RTS, taking into account that separate RTS will be developed that will determine the exposure value of the synthetic excess spread?

---

[1] Regulation (EU) 2017/2402 relating to a European framework for simple, transparent and standardised securitisation including (i) any technical standards thereunder and (ii) any guidance relating thereto as may from time to time be published by applicable EU regulatory bodies.

[2] As of 24th August; 2021 Standard and Poor's Global Ratings.

Not applicable as CLOs are typically not synthetic transactions.

Question 3: Do you agree with the provisions set out in this Article 15 on fees payable to the retainer?

The LMA is of the view that the final paragraph of Article 15(2) is unclear and can be interpreted very broadly to effectively require that any guaranteed or upfront fees must be deducted from the "material net economic interest" of the retention interest even if such guarantee or upfront fee meets the requirements of Article 15(2). Following the EBA public hearing, we understood that this was not the intention, in particular where a fee is charged on an arm's length basis and appropriate for the services being provided. Lastly, we do not believe it would make sense to prohibit fees that are guaranteed or payable upfront where the value of such guarantee or fee does not actually depend on the outstanding amount and/or credit quality of the securitised assets over time. The LMA supports the amendments below to Article 15(2) in order to clarify these points:

2. Arrangements on fees payable to the retainer on a priority basis to remunerate that retainer for services of any kind provided to the securitisation shall only be deemed as complying with the previous paragraph where all of the following conditions are met:

(a) the amount of the fees is set on an arm's length basis having regard to comparable transactions in the market. In the absence of comparable transactions in the relevant market, the set amount may be deemed compliant by reference to fees payable in similar transactions in other markets or by using appropriate valuation metrics, taking into account the type of securitisation and the service being provided; and

(b) the fees are structured as a genuine consideration for the provision of the relevant service and do not create an undue preferential claim in the securitisation cash flows that effectively declines the retained interest faster than the transferred interest.

The condition in this point shall not be considered to be met, ~~where the fees are guaranteed or payable up-front in any form, in full or in part, and~~ where the effective retention amount after deducting the amount of any fees relating to services provided to the securitisation, post-closing, the value of which depends on the outstanding amount and/or credit quality of the securitised exposures over time and which are guaranteed or payable up-front (that is, in advance of the related service being provided)~~such fees~~ is lower than the minimum net economic interest required under the respective retention option in accordance with Article 6(1) of Regulation (EU) 2017/2402.

Figure 1.

Recital 6 can also be amended, as indicated below, to provide examples of services not intended to be captured by the restriction on upfront/guaranteed fees (the language in square brackets to be included only if the restrictions on guaranteed/up-front fees are retained):

(6) In order to ensure the ongoing retention of the material net economic interest, retainers should ensure that there is no embedded mechanism in the securitisation structure by which the retained material net economic interest measured at origination would necessarily decline faster than the interest transferred. Similarly, the retained material net economic interest should not be prioritised in terms of cash flows to preferentially benefit from being repaid or amortised such that it would fall below 5 % of the ongoing nominal value of the tranches sold or transferred to investors or the exposures securitised, or the 5 % net value in the case of non-performing exposures of traditional NPE securitisations. Moreover, the credit enhancement provided to the investor assuming exposure to a securitisation position should not decline disproportionately to the rate of repayment on the underlying exposures. This should not prevent the retainer from being remunerated on a priority basis for services rendered to the securitisation's special purpose entity (as is typical for many such services, including structuring, arranging and underwriting services, as well as asset servicing and credit enhancement-related services, because the provision of those services is essential for the transaction to take place), provided that the remuneration's amount is set on an arm's length basis and the structure of such remuneration does not undermine the retention requirement. [In satisfying this requirement, this Regulation imposes specific requirements for fees that are guaranteed, or payable, up-front (that is, in advance of the related service being provided) in respect of services rendered to the securitisation's special purpose entity, post-closing, the value of which depends on the outstanding amount and/or credit quality of the securitised exposures over time. These requirements are not relevant to services associated with the establishment of the securitisation, such as structuring, arranging and underwriting services.][***Note bracketed wording to be included only if restrictions relating to guaranteed/upfront fees are retained***]

Figure 2.

