

12 March 2018

European Banking Authority  
Floor 46  
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London E14 5A  
UK

Dear Sirs

**Consultation Paper on the Draft Regulatory Technical Standards specifying the requirements for originators, sponsors and original lenders relating to risk retention pursuant to Article 6(7) of the Securitisation Regulation (the “Consultation Paper”)**

We are writing regarding the questions raised in the Consultation Paper and in relation to the annexed Draft Regulatory Technical Standards (the “**Draft RTS**”).

**Your questions**

**Question 1: Do you have any general comments on the draft technical standards?**

The Loan Market Association<sup>1</sup> (“**LMA**”) welcomes the Draft RTS and the EBA’s overall intention to retain the wording of the current risk retention RTS<sup>2</sup> which were prepared pursuant to the Capital Requirements Regulation<sup>3</sup> (the “**Current CRR Risk Retention RTS**” and the “**CRR**” respectively), as far as possible. The maintenance of the current regime where possible is important in avoiding undue disruption to the market and any unnecessary complexity arising in existing securitisations which comply with the current rules, but which have new issues of securities after 1 January 2019 and so will also fall within the new regime.

The LMA also agrees with the intention to clarify various aspects of the risk retention aspects of the Securitisation Regulation. However, there are some areas on which we believe that the

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<sup>1</sup> Please see Appendix.

<sup>2</sup> Commission Delegated Regulation (EU) No 625/2014 of 13 March 2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council by way of regulatory technical standards specifying the requirements for investor, sponsor, original lenders and originator institutions relating to exposures to transferred credit risk.

<sup>3</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

EBA could provide further guidance, if possible by way of amendments to the Draft RTS. The most significant of these points are; (i) the need to provide clarity on the jurisdictional scope of the new “direct” obligation on one of the originator, sponsor or original lender to comply with the risk retention requirements; and (ii) clarification and perhaps amendments to the CRR regarding the operation of Article 14 of the CRR (please see below for a discussion of both these points).

**Question 2: Considering the mandate granted to ESMA in Article [7(3)] of the STS Regulation, do you believe that these technical standards should include disclosure-related provisions relevant to risk retention and, if so, do you agree with the scope of the obligations set out in the draft technical standards?**

The mandate granted to ESMA in Article 7(3) of the Securitisation Regulation provides that ESMA (in close cooperation with the EBA and EIOPA) shall develop draft regulatory technical standards to specify the information that the originator, sponsor and SSPE are to provide on the underlying exposures, and in the periodic investor reports, taking into account the usefulness of such information for securitisation holders.

We do not believe that there is a great need for further prescribed disclosures regarding risk retention, especially given that the existing disclosure obligations in the Securitisation Regulation are already extensive. However, consideration could be given to disclosure in the investor reports of material changes relating to risk retention, such as changes in the chosen method of risk retention and any change of retainer (in circumstances in which such a change in retainer is permitted under the Draft RTS). We presume that the EBA will liaise with ESMA in relation to such matters.

**Question 3: Do you believe that the provisions in Article 11 of the draft technical standards (relating to the measurement of retention for the undrawn amounts in exposures in the form of credit facilities) are needed?**

We note that Article 11 of the Draft RTS (relating to the measurement of retention for the undrawn amounts in exposures in the form of credit facilities) follows the wording of the Current CRR Risk Retention RTS. We do not see a reason to change the existing regime with which the industry is familiar. The provision in the Current CRR Risk Retention RTS equivalent to Article 11 of the Draft RTS has been helpful to market participants and we see no need to delete it.

**Question 4: Do you consider the provisions of Article 12(3) of the draft technical standards to be useful and how would you see such a transaction working in practice, including following a default by the retainer under the secured funding arrangements?**

Again, we note that Article 12(3) of the Draft RTS follows the wording under the Current CRR Risk Retention RTS. This provision is important in clarifying that retention financing is permitted, and it should not be deleted.

Article 12 of the Current CRR Risk Retention RTS permits retention holders to use their retention positions as collateral for secured financings provided that the credit risk of the retention is not passed on to the finance provider. In the event that the retention holder defaults on a financing arrangement, the finance provider would expect to be able to enforce any security granted to it and to be able to liquidate all secured assets. Under the current regime, the retention holder would no longer be retaining.

We consider that the position on retention financing could be clarified in the Draft RTS to specify that an enforcement action by a lender would not cause the retention holder to be in breach of its obligations under the Securitisation Regulation. If this is not possible, it should be made clear that in such circumstances investors will not be penalised.

**Question 5: Do you believe that the provisions of Article 16 of the draft technical standards relations to assets transferred to the SSPE are adequate?**

We agree that it is important that the RTS provide more details of the scope of restriction on the selection of assets to be transferred to an SSPE.

