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for securitisation

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Dear Sirs and Madams

Response on the draft Regulatory Technical Standards on the homogeneity of the underlying exposures in STS securitisation under Articles 20(14), 24(21) and 26b(13) of Regulation (EU) 2017/2402, as amended by Regulation (EU) 2021/557

PCS would like to thank the EBA for giving us the opportunity to respond to the proposed text on homogeneity.

General Comments

PCS is very supportive of the approach that underpins the EBA's proposals.

More specifically, we agree with the principle that the definition of homogeneity should be identical as between true-sale non-ABCP, ABCP and on-balance-sheet securitisations. The purpose of this STS criterion is the same across the three types of securitisations. Although in some instances the differences in structure or purpose between the types of securitisations require a difference of legislative or regulatory approach, this is not such a case.

We are also strongly supportive of the desire to clarify the differences between micro/small/medium enterprises and large enterprises so as to render the determination of which "bucket" an exposure falls into an objective and simple determination. As we set out below, though, we do not believe the proposed solution is the correct approach or, to be more precise, the only approach that is appropriate to achieve this necessary certainty.

Finally, we believe the issue of grandfathering and transition to be extremely important. As Europe is entering turbulent times which may erode bank capital,

it is crucial that prudential regulation be prudent and dampens rather than exacerbates systemic instability.

Responses to the questions

Q1: Do you agree with the proposed amendment to the asset category in Article 1 with respect to the addition of "credit facilities provided to enterprises where the originator applies the same credit risk assessment approach as for individuals not covered under points (i), (ii) and (iv) to (viii)"? Please elaborate on the practical relevance.

Yes, we do.

At the level of micro-SMEs, whether the loan is made to an individual or to a corporation is broadly arbitrary and has no meaningful impact on underwriting, servicing and overall approach of the lender. Such an arbitrary factor should not drive homogeneity. This will allow homogeneous types of micro-SME exposures to be treated as such for the purposes of STS.

Q2: Do you agree with the proposed amendment in Article 1 to the "type of obligor" for credit facilities, including loans and leases, provided to any type of enterprise or corporation?

PCS does not agree that dividing enterprises along the single, one size fits all, line at €500m turnover is the correct approach.

On the contrary, we believe the regulation does not call for an objectively drawn line that applies in the same way to every deal and every originator. In fact, such an arbitrary single line will very likely result in non-homogeneous pools as an "objective" one size fits all dividing line will almost certainly cut across financial institutions' internal approaches to bucketing corporates.

Purpose of the homogeneity criterion

The purpose of the STS homogeneity criterion is, like most STS criteria, an investor protection measure. It is unambiguously and explicitly designed to ensure that the assets in every STS securitisation are homogeneous as amongst themselves so that investors can use a single analytical tool *for each individual transaction.*

When reading paragraph 6 of the "Background and rationale" of the consultation, we wonder if the EBA may not have erred in its understanding of the purpose of the criterion, as the text suggests that the criterion may exist to ensure homogeneity not within individual transactions but homogeneity of the market. In other words, the current proposal would ensure that all "large corporate STS securitisations" would be homogeneous amongst themselves rather than each individual STS corporate securitisation would have a homogeneous pool.

Arguably, if the two could be achieved at the same time, the use of an arbitrary dividing line that would result in both a homogeneous market and individually homogeneous transactions would be harmless even if it went further than the legislation required.

Unfortunately, we believe that the use of an arbitrary line would only achieve market homogeneity at the cost of the homogeneity that is explicitly sought by the legislation, namely individual transaction homogeneity.

Consequences of an arbitrary definition

Different banks will internally divide their underwriting and servicing functions at different borrower size levels. These differences will reflect, amongst other things the size of the bank, the market segment it covers and the jurisdiction or jurisdictions in which it operates. Sometimes the bank will also "bucket" corporates by the type of obligor or its industry segment.

Let us assume that a bank divides its corporate clients between those with over €300m turnover and the others.

All €300m plus clients will be underwriting and marketed to by the same team of individuals within the bank. All €300m plus client facilities will be submitted to the same credit committee using the same standard documentation and assessment tools. That credit committee will determine whether to advance funds on the same overall basis taking into account, inter alia, the strategy of the bank and the shape of its risk appetite.

All sub-€300m will also be treated internally in the same manner amongst themselves and differently from all €300m plus clients.

Under the current proposals, a securitisation of corporate loans, to be STS, will contain sub-€300m clients and €300m plus clients up to €500m clients. The RTS will compel non-homogeneity.[1]

Additional issues

- The current proposal designates as a "large corporate" an enterprise, inter alia, that is part of a group with turnover of €500m or more. This would include small SMEs that are part of a larger group. But, if there is no parent guarantee or support, that SME will be treated for the purposes of credit origination as an SME. The current draft RTS would force

[1] We acknowledge that the underwriting approach and servicing need to be similar for a homogeneous pool. But, as made quite rightly clear in the EBA guidelines, similarity of underwriting and servicing is not identity of underwriting and servicing. It is likely that, at least all the way down to small SMEs, corporate underwriting and servicing are similar within pretty much all banks.

originators to add such small SMEs to the same pools as the largest global corporations. Again, this will compel non-homogeneity.

