# PCS

## Setting the Standard for Securitisation

STS Synthetic Securitisations

# Agenda

- Why consider Synthetics?
- Synthetics – An Overview
- STS Synthetic Regime

# PCS

## Setting the Standard for Securitisation

Synthetics – Why should I care?

# STS Synthetic SRT

## What can an SRT transaction do for you?

### Increase Capital Velocity

**Improves ROE & NII**

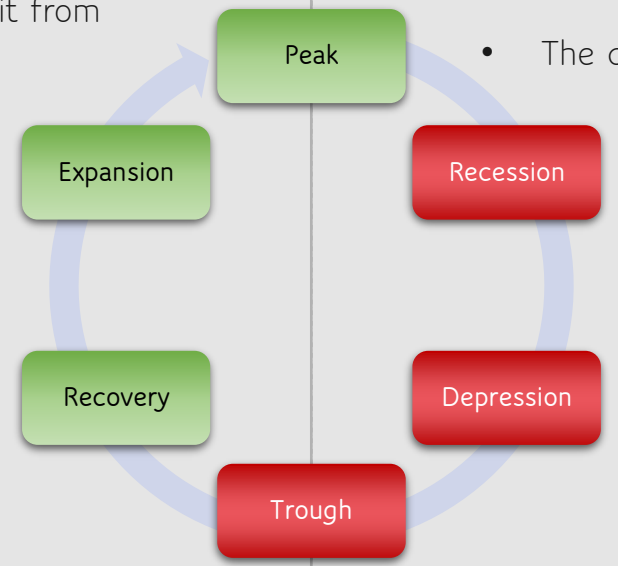
- Capital relief can improve ROE and NII via origination of new assets without the need for more capital
- Enables the bank to benefit from growing economic activity
- Cost is stable through the lifetime of the transaction

**Risk Sharing**

- The risk of the portfolio is shared with non-bank investors
- Acts as a check on the business origination
- Cheaper funding via lower average RWA

**Concentration management**

- Allows the reduction of concentration limits
- Allows the continuation of origination of loans in industries with high concentration limits




### Capital Protection during a downturn

**Insurance against a downturn**

- Protects the bank's profitability and capital against an economic downturn
- Allows for the continuation of loan origination
- The cost of the insurance is known upfront and does not increase with the worsening economic conditions

**When do buy Insurance**

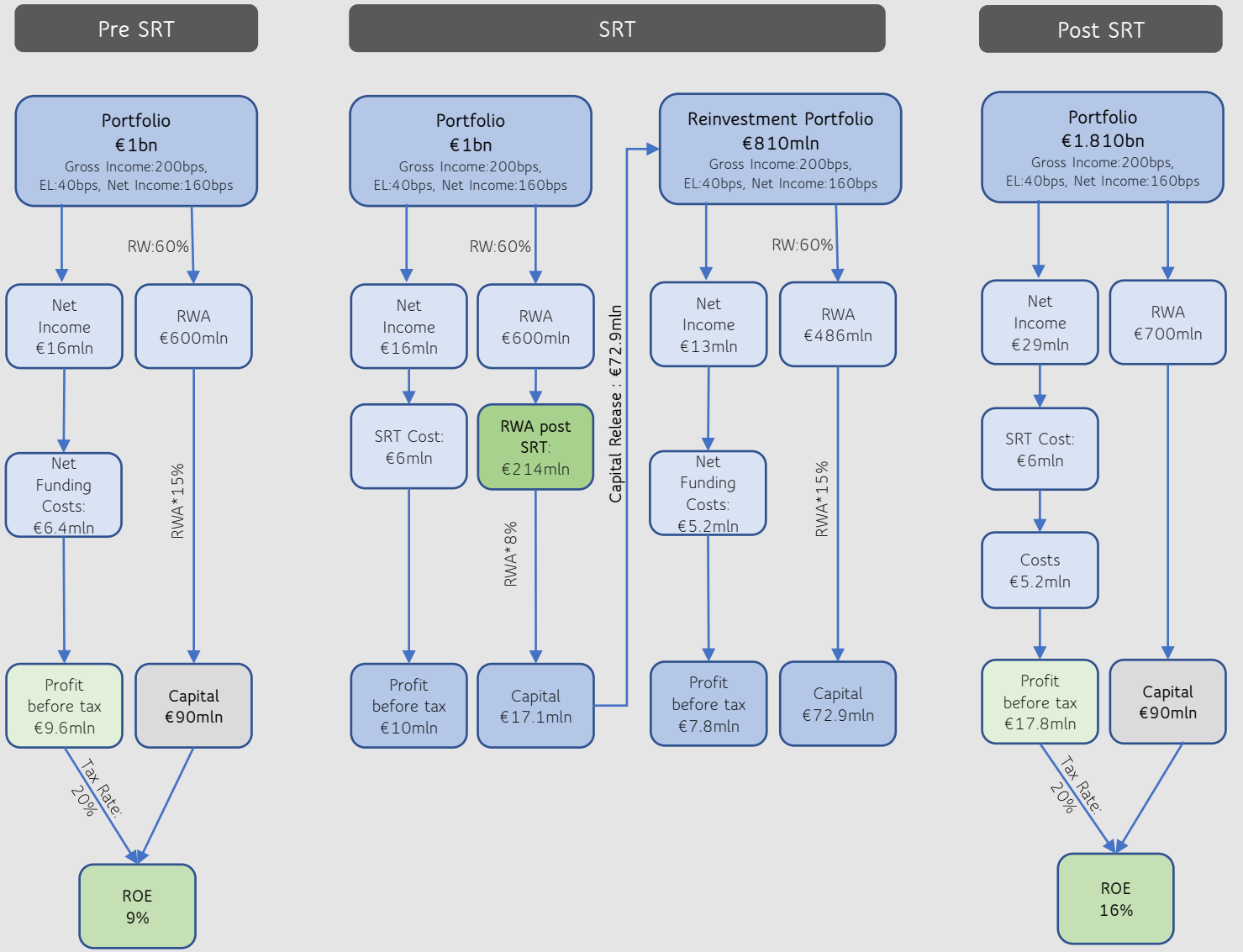
- The best time to buy insurance is when you don't need it
- In a downturn the market appetite is low and expensive

**Can I buy Insurance**

- In order to benefit from the SRT investor base the bank needs to have the right infrastructure in place
- Typically, it can take between 1-2 years for the infrastructure to be put in place

# STS Synthetic SRT

## What can an SRT transaction do for you?



# STS Synthetic SRT

## What can an SRT transaction do for you?

| Economic Cycle | Recovery | Expansion | Peak | Recession | Depression | Trough |
|---|---|---|---|---|---|---|
| Portfolio | € 1,000 | € 994 | € 989 | € 985 | € 977 | € 967 |
| RW | 60% | 50% | 40% | 70% | 100% | 120% |
| Expected Loss % | 0.6% | 0.5% | 0.4% | 0.8% | 1.0% | 1.2% |
| Funding Cost % | 0.50% | 0.40% | 0.30% | 0.60% | 0.70% | 0.80% |
| | | | | | | |
| Gross Income | € 20 | € 20 | € 20 | € 20 | € 20 | € 19 |
| Loss | € 6 | € 5 | € 4 | € 8 | € 10 | € 12 |
| Cumulative Loss | € 6 | € 11 | € 15 | € 23 | € 33 | € 44 |
| Cumulative Loss % | 0.6% | 1.1% | 1.5% | 2.3% | 3.3% | 4.6% |
| Pre Securitisation | | | | | | |
| RWA | € 600 | € 497 | € 396 | € 690 | € 977 | € 1,161 |
| Loss allocated to the bank | € 6 | € 5 | € 4 | € 8 | € 10 | € 12 |
| **Net Income** | **€ 14** | **€ 15** | **€ 16** | **€ 12** | **€ 10** | **€ 8** |
| On B/S Funding Costs | € 5 | € 4 | € 3 | € 5 | € 6 | € 6 |
| **Profit Before Tax** | **€ 9** | **€ 11** | **€ 13** | **€ 7** | **€ 4** | **€ 1** |
| Capital | € 90 | € 75 | € 59 | € 103 | € 147 | € 174 |
| **ROE** | **11%** | **15%** | **22%** | **6%** | **3%** | **1%** |
| Capital Ratio if no new capital raised | 15.0% | 18.1% | 22.7% | 13.1% | 9.2% | 7.8% |
| **Capital Ratio Shortfall** | **0.0%** | **0.0%** | **0.0%** | **1.9%** | **5.8%** | **7.2%** |
| Post Securitisation (STS SRT Mezz) | | | | | | |
| RWA | € 214 | € 177 | € 152 | € 139 | € 89 | € 89 |
| Loss allocated to the bank | € 3.0 | € 2.0 | € 1.0 | € 4.0 | € 0.0 | € 0.0 |
| Loss allocated to mezz | € 0.0 | € 0.0 | € 0.0 | € 0.9 | € 6.8 | € 8.7 |
| Securitisation Costs | € 5.4 | € 5.4 | € 5.4 | € 5.3 | € 4.9 | € 4.4 |
| **Net Income** | **€ 8.6** | **€ 9.5** | **€ 10.4** | **€ 7.4** | **€ 11.7** | **€ 12.0** |
| On B/S Funding Costs | € 4.4 | € 3.5 | € 2.6 | € 5.2 | € 6.1 | € 6.9 |
| **Profit Before Tax** | **€ 4.2** | **€ 6.0** | **€ 7.8** | **€ 2.1** | **€ 5.6** | **€ 5.1** |
| Capital | € 32.1 | € 26.5 | € 22.7 | € 20.9 | € 13.4 | € 13.4 |
| **ROE Post Securitisation Capital** | **10%** | **18%** | **27%** | **8%** | **33%** | **31%** |
| Capital Released | € 57.9 | € 44.3 | € 33.6 | € 77.4 | € 125.9 | € 152.1 |
| **Capital Released Cost Saving** | **€ 5.8** | **€ 4.4** | **€ 3.4** | **€ 7.7** | **€ 12.6** | **€ 15.2** |
| Capital Ratio if no new capital raised | 42.1% | 51.0% | 59.3% | 64.6% | 101.1% | 101.1% |
| **Capital Ratio Shortfall** | **0.0%** | **0.0%** | **0.0%** | **0.0%** | **0.0%** | **0.0%** |