Article 16(1) of the Draft RTS

We welcome Article 16(1) of the Draft RTS which concern dealing with the restriction in Article 6(2) of the Securitisation Regulation by way of disclosures to investors. This method was only mentioned in the Recitals to the Securitisation Regulation and so we consider that its inclusion in the operative provisions of the Draft RTS is essential for legal certainty

We would, however, question the rationale of extending the communication requirement to competent authorities, in addition to those communications to investors or potential investors as provided for by Recital 11 to the Securitisation Regulation. We would have thought that any benefit to obtained by competent authorities from the receipt of such information would be unlikely to outweigh the additional compliance burden that would result from the imposition of this obligation.

The Securitisation Regulation concerns circumstances in which *originators* are not permitted to select assets to be transferred to a SSPE. In contrast, Article 16(3) of the Draft RTS refers to circumstances in which originators *and sponsors* shall have the right to select assets to be transferred to the SSPE. We think that it would be preferable if it were made clear why the Draft RTS also refer to sponsors whereas the Securitisation Regulation restriction just applies to *originators*.

Article 16(2) of the Draft RTS

The Recitals to the Draft RTS clarify that the prohibition on adverse selection should not apply where there are no comparable assets against which to perform such a comparison exercise. It would increase legal certainty if this clarification were to be included in the operative provisions of the RTS, rather than merely appearing in the Recitals.

Article 16(3) of the Draft RTS

The Draft RTS provide that, even where no communication to investors etc has been made, an originator will not be considered to have intentionally breached the selection of assets provision (in the absence of evidence to the contrary), if it proves that it has established and applied policies and procedures to ensure that the securitised assets would reasonably be expected not to lead to higher losses than those on comparable assets held on its balance sheet. We welcome this provision which is in accordance with the intention of the Securitisation Regulation. A proviso for reliance on such a policies and procedures route is that that the criteria defined in the originator's policies and procedures must be "appropriate to that end". Although the Draft RTS should balance flexibility with legal certainty, it may be that the EBA could consider if further guidance can be provided (guidance may be better than

RTS on this point) as to what type of policies and procedures would be “appropriate to that end”.

**Question 6: Do you consider that the provisions of Article 17 of the draft technical standards relating to a change of retainer are adequate?**

The Draft RTS allow for a change in the retainer in the limited circumstances in which it is unable to continue acting as retainer, due to the transfer of a direct or indirect holding in the retainer, or for legal reasons beyond its control and beyond the control of its shareholders. The “remaining retained material net economic interest shall, instead, be retained by another entity ...”.

The provision has been drafted as a prescriptive requirement to appoint a replacement. There may be circumstances in which there is no entity available to retain. We would propose that the wording be changed to clarify that the article *permits* the retention by another entity in the circumstances described in the Draft RTS, rather than requires it.

Other amendments to the article could be made in order to clarify its scope. For example, it is not clear whether this provision is wide enough to include the removal and/or replacement of a retainer, such as a CLO manager, due to investors exercising a contractual right to remove such a party. Such an event would be at the election of the investors and would not be within the control of the retention holder.

It is also not clear if the wording in this article regarding “a transfer of a direct or indirect holding in the retainer” is intended to extend to a situation where there is a sale of a business structure which includes a sponsor and where it no longer makes sense for such an outgoing sponsor to be holding the retention since it is no longer aligned to the interests of investors. In such cases, it may make sense as part of a reorganisation of a corporate group, to then reposition where the retention is being held. If it is the intention of this article is to cover such situations, we wondered if this could be made clearer. The intention behind this wording and the scope of this article is not clear in the current draft.

**Question 7: Should the draft technical standards contain any additional guidance on the operation of Article 14 of Regulation (EU) No 575/2013?**

Yes – we think that additional guidance on the operation of Article 14 of the CRR is required. A point that has caused concern is the jurisdiction of the risk retention, due diligence, transparency and “criteria for credit-granting” obligations under the Securitisation Regulation as a result of changes to the CRR. Article 1(11) of the CRR Amendment Regulation<sup>4</sup> has the effect that Article 14 of the CRR applies the risk retention, due diligence, transparency and “criteria for credit-granting” obligations under the Securitisation Regulation to EU institutions subject to the CRR, on a consolidated basis.

We appreciate that Article 2(4) of the Draft RTS does carry over existing provisions in the Current CRR Risk Retention RTS as regards the application of Article 14 of the CRR in respect of institutions’ compliance with the due diligence requirements in Article 5 of the Securitisation Regulation.

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<sup>4</sup> Regulation (EU) 2017/2401 of the European Parliament and of the Council of 12 December 2017 amending the Capital Requirements Regulation on prudential requirements for credit institutions and investment firms.



However, the implications of Article 1(11) of the CRR Amendment Regulation are much more wide ranging. The direct risk retention obligation could apply on a consolidated basis to a non-EU subsidiary. Such a subsidiary would have to comply both with the EU risk retention rules and any locally applicable rules. It does not appear that this was the intention of the legislators. Similar issues arise as regards applying the transparency requirements on a consolidated basis to non-EU subsidiaries.

These issues could have significant implications for EU banks operating in third countries through local subsidiaries. Non-EU subsidiaries of EU banks operating in non-EU jurisdictions would be put at a competitive disadvantage to other third country entities operating in those jurisdictions.