At the very least, the RTS should exclude subsidiaries in a large group where no guarantee or other credit support is provided by the parent.

- There is another issue with a definition that includes groups. When the loan was generated, the borrower may have been a medium size enterprise and treated as such. But article 20(8) of the Securitisation Regulation applies at the time of the securitisation. If the borrower was purchased since the grant of the facility by a larger group, it would now fall under the "large corporate" definition. Not only does this create the problem set out in the previous paragraph, but it is also not clear how much due diligence the originator would now have to conduct on its pool of borrowers to ensure that their ownership had not changed since the grant of the facility. This is even though the method for the grant of the facility would, in the logic of the legislative text, require them to stay in the category they belonged to at the time the facility was agreed.

  Again, at the very least, the RTS should define the categories as "at the time the exposure was underwritten and approved".

- The current proposal discriminates against jurisdictions with smaller economies. In those jurisdictions with very few €500m plus groups but where exposures to such groups are likely to be the largest exposures of local banks, those banks will not be able to securitise and remove the risks of their largest exposures because there are likely not enough of them to make a single commercially viable STS synthetic deal.

Alternative approach

It is necessary that the rule provide certainty for each individual transaction so that neither investor, verification agent nor supervisor need scratch their heads and wonder if the securitised exposures have been correctly bucketed. This must also be done in a manner that preserves the purpose of the legislation and therefore does not drive non-homogeneity at individual transaction level.

This can be achieved by requiring that the dividing line between large and other borrowers be drawn along the line of the originator's own internal processes. This has the following benefits:

- It will remove any uncertainty since the originator's own "bucketing" of borrowers is objective and determinable in every securitisation.

- It will ensure real homogeneity since the definition will match the originator's actual practices

- It is not subject in the case of prudentially supervised institutions (ie most of the true sale STS originators and ALL the on-balance-sheet STS originators) to arbitrage since their "bucketing" approaches have been approved as reasonable and prudent by their supervisor.

One or two approaches

It is possible that the introduction of article 142 (1) of CRR3 will drive banks to modify their internal processes to meet the €500m threshold. This could arguably, at some point in the future, mean that the proposed approach of the draft RTS and that of using the actual "bucketing" approach of the originator merge.

In this respect therefore, the EBA may wish to retain the current proposal as one alternative approach. But, since 142 (1) is not even passed, it cannot be – for the reasons set out above – the only approach.

Q3: Do you agree with the proposed amendment in Article 1 to the "type of obligor" for auto loans and leases?

See our response to Question 2

Q4: Do you agree with the proposed amendment in Article 1 to the "type of obligor" for credit card receivables?

See our response to Question 2. Although, for this asset class, most of the issues raised in our response to Question 2 are not relevant and it is difficult to see any damage resulting from the current proposal.

Q5: Do you see the need for the grandfathering provisions in Article 2 for the outstanding STS ABCP and STS non-ABCP securitisations? If yes, please elaborate. Accordingly, for the outstanding STS on-balance-sheet securitisations notified to ESMA prior to the entry into force of this Regulation, the EBA is considering a deferred application date to ensure a smooth transition to the new requirements.

The grandfathering provisions and the transition proposals for on-balance-sheet transactions are not only needed but essential.

Their absence would offend against the principles of natural justice and fairness that are integral to EU law. Market participants, including investors, who have complied with all the legislation in place in an honest endeavour to meet the letter and the spirit of the rules should not suffer unnecessary penalties.

Their absence would damage the reputation of the EU financial markets as markets where regulatory action is predictable and fair. This is not, in our view, in the long-term interest of the European Union and its ambitions for a Capital Markets Union.

Their absence could result in a number of on-balance-sheet transactions no longer providing effective capital relief. This would force banks to raise more capital at a time when economic uncertainty could result in capital being eroded and the Basel III implementation (including the output floors) is going to require many to raise yet more capital. This would result in what is supposed to be a prudential regulation exacerbating systemic instability. It is difficult to see what systemic risk flows from the current approach to homogeneity compared to that proposed and how such risk (if it exists) could counterbalance the systemic risk of closing out of billions of Euros of on-balance-sheet SRT transactions at a time of possible banking stress.

Q6: Do you agree with the deferred application date in Article 2 for the outstanding STS on-balance-sheet securitisations?

See our response to Question 5.

We would also very much argue for a long transition and preferably five years. Transition periods are designed to provide market participants with sufficient time to adapt to the new rules and thus avoid cliff effects. Here though the rules are applied to events that have already occurred. There is no possible way in which market participants can "adapt" to the new rules in respect of transactions that have already been completed. Therefore, the only way to avoid destabilising cliff effects – the very purpose of transition provisions - is to have a transition that reasonably allows existing transactions to fulfil their SRT role.

Q7: Are there any aspects that should be considered with regard to the homogeneity of the STS on-balance-sheet securitisations which are not specified in these RTS?

No.

Q8: Are there any impediments or practical implications of the criteria as defined in these draft RTS for STS traditional securitisations?

No save for those already discussed.

Q9: Are there any important and severe unintended consequences of the application of the homogeneity criteria as specified in these RTS?

Yes. See our response to Questions 5 and 6.

We remain, of course, at the EBA's entire disposal to discuss further any of the matters raised in this response.

Yours faithfully

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