# STS Full Stack

## What can an SRT transaction do for you?

| Economic Cycle | Recovery | Expansion | Peak | Recession | Depression | Trough |
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| On B/S Funding Costs | € 5 | € 4 | € 3 | € 5 | € 6 | € 6 |
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| **Capital Ratio Shortfall** | **0.0%** | **0.0%** | **0.0%** | **1.9%** | **5.8%** | **7.2%** |
| Post Securitisation (STS Full Stack) | | | | | | |
| RWA | € 30 | € 25 | € 20 | € 34 | € 49 | € 58 |
| Loss allocated to the bank | € 0.3 | € 0.2 | € 0.2 | € 0.4 | € 0.5 | € 0.6 |
| Loss allocated to securitisation | € 5.7 | € 4.7 | € 3.8 | € 7.5 | € 9.3 | € 11.0 |
| Securitisation Costs | € 8.6 | € 8.6 | € 8.6 | € 8.6 | € 8.6 | € 8.6 |
| **Net Income** | **€ 5.4** | **€ 6.3** | **€ 7.2** | **€ 3.2** | **€ 2.3** | **€ 2.2** |
| On B/S Funding Costs | € 0.2 | € 0.2 | € 0.1 | € 0.3 | € 0.3 | € 0.4 |
| **Profit Before Tax** | **€ 5.1** | **€ 6.1** | **€ 7.1** | **€ 2.9** | **€ 2.0** | **€ 1.8** |
| Capital | € 4.5 | € 3.7 | € 3.0 | € 5.2 | € 7.3 | € 8.7 |
| **ROE Post Securitisation Capital** | **91%** | **131%** | **190%** | **45%** | **22%** | **17%** |
| Capital Released | € 85.5 | € 70.8 | € 56.4 | € 98.3 | € 139.3 | € 165.4 |
| **Capital Released Cost Saving** | **€ 8.6** | **€ 7.1** | **€ 5.6** | **€ 9.8** | **€ 13.9** | **€ 16.5** |
| Capital Ratio if no new capital raised | 300.0% | 362.2% | 455.0% | 261.0% | 184.2% | 155.1% |
| **Capital Ratio Shortfall** | **0.0%** | **0.0%** | **0.0%** | **0.0%** | **0.0%** | **0.0%** |

# STS Mezz SRT vs Full Stack

How do the various options compare?

| Economic Cycle | Recovery | Expansion | Peak | Recession | Depression | Trough |
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| Net Income | | | | | | |
| Pre Securitisation | € 14.0 | € 14.9 | € 15.8 | € 11.8 | € 9.8 | € 7.7 |
| STS SRT Mezz | € 8.6 | € 9.5 | € 10.4 | € 7.4 | € 11.7 | € 12.0 |
| STS Full Stack | € 5.4 | € 6.3 | € 7.2 | € 3.2 | € 2.3 | € 2.2 |
| Profit Before Tax | | | | | | |
| Pre Securitisation | € 9.5 | € 11.2 | € 13.0 | € 6.5 | € 4.0 | € 1.4 |
| STS SRT Mezz | € 4.2 | € 6.0 | € 7.8 | € 2.1 | € 5.6 | € 5.1 |
| STS Full Stack | € 5.1 | € 6.1 | € 7.1 | € 2.9 | € 2.0 | € 1.8 |
| ROE Post Securitisation Capital | | | | | | |
| Pre Securitisation | 11% | 15% | 22% | 6% | 3% | 1% |
| STS SRT Mezz | 10% | 18% | 27% | 8% | 33% | 30% |
| STS Full Stack | 91% | 131% | 190% | 45% | 22% | 17% |
| Capital Ratio Shortfall | | | | | | |
| Pre Securitisation | 0.0% | 0.0% | 0.0% | 1.9% | 5.8% | 7.2% |
| STS SRT Mezz | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| STS Full Stack | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |

# STS Securitisation

## Benefits

Summary

- The benefits of securitisation need to be analysed throughout the business cycle
- Securitisation can improve ROE & NII in good times and can protect capital ratios in bad times
- Can protect against need for increase provisions due to risk migration
- Funding costs/insurance costs are fixed throughout the lifetime of the portfolio thus enabling the originator to avoid refinancing costs at times of stress
- Enables risk sharing and management of concentrations limits
- Provides a reference point for origination of new assets both in terms of spread
- Securitisation increases the capital base and brings non-bank capital to the banking sector
- Securitisation acts counter-cyclical during the economic cycle

# PCS

## Setting the Standard for Securitisation

Synthetics – An overview

# Public Service Announcement

Key notions

# Synthetic securitisations

"Synthetic securitisations" are called "on-balance-sheet securitisations" in the legislation

They are the exact same thing but someone obviously thought "on-balance-sheet" sounded less sinister than "synthetic"

In this presentation we will use the more common term of "synthetic", but bear this identity in mind when you read documents from the public sector

# Synthetics an overview

## Key notions

# "true sale" vs "synthetic"

- All securitisations are limited recourse asset-based finance where the investors take the risk of the assets
- In traditional/"true sale" securitisations this is achieved by the legal sale of the relevant assets by the originator to a special purpose vehicle funded by the investors
- "Synthetic" securitisation are so called because they originally were supposed to achieve the same result as "true sale" securitisations ***without*** a legal sale of the assets
- Without a legal transfer (by sale or rarely a security interest) the assets remain on the balance sheet of the originator – and so "on-balance-sheet securitisations"
- "True sale" securitisations and synthetic securitisations share the same parents but grew up and drifted somewhat apart – they now tend to proceed from different motivations, involve different market players and different investor bases
- Yet, they share two fundamental aspects: investors take the risk of the securitised assets *and* they have credit tranching
- It is those two things that make them both, in Europe, legally "securitisations"

# Synthetics an overview

## Key notions

# "synthetics" as credit insurance

- Lawyers will tell you that "synthetic securitisations" are not legally "insurance" – or else people would have to go to jail
- Of course, the lawyers are right, but if you want to understand how synthetics work, just remember: "Synthetic securitisations are insurance"
- In a synthetic securitisation, an investor tells an originator: "If a borrower X to whom you have lent money does not pay you back, I will compensate you for the loss". Basically, insurance
- If you keep in mind always that fundamental truth – synthetic securitisation is credit insurance by another name – a lot of the real complexity of the world of synthetic securitisation ("Is it a funded CDS or an originator CLN?") will become a lot easier to navigate

# Synthetics an overview

## Key notions

## “true sale” vs “synthetic”

## each to their own

Technically, everything that one can achieve with a “true sale” securitisation can be achieved with a synthetic securitisation and vice-versa. But, in Europe, the two markets have grown to serve different purposes

| True Sale | Synthetic |
|---|---|
| always funding/ rarely capital management | almost always capital management/very rarely funding |
| mainly highly rated senior notes/some mezz/no first loss | mainly lowly or unrated mezz or first loss/no seniors placed with investors |
| wide distribution with traditional market syndication | very small number of investors (often one) and no distribution |
| tradeable bonds with a secondary market | variety of instruments and no secondary market |