Rather than implementing the limited amendments above, however, it is our strong view that the proposed prescriptive and inflexible: (i) restrictions on fees that are guaranteed or payable upfront, and (ii) requirements in relation to the meaning of the term "arm's length", should be deleted altogether. The current proposals are vague, unhelpful, and would introduce significant uncertainty (for example, the meaning of the phrase "undue preferential claim" is unclear and open to interpretation). Instead, the EBA should have faith in (i) the arm's-length concept, which is widely employed, and well understood, in contract and legal interpretation; and (ii) the clear statement of principle in Article 15(1) to the effect that: "There shall be no arrangements or embedded mechanisms in the securitisation by virtue of which the retained interest at origination would decline faster than the interest transferred." Fees that are arm's-length (on the ordinary meaning of the words) – and therefore not designed to undermine the risk retention – should have no impact on the level of retention required. On this basis, Article 15 could be redrafted as follows:

Fees – preferred proposal:

Article 15

Requirements on the allocation of cash flows and losses to the retained interest and on fees payable to the retainer

1. There shall be no arrangements or embedded mechanisms in the securitisation by virtue of which the retained interest at origination would decline faster than the interest transferred. The retained interest shall not be prioritised in the allocation of cash flows to preferentially benefit from being repaid or amortised ahead of the transferred interest. The amortisation of the retained interest via cash flow allocation or through the allocation of losses that, in effect, reduce the level of retention over time shall not be deemed as a breach of the criteria set out in this paragraph.

Figure 3.

2. Arrangements on fees payable to the retainer on a priority basis to remunerate that retainer for services of any kind provided to the securitisation shall only be deemed as complying with the previous paragraph where ~~all of the following conditions are met:~~

~~(a)~~ the amount of the fees for the relevant service is set on an arm's length basis. ~~having regard to comparable transactions in the market. In the absence of comparable transactions in the relevant market, the set amount may be deemed compliant by reference to fees payable in similar transactions in other markets or by using appropriate valuation metrics, taking into account the type of securitisation and the service being provided; and~~

~~(b) the fees are structured as a genuine consideration for the provision of the relevant service and do not create an undue preferential claim in the securitisation cash flows that effectively declines the retained interest faster than the transferred interest.~~

~~The condition in this point shall not be considered to be met, where the fees are guaranteed or payable up-front in any form, in full or in part, and where the effective retention amount after deducting such fees is lower than the minimum net economic interest required under the respective retention option in accordance with Article 6(1) of Regulation (EU) 2017/2402.~~

Figure 4.

We note that certain fees are typically paid in priority: this is required by investors and rating agencies in order to ensure that service providers are sufficiently remunerated and incentivised to provide the best service and maximise collections. Priority payment is also the norm for operating expenses which are necessary to ensure the proper operational functioning of the SSPE, such as those associated with: management companies, custodians, account banks, representatives of the noteholders, paying agents, and listing agents. Clarity of the contemplated scope of services would be welcome, as would be a recognition that it is usual for such service providers to be paid at top of the priorities of payment.

Question 4: Do you agree with the provisions with respect to securitisations of own issued debt instruments [Article 16]?

Not applicable to CLOs

Question 5: Do you agree with the provisions with respect to resecuritisations [Article 17]?

No comment

Question 6: Do you agree with the provisions in this Article 18 with respect to assets transferred to SSPE? Are there any additional aspects that should be further specified in these RTS, taking into account that no clarification is provided with respect to Recital 11 of the Securitisation Regulation (for example, do you see any specific implications for the securitisations of NPE securitisations and how these should be tackled)?

New Article 18(3) is helpful,

Question 7: Do you agree with the provisions set out in this Article 19 with respect to expertise of the servicer of a traditional NPE securitisation?

Not generally applicable to CLO.

Question 8: Do you have any comments on the remaining Articles of these draft RTS?

A. Sole purpose test – Article 2(7)

The LMA supports the principles-based approach applied to the "sole purpose test" guidance under Article 2(7) of the Draft RTS. It is essential that such guidance can be interpreted sufficiently flexibly so as to allow for appropriate application across the full range of scenarios that may arise, including in the context of existing securitisations in-scope of the Securitisation Regulation that had to comply with the sole purpose test post-1 January 2019 under the transitional provisions and in the absence of the finalised recast retention RTS having to refer, in the first instance, to Article 6(1) of the Securitisation Regulation, the EBA's final report on the earlier version of the draft RTS of July 2018 and related background materials on the policy behind this test, including the EBA's report of December 2014.