As a result of the potentially serious consequences that would arise otherwise, we consider that it is very important that these issues are addressed. It would seem that it may be necessary to amend the CRR itself to address these issues properly.

**Question 8: Do you consider that wording similar to that which is set out in Article 5(1)(a) of Commission Delegated Regulation (EU) No 625/2014 relating to revolving securitisations should be maintained in these technical standards?**

We note that Article 6(3) of the Securitisation Regulation does already refer, in the case of revolving securitisations, to the retention of the originator's interest of not less than 5% of the nominal value of each of the securitised exposures, in relation to interests qualifying for the retention of a material net economic interest of not less than 5%.

However, for clarity and for consistency with current practices, it would be better if the same wording that appears in the Current CRR Risk Retention RTS could be carried over to the Draft RTS.

**Question 9: Do you consider that guidance is required on what constitutes a significantly lower performance for the purposes of Article [6(2)] of the STS Regulation and, if so, what would you propose?**

If there is uncertainty and a lack of harmonisation in respect of the circumstances in which sanctions are to be imposed by competent authorities where there is a significantly lower performance, it may be appropriate for further guidance to be given. However, we do not think that this is essential given that such sanctions would only apply where there is an intentional transfer of assets in breach of these requirements, which we would expect to be an unusual occurrence.

### **Other points**

#### **Jurisdictional Scope of the “Direct” Obligation to Comply with the Risk Retention Requirements.**

The Draft RTS do not provide any more clarity on the jurisdictional scope of the new “direct” obligation on one of the originator, sponsor or original lender to comply with the risk retention requirements. Although it appears from the Explanatory Memorandum to the original 2015 Commission proposal for the Securitisation Regulation that the intention is that where none of the originator, sponsor or original lender is “established in the EU”, the direct approach will not apply, this has not been provided for in the Securitisation Regulation or in the Draft RTS.

This point can have practical implications for EU banks operating in non-EU countries, and whether they operate through branches or subsidiaries. Subsidiaries are separate legal entities, whereas branches are not. If the jurisdictional scope of the direct risk retention obligation in the Securitisation Regulation is to be interpreted in line with the Commission's 2015 statement, and given that the country in which a legal entity is "established" normally refers to that in which the legal entity is incorporated or has its registered office, there could be a difference in the application of the direct retention obligation according to whether an EU bank operates in a non-EU country through a subsidiary or through a branch.

So, for example, it appears that the direct risk retention requirement will apply to the US activities of EU established banks, including those taking place through US branches (which are part of the legal entities established in the EU). However (if the applicability of the direct obligation is to be based on whether or not the entity is "established" in the EU), it would appear that the direct obligation would not apply to the activities of a US subsidiary (subject to the consolidation point discussed above).

It is important that the jurisdictional scope of the direct retention obligation be set out in operative legislative provisions in the Draft RTS, in order to ensure legal certainty as to the jurisdictional scope of these obligations.

#### **"Originator" Definition for Risk Retention and the Sole Purpose Test**

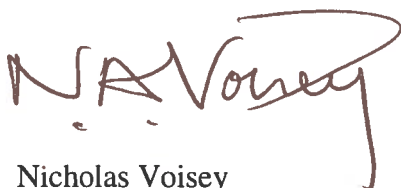
We welcome the further details provided of the "sole purpose" test in the Draft RTS. However, it is not clear if conditions (a) to (c) in Article 3(6) of the Draft RTS must be satisfied in order to satisfy the sole purpose test, or whether Article 3(6) is merely stating that if each of these conditions are satisfied, then that it is one way of ensuring that the originator satisfies the sole purpose test. We presume that the latter is the intention, but the wording could be clarified in this respect.

#### **Conclusion**

We would like to thank you for consulting on these issues. We would be pleased to answer any questions you may have and to meet if you wish or to discuss the points we have raised.

If you would like to do so, please contact Nicholas Voisey of the Loan Markets Association ([nicholas.voisey@lma.eu.com](mailto:nicholas.voisey@lma.eu.com)) or David Quirolo ([david.quirolo@cwt.com](mailto:david.quirolo@cwt.com)) and Neil Macleod ([neil.macleod@cwt.com](mailto:neil.macleod@cwt.com)) of Cadwalader, Wickersham & Taft LLP.

Yours faithfully



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## **APPENDIX**

### **The Loan Market Association**

The Loan Market Association (“LMA”) is the trade body for the European syndicated loan market founded by banks operating in that market. Its aim is to encourage liquidity in both the primary and secondary loan markets by promoting efficiency and transparency, as well as by developing standards of documentation and codes of market practice which are widely used and adopted.

Since the establishment of the LMA in 1996, membership has grown to over 600 organisations, comprising commercial and investment banks, institutional investors, law firms, service providers and rating agencies.

The LMA has gained substantial recognition in the market and has expanded its activities to include all aspects of the primary and secondary syndicated loan markets. It sees its overall mission as acting as the authoritative voice of the European loan market *vis à vis* lenders, borrowers, regulators and other interested parties.