*WARNING: For every rule, someone will tell you about the exception*

# Synthetics an overview

## Key notions

# Finance & jargon

# the love affair

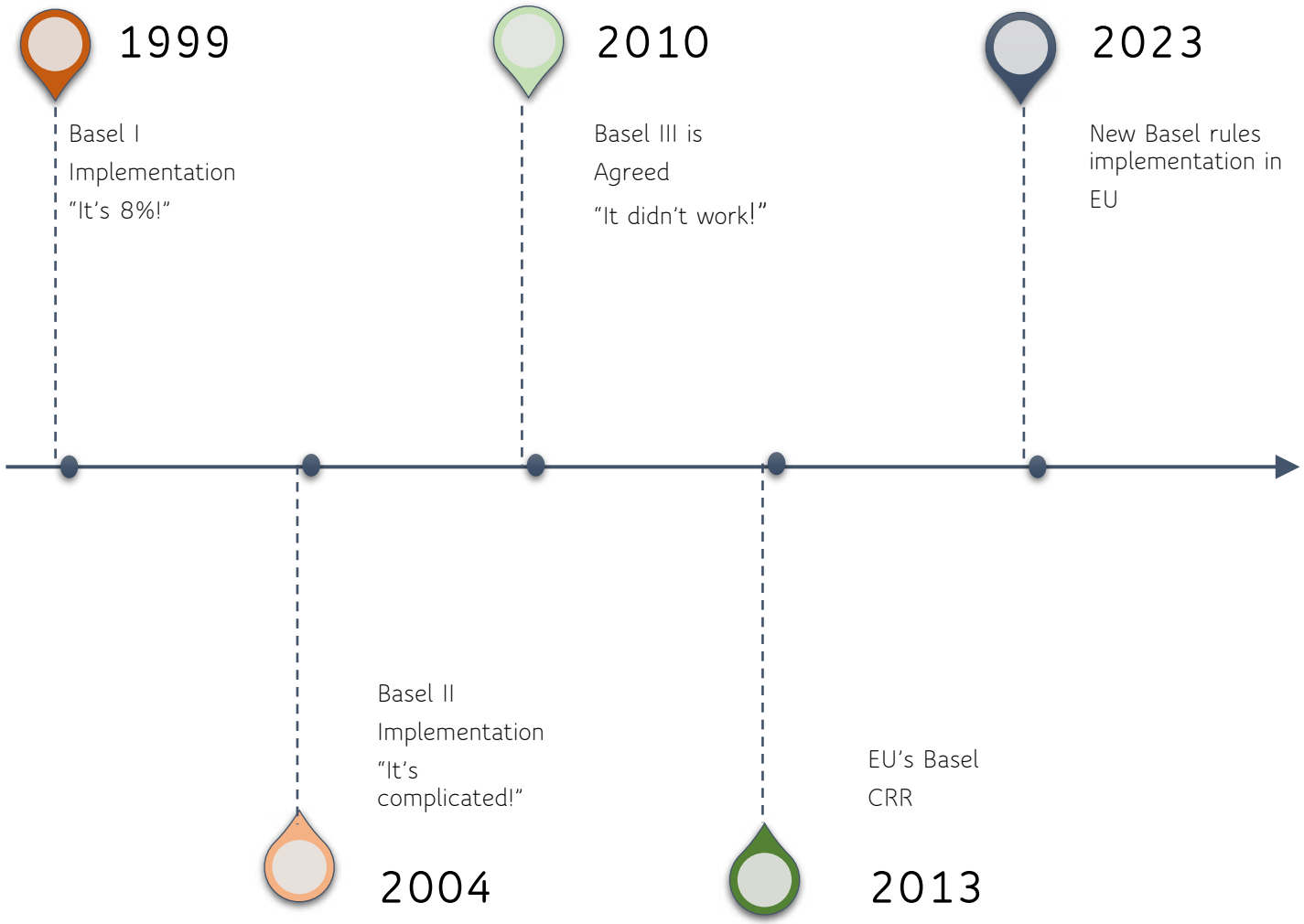
*Some expressions one hears around synthetics*

- "**Protection buyer**" – the bank that is "issuing" the synthetic securitisation also called the "originator" or the "issuer"
- "**Protection seller**" or "**protection provider**"– the entity providing the credit protection also called "investor"
- "**Reference pool**" – the assets which are securitised and part of which are covered by the credit insurance (see "attachment point" and "detachment point")
- "**Attachment point**" – the level of losses on the reference pool at which the protection sellers start to compensate the protection buyer. Anything below the attachment is like an insurance deductible
- "**Detachment point**" – the level of losses beyond which the protection sellers no longer need to compensate the protection buyer. The amount between the attachment point and the detachment point is the maximum amount the protection sellers will ever be obliged to pay
- "**Unfunded**" – means that the protection sellers do not have to put up any money at the start of the transaction. Just like an insurance company, money only moves when a claim is made
- "**Funded**" – means the amount between the attachment point and the detachment point is paid by the protection sellers. That amount is designed so that the protection buyer does not need to worry if the protection sellers are good for the money at the time of a claim. The cash is returned at the end of the deal (minus losses on the protected reference pool)

# Synthetics an overview

## Key notions

# The answer is always **capital**

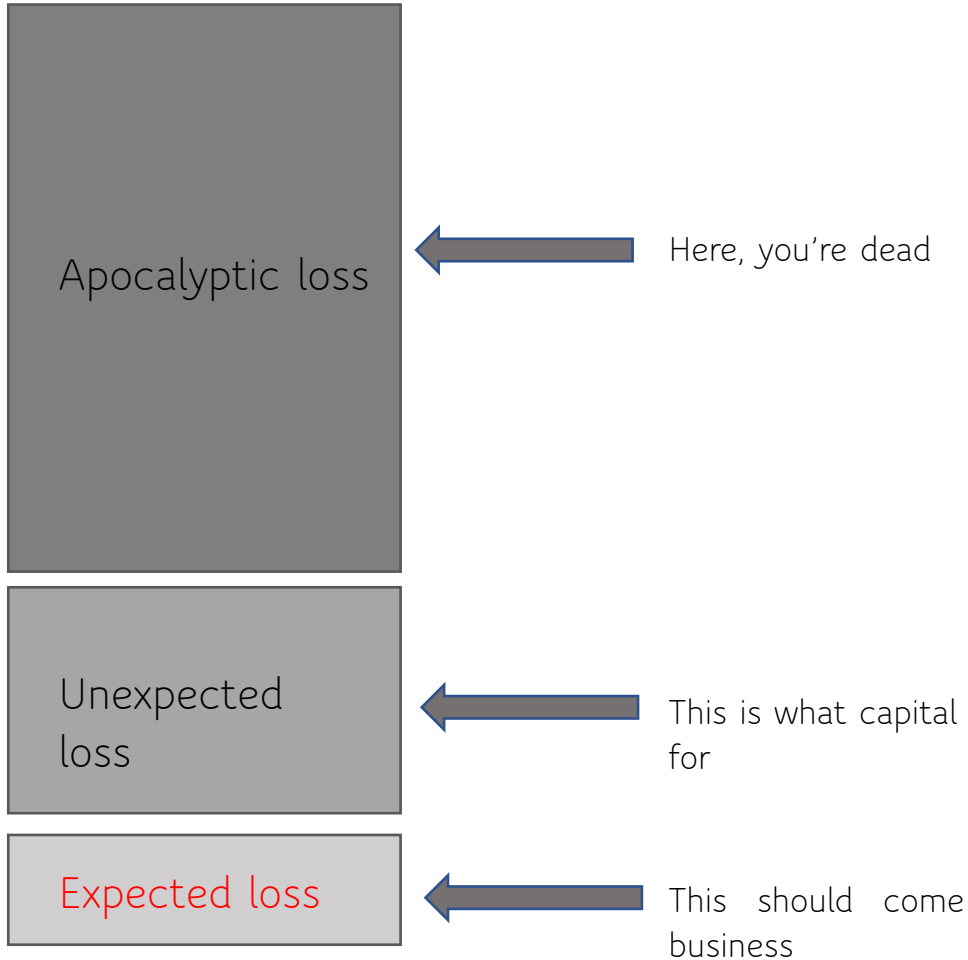


# Synthetics an overview

## Key notions

# The answer is always **capital**

The fundamentals of capital requirements in one graph and how it explains synthetics



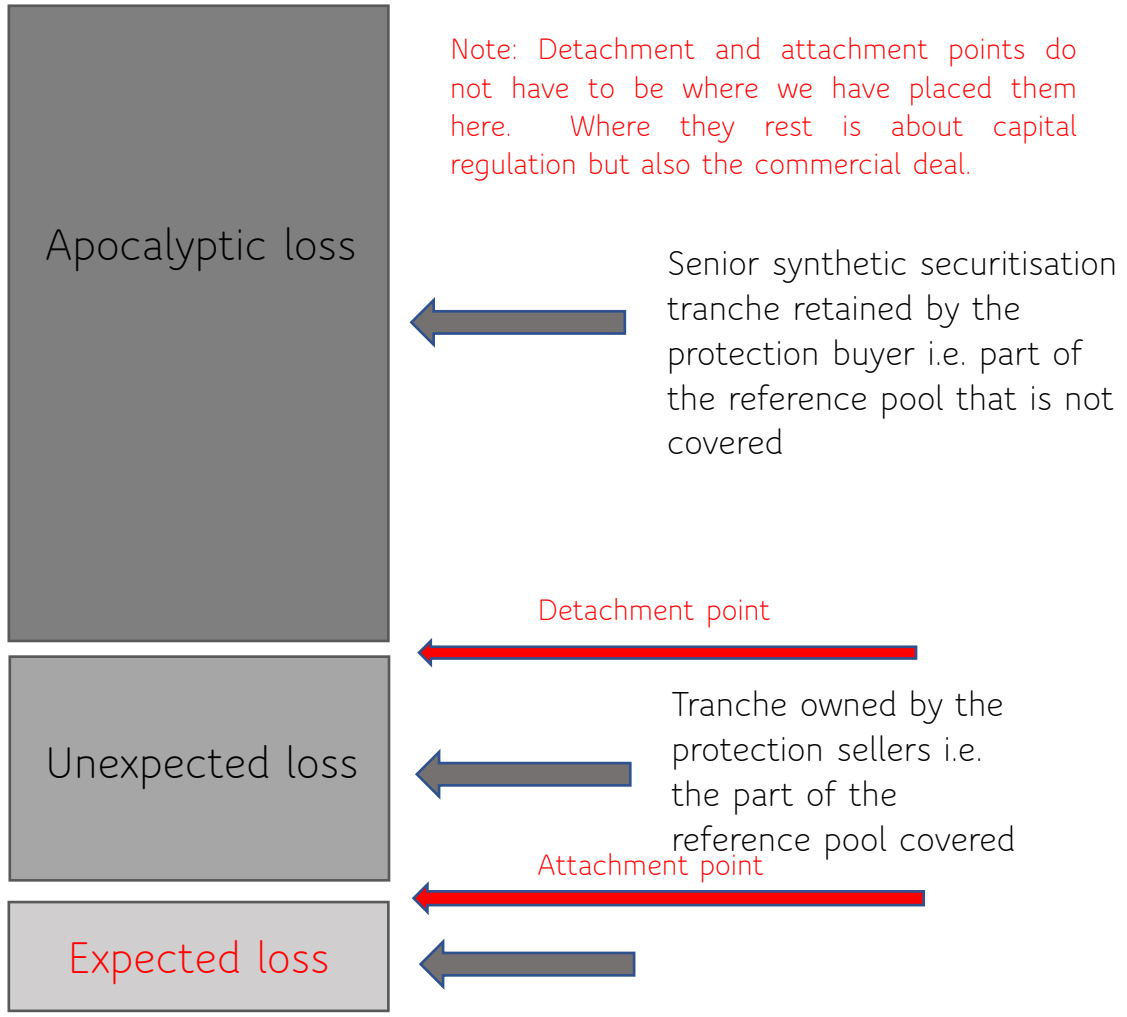
# Synthetics an overview

## Key notions

# The answer is always **capital**

This is how synthetic securitisation is supposed to help with capital

(A very simplified diagram)