We note that as mentioned during the public hearing, the EBA's approach continues to be focused on high-level principles (by broadly being substantially similar to the wording of the earlier version of the draft RTS of July 2018).

We understand that the changes made are not intended to tighten or to broaden the sole purpose test parameters provided in the earlier EBA draft of July 2018, which the LMA support. However, we believe that further improvements could be made to the drafting of the guidance in order to: (i) further clarify that the sole purpose test requires appropriate consideration being given to the relevant principles (i.e. it does not mean that each of the identified principles is given equal weight and fully satisfied in all circumstances); and (ii) more closely track the wording of Article 6(1) of the Securitisation Regulation itself. These improvements will assist with legal certainty, as the current wording is potentially open to interpretation (including a presumably unintentional interpretation which, if followed, would be inconsistent with the text of Article 6(1) of the Securitisation Regulation).

We believe that a minor amendment to the introductory paragraph of Article 2(7) of the Draft RTS and the deletion of the words "or predominant", as set out below, could achieve this. This will ensure clarity that the interpretation of the guidance should not result in the effective replacement of the test in Article 6(1) of the Securitisation Regulation with a more rigid test. The amended wording makes it clear that each of the principles should be taken into account when assessing whether the sole purpose test is satisfied and allows for adjustments in weighting through the reference to "appropriate consideration". Such adjustments may be required, for example, where the relevant entity has been established relatively recently and it is intended to operate for purposes consistent with a broader business purpose but it is not possible to point to a material operating history at the time of closing.

We consider the suggested amendments (as per the mark-up of Article 2(7) set out below) to be necessary for sensible application of the guidance, and to ensure that the sole purpose test set out in Article 6(1) of the Securitisation Regulation is not effectively replaced by another test in Article

2(7) of the Draft RTS. Moreover, the revised wording should function to deliver appropriate outcomes under the retention requirements from a policy perspective.

7. For the purposes of assessing whether an entity has been established or operates for the sole purpose of securitising exposures as referred to in the first subparagraph of Article 6(1) of Regulation (EU) 2017/2402, appropriate consideration should be given to the following principles ~~shall be taken into account~~:

(a) the entity has a strategy and the capacity to meet payment obligations consistent with a broader business model that involves material support from capital, assets, fees or other sources of income, by virtue of which the entity does not rely on the exposures to be securitised, on any interests retained or proposed to be retained in accordance with this Regulation or on any corresponding income from such exposures and interests as its sole ~~or predominant~~ source of revenue;

(b) the responsible decision makers have the necessary experience to enable the entity to pursue the established business strategy, as well as adequate corporate governance arrangements.

Figure 5.

B. Prohibition on selling the retained interest – Article 12(3) should track the wording of Recital (10) more closely

Recital (10) helpfully clarifies that it is possible to change the retainer (i) where insolvency proceedings have been commenced in respect of the retainer; or (ii) the retainer is unable to continue acting in that capacity for reasons beyond its control or the control of its shareholders. However, limb (ii) of the recital wording is missing from Article 12(3). Therefore, we propose to amend Article 12(3) as follows to track the wording of Recital (10) more closely:

3. The condition of paragraph 1(b) shall not apply in the event of the insolvency of the retainer or in the event the retainer is unable to continue acting in that capacity for reasons beyond its control or the control of its shareholders.

Figure 6.

C. Consolidated application – clarification for entities other than relevant credit institutions

The Securitisation Regulation (unlike the CRR (and its predecessor CRD2) from which the risk retention requirements originate) is a cross-sectoral regulation. Ability to fulfil the risk retention on a consolidated basis under Article 6(4) of the Securitisation Regulation should also apply to sponsors, originators or original lenders other than credit institutions (as was explicitly stated in paragraph 71 of the CEBS Guidelines to CRD2 Article 122a) and should apply whether or not such entities are established in the EU. This issue should be considered as part of the wider review of the Securitisation Regulation and we would welcome further engagement with the EBA on this and related topics.

We would welcome the opportunity to discuss this response with you and provide a further update of the market in order to highlight how well CLOs have performed through the global financial crisis as well as the Covid-19 pandemic.

If you would like to do so, please contact Nicholas Voisey of the Loan Markets Association (nicholas.voisey@lma.eu.com).

Yours faithfully,

Nicholas Voisey
Managing Director
Loan Market Association