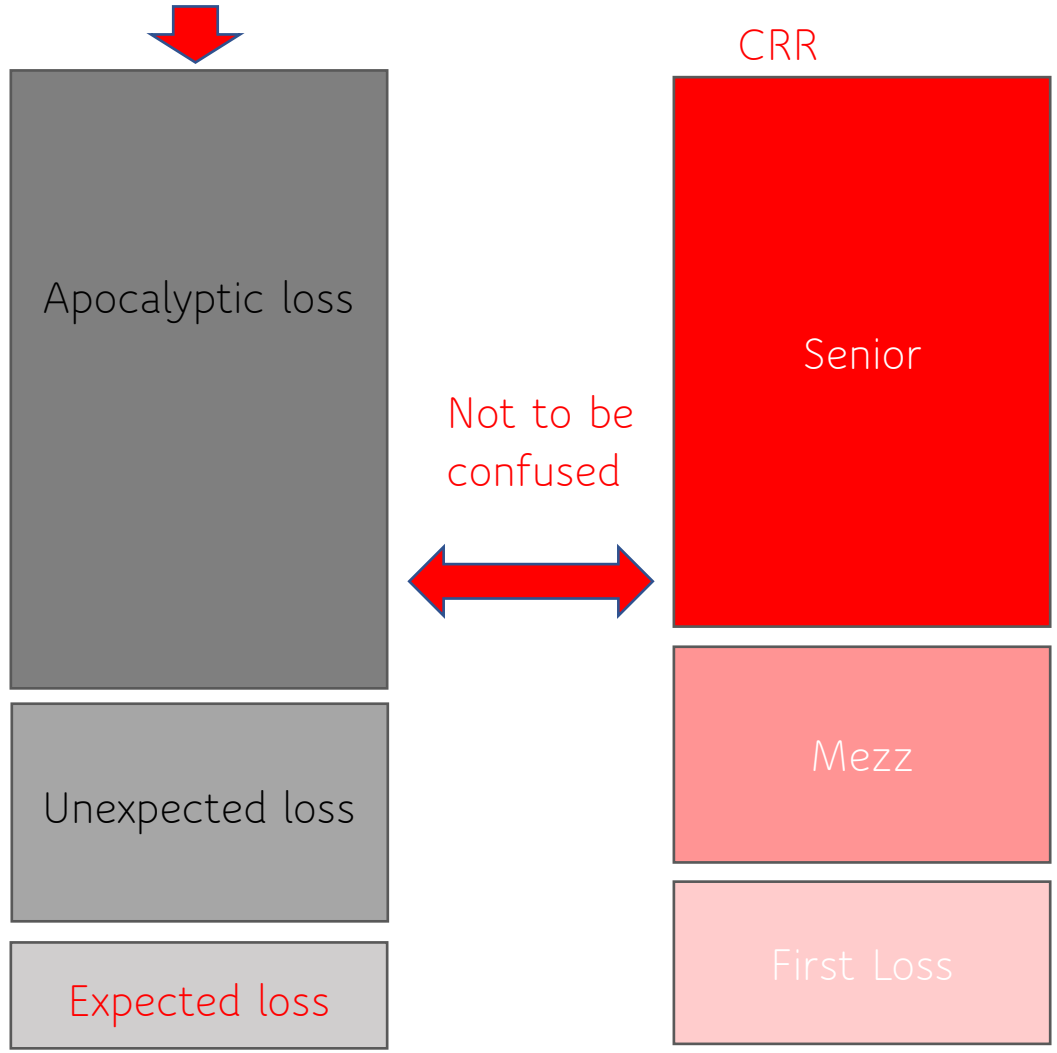


# Synthetics an overview

## Key notions

## The answer is always **capital**

**WARNING** – This is a simplified conceptual explanation of how bank capital works



# Synthetics an overview

## Key notions

## The answer is always **capital**

- In theory, if a bank can convince its prudential regulator that it has removed from its balance sheet the risk for which capital is required, the prudential regulator will allow that bank to reduce or redeploy that capital
- The rules that set out how much capital a European bank must have appear in the European Union Capital Requirements Regulation or "CRR" for short
- The rules which European regulators apply to determine whether they agree that a bank has removed that risk are called the "significant risk transfer" rule or "SRT" rules for short
- The basic purpose of most synthetic securitisations is to allow prudential regulators to determine (following the CRR and the SRT rules) that the amount of capital required by the bank can be reduced or eliminated.
- In practice, operating the combination of the CRR and the SRT rules is closer to performing delicate brain surgery in the dark, but just with more maths.
- *Note: even though most banks seek to achieve regulatory capital relief via synthetics, one should not underestimate the value of these instruments in managing economic capital and risk.*

# Synthetics an overview

## Key notions

# SRT Basics

The SRT rules flow from the CRR and various complex guidelines issued by prudential regulators

To recognize that a securitisation (synthetic or "true sale") reduces credit risk and allows a capital reduction two tests must be met

- Qualitative Test – A series of features that the securitisation must contain (e.g. no early termination provisions)
- Quantitative Test – One of two tests set out in Art. 244 and 245 of the CRR and which set out how much of the asset credit risk must be transferred
    - Mezzanine Test – bank cannot retain more than 50% of the related RWEAs* OR
    - First Loss Test – bank must
        a) sell at least 80% of the relating exposure value; and
        b) the relating tranche thickness must be high enough to cover the estimated expected loss by a substantial factor

*risk-weighted exposure amount

# Synthetics an overview

Key notions

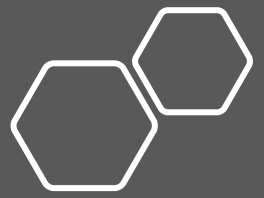
# How do they work?

## The Classic Three

The *vast majority* are structured using one of 3 legal devices.

- Guarantees – where the protection sellers issue a guarantee of the reference pool for which they receive a stream of regular premia
- Credit Derivatives – usually a credit default swap where the protection sellers agree to swap the defaulted amounts against a stream of agreed payments
- Credit Linked Notes – where the protection sellers purchase a limited recourse debt instrument (e.g., a bond) issued by the protection buyer or an SPV and receive interest on that instrument. The principal is repaid net of any defaults on the reference pool

***Note**: Remember this slide when we discuss collateral and the STS Regulation*



# Synthetics an overview

Key notions

# How do they work?

## Funded or Unfunded?

In a funded transaction that is not a CLN:

- the protection sellers put up cash
- the  cash is used as collateral for the protection sellers' obligations
- the unused cash is returned at the end of the deal
- this allows the protection buyer to avoid the protection sellers' credit risk
- this allows the regulator to remove the risk from the protection buyer's balance sheet *rather* than substitute that of the protection sellers

In a funded transaction that is a CLN:

- the CLN is a debt instrument, so the cash is simply the principal under the note
- the principal can either be taken as such by the protection buyer or can be set aside to collateralise the protection buyer's obligations to repay the CLN

In an unfunded transaction:

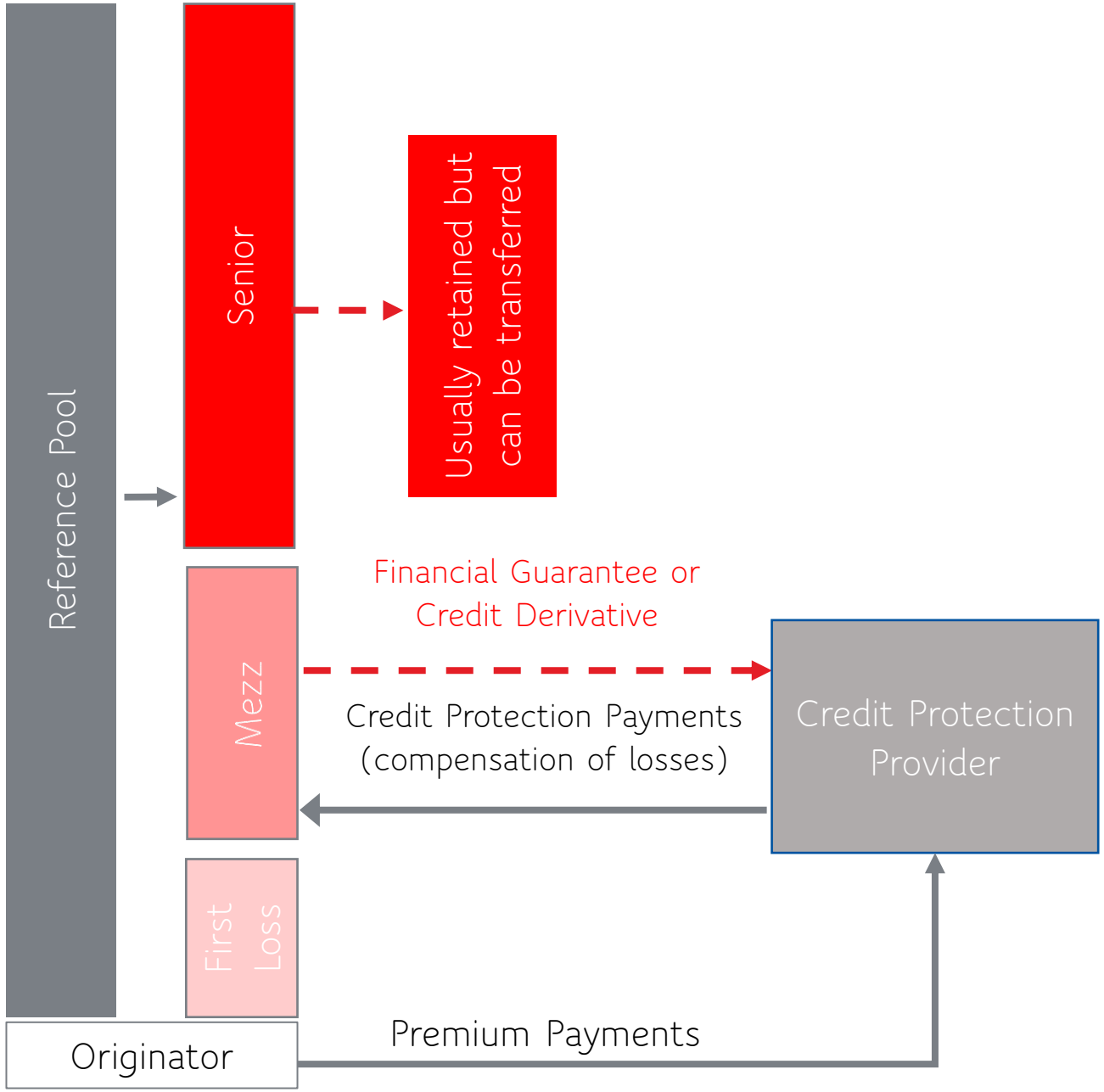
- the protection sellers put up no cash
- the protection buyer relies on the protection sellers' credit when calling on them to compensate it for a default

# Synthetics an overview

## Key Structures : 1

## "unfunded"

*(usually with supranational, sovereign or public counterparty)*

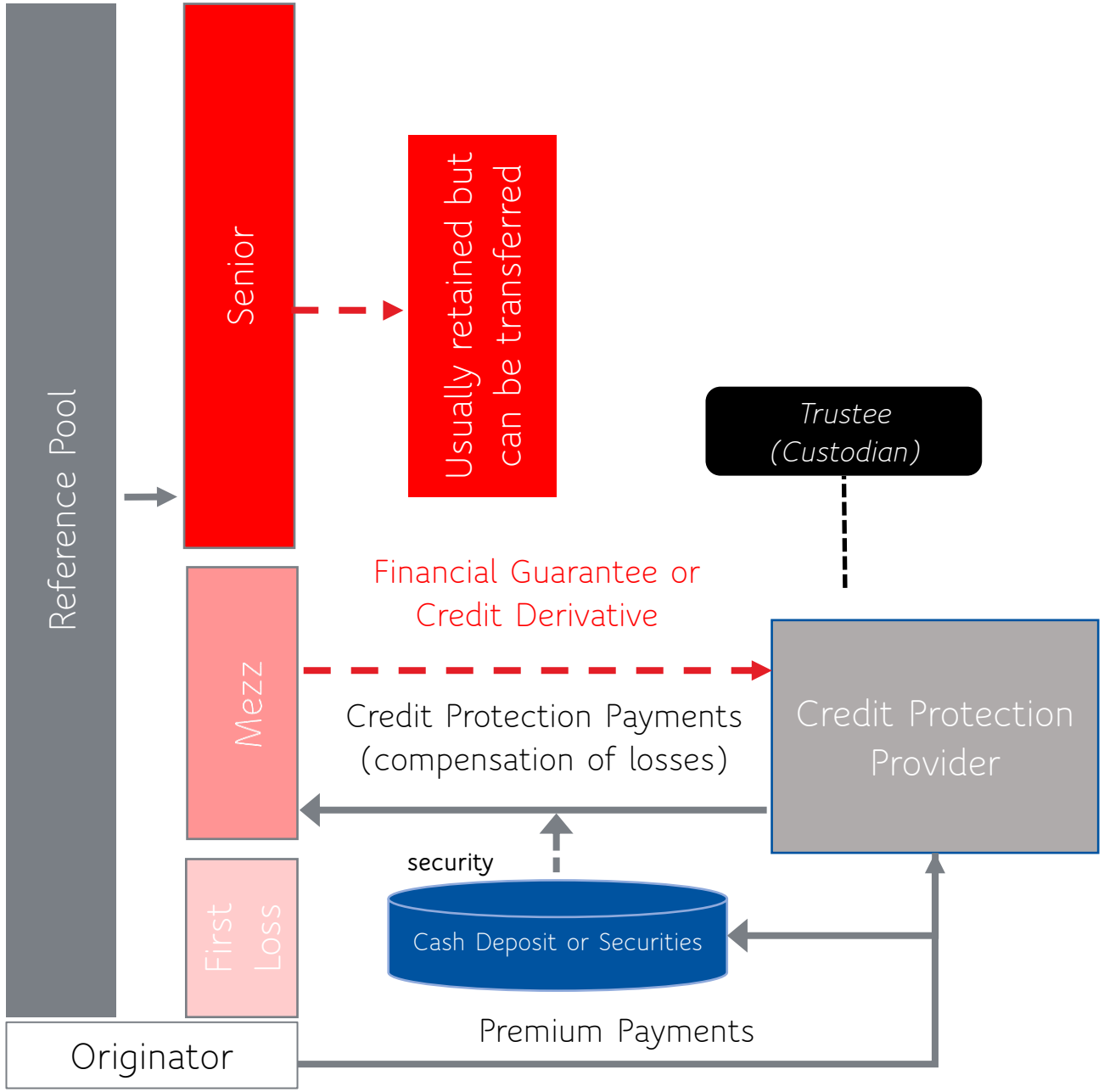


# Synthetics an overview

## Key Structures : 2

## "funded" Version 1

*(usually with a bank, fund or insurance company as "**protection provider**")*

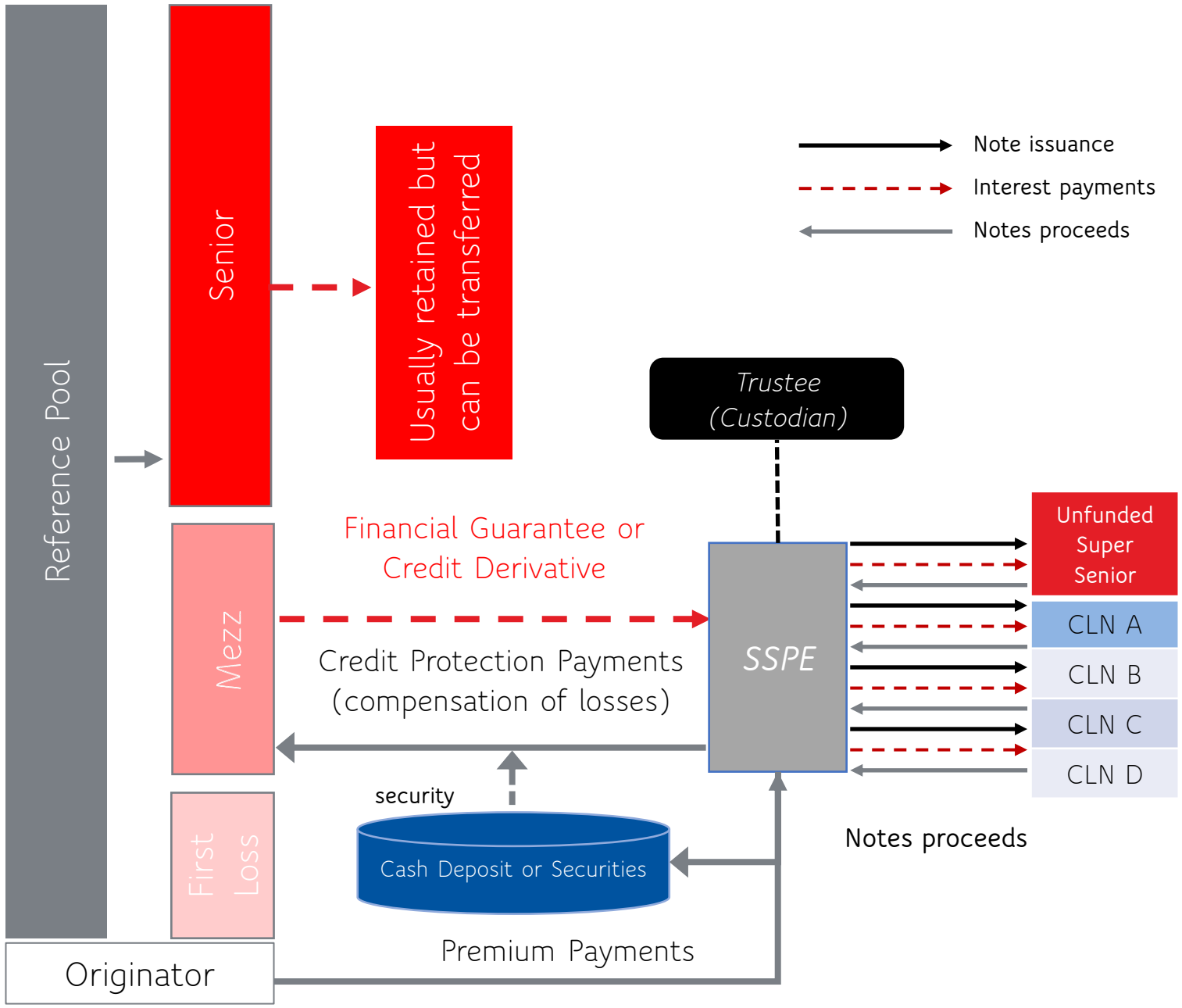


# Synthetics an overview

## Key Structures : 3

## "funded" Version 2

*(with SPV issuing credit-linked notes to investors)*

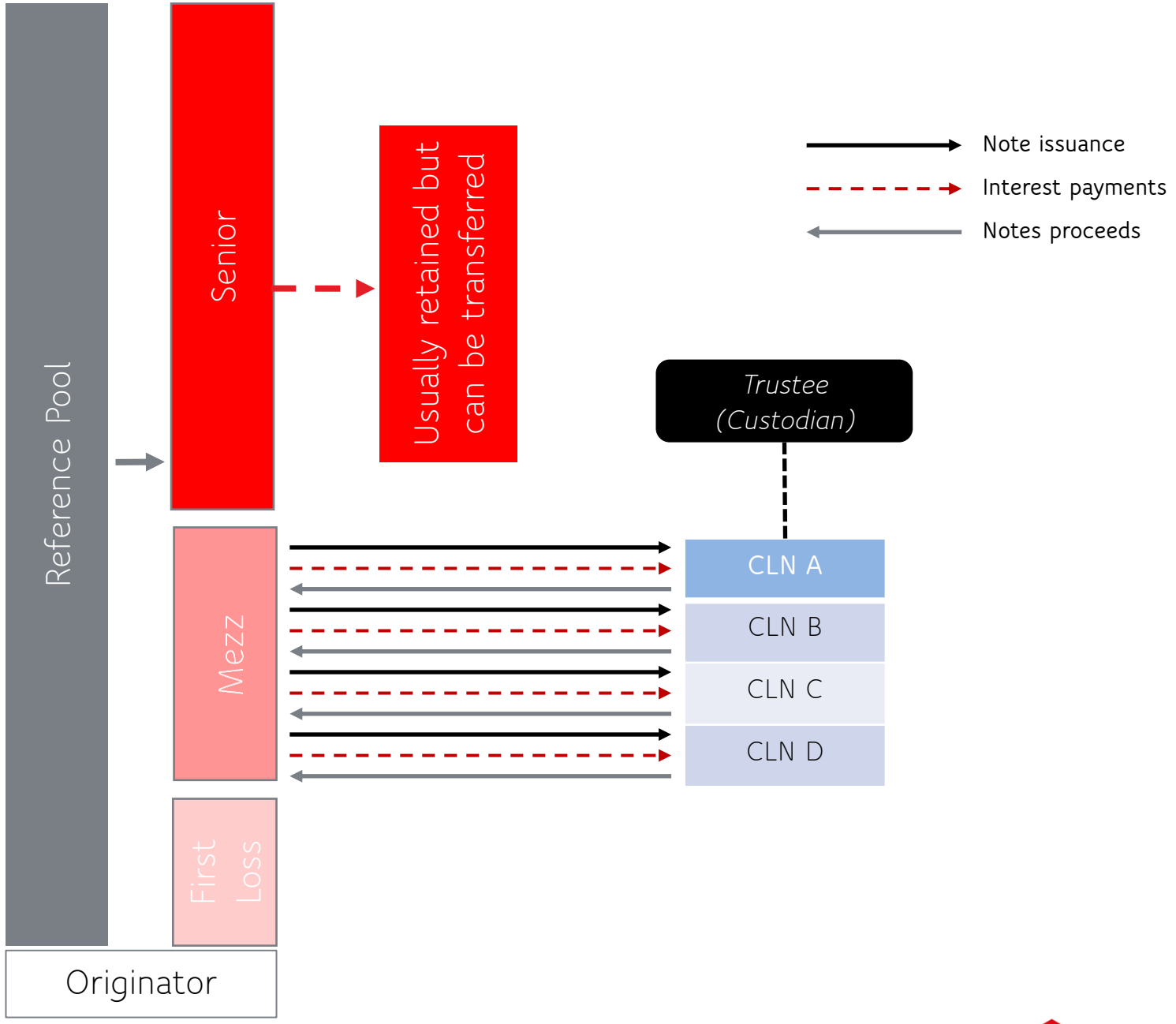


# Synthetics an overview

## Key Structures : 4

## "funded" Version 3

*(with protection buyer issuing credit-linked notes to investors)*



# Synthetics an overview

## At the heart of the risk transfer

"the Credit Event"
and the
"compensation for losses"
by the protection provider

## The Credit Event – Loss Payments

Credit Event: an event that triggers a payment by the protection seller e.g.:

- Payment default of reference obligation
- Insolvency of reference obligor
- Restructuring of the reference obligation
- Further credit events are possible

Credit Protection Payment: a payment by the protection seller to the protection buyer on the occurrence of a credit event

- First: Interim loss payment (bank's accounting loss, 180 days after credit event)
- When the loss is finally determined: realized loss payment (can mean additional loss payment or reimbursement)
- After sched. maturity, a maximum time for workout of up to two years: payment of losses if the workout is still ongoing,
- The affected principal remains outstanding, although the investor does not receive any coupons any more

Verification Agent: an independent agent who checks the occurrence of the credit event and confirms all the conditions for a credit protection payment are met

# Synthetics an overview

## Theory to Practice

SRT imposes numerous rules

- All synthetics that seek to reduce regulatory capital, in practice need to conform to stricter rules than theory allows:
- SRT impose strict requirements as to, amongst others:
- Mandatory credit events;
- Allowable termination rights
- Use of any collateral
- Types of counterparties
- The use of excess spread
- Premia paid to protection sellers

# Synthetics an overview

Q&A

# Q&A

# PCS

## Setting the Standard for Securitisation

STS Synthetic Regime

# Synthetic STS Regime

THE LAW

(EU) 2017/2402

General framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation **("STS Regulation")**

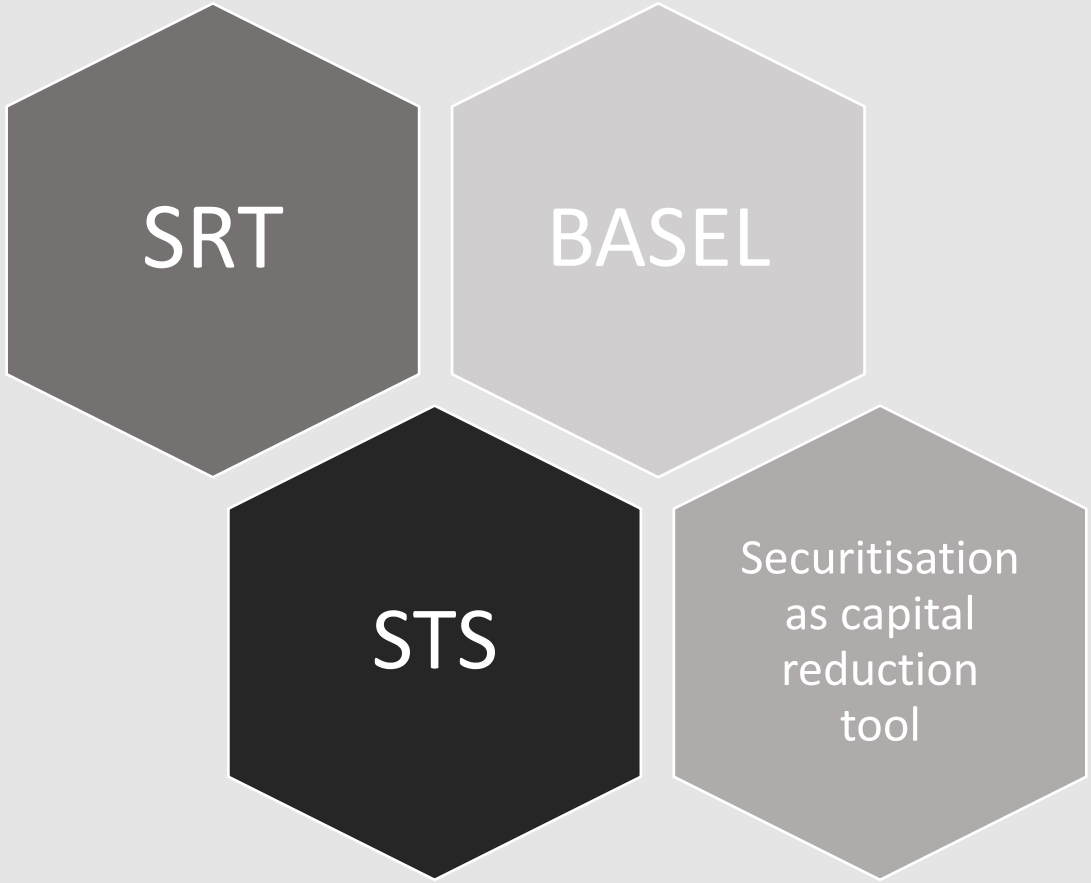
**amended by**

**(EU) 2021/557** - amending Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation to help the recovery from the COVID-19 crisis **("Synthetic STS Regulation")**

# Synthetic STS Regime

THE LAW

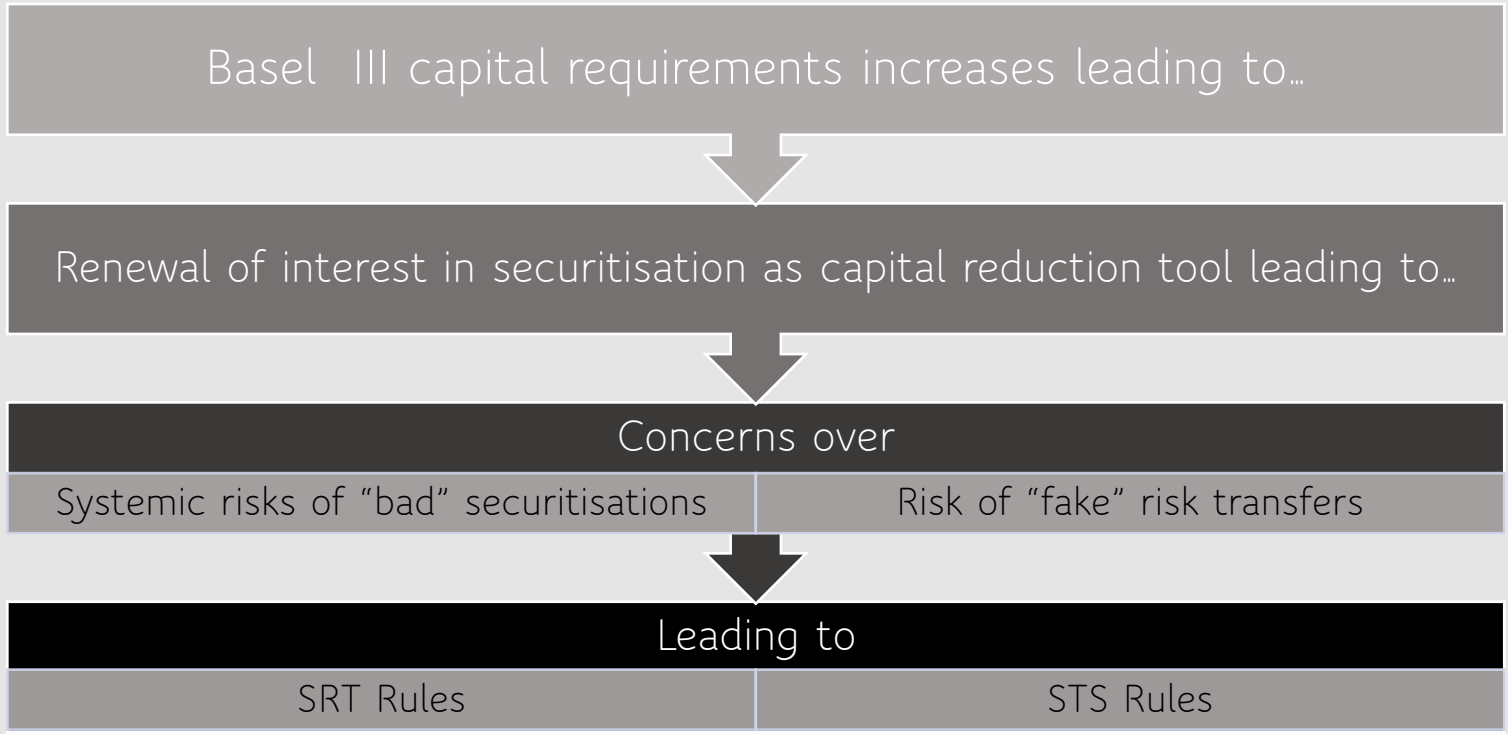
## An Origin Story



# Synthetic STS Regime

THE LAW

## An Origin Story



# STS Regime

## Synthetic STS

- Synthetic securitisations were not allowed to be STS in the original 2017 legislation
- But the European legislators instructed the European Commission to look into creating a "synthetic STS" category
- In 2021, this was done by passing an amending regulation which came into force on 9th April 2021
- The new regulation also amended certain provisions of the STS Regulation relating to retention and NPLs to make NPL securitisations easier
- Reminder: in the new regulation, "synthetic securitisations" are called "on-balance-sheet securitisations" and "true sale securitisations" are called "traditional securitisations" – just so you should know.

# STS Regime

## Synthetic STS Why the change?

### CRR impact of a synthetic securitisation

- CRR includes a "non-neutrality" principle for securitisations
- Under non-neutrality, if a pool X is securitized into three tranche (A,B,C), under the CRR, $K_A+K_B+K_C$ is substantially more than Kx
- If you enter into a synthetic securitisation removing the credit risk of tranche B, you should "mathematically" achieve a large reduction of capital requirement for pool X ***but***…
- …by doing so, the originator "creates" a new securitisation corresponding to the unprotected tranche A. Since tranche A is usually retained by the originator, the new capital requirement for this part A of the pool ($K_A$) can be almost the same (and in some cases larger!) that the old $K_X$
- By allowing the synthetic securitisation to access the lower STS CRR capital requirements for tranche A, the new regulation softens the impact of "non-neutrality" and makes (many) more pools capable of meaningful risk transfer.

# STS Regime

# STS Bank Investor Capital Benefit

| Risk Weights for securitisations under the SEC-ERBA | | | | | | |
|---|---|---|---|---|---|---|
| Credit Quality Step | STS | | Non-STS | | Non-STS % vs STS RW increase | |
| | Senior Tranche | | Senior Tranche | | Senior Tranche | |
| | Tranche Maturity | | Tranche Maturity | | Tranche Maturity | |
| | 1 year | 5 years | 1 year | 5 years | 1 year | 5 years |
| 1 | 10% | 10% | 15% | 20% | 50% | 100% |
| 2 | 10% | 15% | 15% | 30% | 50% | 100% |
| 3 | 15% | 20% | 25% | 40% | 67% | 100% |
| 4 | 15% | 25% | 30% | 45% | 100% | 80% |
| 5 | 20% | 30% | 40% | 50% | 100% | 67% |
| 6 | 30% | 40% | 50% | 65% | 67% | 63% |
| 7 | 35% | 40% | 60% | 70% | 71% | 75% |
| 8 | 45% | 55% | 75% | 90% | 67% | 64% |
| 9 | 55% | 65% | 90% | 105% | 65% | 62% |
| 10 | 70% | 85% | 120% | 140% | 71% | 65% |
| 11 | 120% | 135% | 140% | 160% | 17% | 19% |
| 12 | 135% | 155% | 160% | 180% | 19% | 16% |
| 13 | 170% | 195% | 200% | 225% | 18% | 15% |
| 14 | 225% | 250% | 250% | 280% | 11% | 12% |
| 15 | 280% | 305% | 310% | 340% | 11% | 12% |
| 16 | 340% | 380% | 380% | 420% | 12% | 11% |
| 17 | 415% | 455% | 460% | 505% | 11% | 11% |
| 18+ | 1250% | 1250% | 1250% | 1250% | 0% | 0% |

Risk Weights according to Article 263 & 264 of the REGULATION (EU) 2017/2401

Please Note:

- For Synthetic STS, these benefits apply only to the originator as "investor" in the senior tranche
- This table only shows the senior tranche capital benefit

# STS Regime

# Synthetic STS Capital Benefit

Let's assume a synthetic transaction with the following characteristics:

| Tranche | Size | RW | Capital | Protection (Spread) | Interest Cost (Spread) | CoC Released |
|---|---|---|---|---|---|---|
| Senior | 880 | 10% | 7 | 20bps | 1.8 | 25% |
| Mezz | 100 | 660% | 53 | 600bps | 6.0 | 11% |
| Junior | 20 | 1250% | 20 | 10000bps | 2.0 | 10% |
| **Total** | **1000** | **100%** | **80** | | **7.8** | **23%** |

If the originator decides to buy protection for the Senior tranche, then the implicit cost of the capital release is quite high

Synthetic STS allows the originator to reduce the cost of the capital release by selling only the Mezz tranche

Selling only the Mezz tranche can lead to a significant release of capital

By selling the Junior tranche instead of the Senior tranche significantly more capital is released for a similar cost

# STS Regime

## Synthetic STS Key provisions

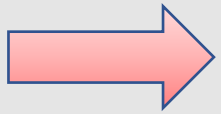
- Synthetic STS is only available to prudentially regulated European banks
- Synthetic securitisations are subject to the same retention requirements as true sale securitisations
- The only regulatory benefit provided for synthetic STS is access for the senior retained tranche to the lower STS CRR capital calibrations
- No regulatory benefits are available to the investors/protection sellers
- No Solvency II benefits are available for synthetic STS
- The criteria for synthetics are (with a couple of exceptions) the same as for true sale securitisation plus additional ones
- There are around 145 to 160 criteria for synthetics vs 103 for "true sale"
- Third-party verification agents are available for synthetic STS securitisations on the same basis as for "true sale" transactions.

# STS Regime

## Synthetic STS Criteria

Original 2017 STS Criteria for true-sale securitisations

| | |
|---|---|
| Art.20 | Simplicity |
| Art.21 | Standardisation |
| Art.22 | Transparency |



New 2021 STS criteria for synthetics

| | Art.26.e | Synthetic additions |
|---|---|---|
| Art.20 | Art.26.b | Simplicity plus |
| Art.21 | Art.26.c | Standardisation plus |
| Art.22 | Art.26.d | Transparency plus |

# STS Regime

## Synthetic STS Criteria High and Lowlights

| Article | Heading | Key Provisions |
|---|---|---|
| Art. 26.b | Simplicity | • Originator=EU Bank<br>• Only on-balance sheet exposures<br>• SRT only (i.e. art.249 CRR compliant)<br>• Homogeneity (via new RTS)<br>• No credit impaired borrowers |
| Art. 26.c | Standardisation | • Pro-rata amortisation allowed but with triggers<br>• Duties of the verification agent |
| Art. 26.d | Transparency | • AUP requirement<br>• Art. 7 disclosure requirements |
| Art. 26.e | Synthetic rules | • Minimum mandatory credit events<br>• Nominated Verification Agent<br>• Limited originator call options<br>• Very limited investor call options<br>• Limited use of synthetic excess spread (SES)<br>• Restricted list of synthetic structures<br>• Specific rules on collateral usage |

# STS Regime

## Synthetic STS Criteria High and Lowlights

**Originator calls limited to**

- Investor default
- Regulatory call
- Time call (but with justification to regulator)
- Clean up call

**Investor calls limited to**

- Originator failure to pay
- Originator material breach

**Restricted list of possible structures**

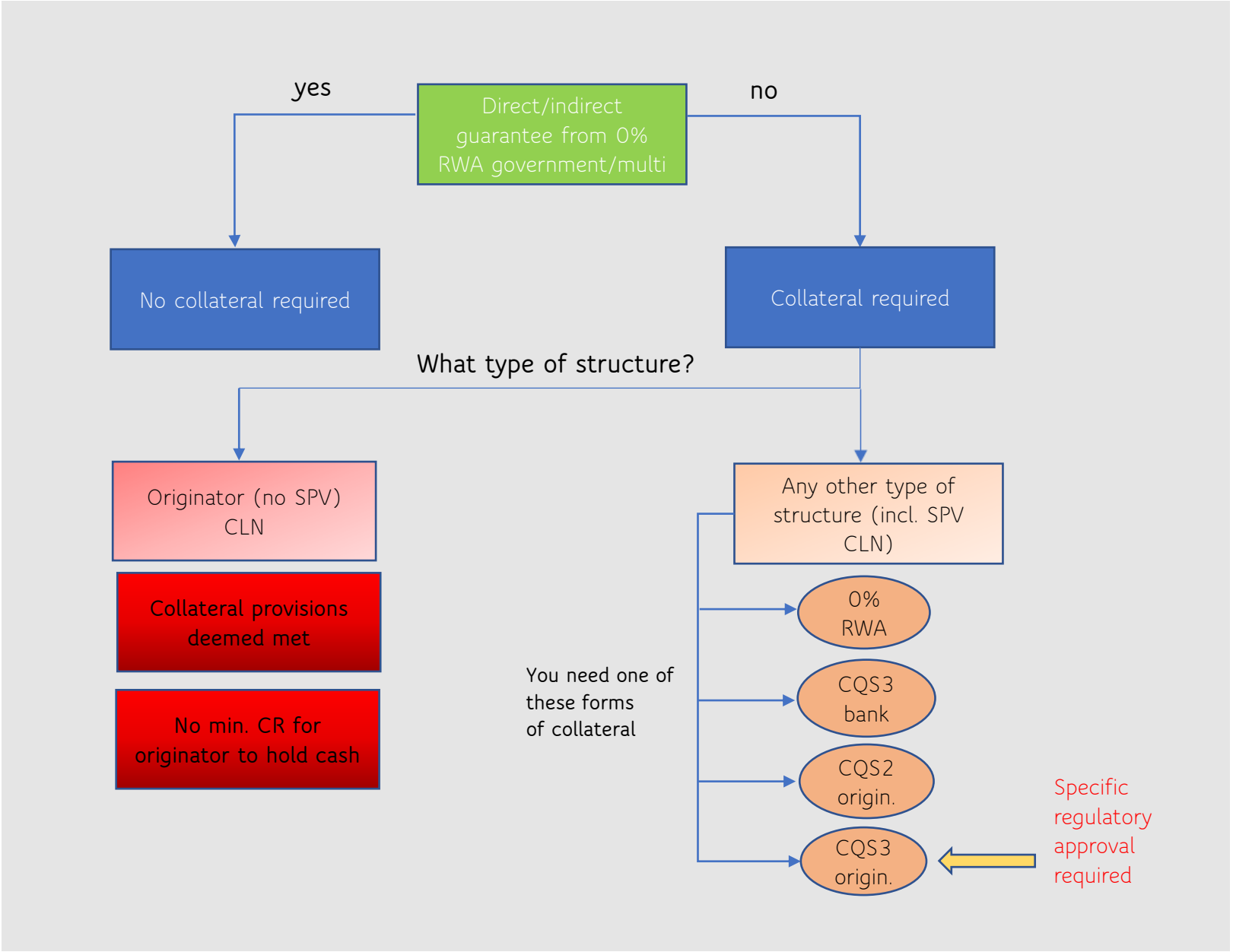
- Guarantees from 0% RWA entities
- Guarantees guaranteed by 0% RWA entities
- Guarantees **OR** credit derivatives **OR** CLN but only if collateralised

**SES can be used but**

- Fixed amount or percentage
- "use it or lose it" rule
- Must be equal to or less than one-year EL

# STS Regime

## Synthetic STS Collateral Requirements



# STS Regime

## Synthetic STS Still pending

**Homogeneity**

- The EBA has until 10th October to publish a draft RTS defining "homogeneity"
- The existing "true sale" Homogeneity RTS will be the starting point

**Pro-rata triggers**

- The EBA has until 30th June to publish a draft RTS on the specification and calibration of performance-related triggers

**Sustainable Disclosure**

- The ESAs have until 10th July to publish a draft RTS on the disclosure of sustainability information
- Only impacts a voluntary disclosure

**SES**

- The EBA will need to publish a draft amendment to the CRR to allocate capital to SES
- The level will crucially determine the feasibility of all synthetics using excess spread

**Green securitisation?**

- The EBA has until 1st November to publish a report on how to structure a Green securitisation framework.

# STS Regime

## Synthetic STS Grandfathering

- Article 43(a) 3 of the new regulation allows for synthetic transactions entered into before April 9th, 2021 to be STS
- To be grandfathered, the synthetic STS transaction must meet all the synthetic STS criteria
- Some criteria must have been met at the time of creation (26b. 1,2,3,4,5,7,8,9,11,12; 26c.1 and 3; 26e.1,2,3,6,7,8 and 9)
- Special rules exist for transactions that benefited from special treatment under the old article 270 of CRR (certain synthetic SME securitisations). Those transactions are automatically grandfathered as STS irrespective of whether they meet the new STS criteria

# STS Regime

## Synthetic STS Asset Verification Agents

- *A legislator's dilemma*: (a) even with savage potential sanctions the legislator did not fully trust banks to police their STS issuance (after 2007/2008) but the European regulators were not prepared to police the STS regime either and (b) the investors informed them in very strong terms that, if they had to perform a full due diligence on the STS status of securitisations (art.5.3), they would leave the market.
- To solve this double-bind the legislators created a new category of capital market participants: the third-party verification agent
- The role of the third-party verification agent is to verify independently the originator's certification of the STS status of its securitisation
- This provides comfort on the policing of the new regime *and* socializes the cost of investor due diligence as investors can base their article 5.3 due diligence on the work of a third-party verification agent.
- The intervention of a third-party verification agent is not mandatory

# STS Regime

## Synthetic STS Asset Verification Agents

- The Synthetic STS Regulation extends the use of regulated TPVs to synthetics
- Only an originator/protection buyer may hire the third-party verification agent
- TPVs are independent, subject to strict rules on conflicts of interest and regulated by national securities regulators
- A TPV's national based authorisation benefits from a passport allowing it to operate across the whole EU
- Warning: although the regulation unhelpfully uses the same "verification agent" wording for both types of actors, the TPVs have nothing to do with "Verification Agents" mentioned in the law as having to verify whether a payment is due from a protection seller

# STS Regime

## Synthetic STS Who benefits from a TPV?

| Who benefits from the intervention of a Third-Party Verification Agent? | |
|---|---|
| The regulators and legislators | By providing an oversight mechanism |
| | By reducing the risk of divergence between jurisdictions (since the STS criteria are national responsibilities) |
| The investors | By providing an STS report that may be used to fulfil investors' article 5.3 obligations |
| The originators | By providing them expert confirmation of their ESMA certification |
| | By providing them a defence against sanctions – as sanctions require negligence or misfeasance |

# STS Regime

## Synthetic STS STS Verification Agents

### Originator/Protection Buyer

- If the STS certification was made in error, the capital benefits will be removed
- If the regulator determines that the error was the result of negligence (or fraud) the originator/protection buyer can be subject to fines of up to 10% of worldwide turnover

### Investor/Protection Seller obligations

- Under article 5.3 (unamended for synthetics) an investor/protection seller must verify the STS status of any synthetic position that has been so certified even when the investor derives no benefit or has no interest in that STS status
- In fulfilling its article 5.3 due diligence obligation, an investor/protection seller cannot rely mechanistically on the originator/protection buyer's statements

STS Regime

Q&A

# Q&A


# Thank you for your attention

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