



October 28, 2022

Re: EBA Consultation Paper on Draft Regulatory Technical Standards on the homogeneity of the underlying exposures in STS securitisation

Response on behalf of IACPM Members

The International Association of Credit Portfolio Managers (IACPM) appreciates the opportunity to provide feedback on draft Regulatory Technical Standards on the homogeneity of the underlying exposures in STS securitisation.

The IACPM is a global industry association established in 2001 to further the practice of credit exposure management by providing an active forum for its member institutions to exchange ideas on topics of common interest.

The IACPM's institutional member firms comprise the world's largest financial institutions, and as such overlap the membership of several other financial industry associations. Our perspective is different, however, in that the IACPM represents the teams within those institutions who have responsibility for managing credit portfolios, including actively controlling concentrations, adding diversification, managing the return of the portfolio relative to the risk, and applying capital to new lending.

In this instance, the IACPM is responding on behalf of the synthetics market. Responses are focused on the impact of RTS on synthetic on-balance-sheet transactions, which are currently executed by banks primarily on portfolios of loans granted to SMEs and Corporates, as well as on asset-based or project finance, and don't use ABCP structures. We have responded only to the questions that are most relevant to our membership, which are questions 1, 2, 6, 7 & 9. For all other questions, the IACPM agrees with AFME's response letter.

The IACPM agree that banks which have a significant "large corporate" or "project finance" business have a dedicated credit underwriting and monitoring process, different from the credit process applicable to other business exposures (SMEs/Mid-Corporates). However, banks with no "large corporates" business do also grant loans to subsidiaries of "large corporates" which have a stand-alone SME profile as per the regulatory definition, and therefore use SME-related underwriting principles to grant and monitor loans that are securitised in mixed pools.

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, the IACPM and its members believe that homogeneity in the process of credit underwriting and risk management should be the key driver in the definition of homogeneity in a securitised portfolio. The credit risk management process includes risk assessment as well as monitoring and work-out processes. It will thereby achieve the intention of allowing homogeneously underwritten and managed enterprises to be grouped with either Retail (iii) or Corporates (iv).

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?

All of the members of the IACPM (banks and investors) firmly consider that the split between Large Corporates and SMEs based on consolidated turnover size is unnecessary” to ensure that investors perform robust due diligence and to facilitate the assessment of underlying risks”, as targeted by the homogeneity objective of the STS regulation at the level of each specific transaction. The definition of “type of obligor” should allow securitising a **mixed pool** of loans to SMEs, Mid-Corporates and Large Corporates irrespective of consolidated turnover size, as long as homogeneous principles of credit underwriting and risk management apply to all securitised assets.

From a survey performed by the IACPM early 2022 on on-balance sheet synthetic securitisations, it appeared that fifteen (15) STS transactions were issued between Q4 2020 and Q1 2022 by EU banks amounting to a total of EUR €36.4 billion in underlying loans. Of these 15 transactions, 14 had SME/mixed or corporates underlying assets. Mixed pool transactions, of which there were four trades totalling €6.4 billion in assets, are significant as they amounted to only slightly less than the 5 trades totalling €8.4 billion performed with SME pools only.

Another similar concern is also raised on the treatment of **Project Finance**. Investors with a high experience in project finance are particularly interested in the impact of the STS homogeneity requirements on the credit risk of their future investments. As project finance is not currently listed as a standalone category (like Large Corporates and SMEs are), the draft RTS is not clear on how project finance exposures will be treated in proposed STS securitizations:

- Will they be considered as “corporates” or *de facto* “Other”? How, then, will the subcategories of homogeneity apply to such exposures?
- Project finance borrowers can be either SPVs or big corporates and therefore potentially not homogenous by type of obligor using the definitions proposed in the draft RTS.
- The project finance pools which are efficient for investors are also often diverse in terms of geography. As a result, synthetic SRT transactions on pools of project finance loans would also not be able to satisfy homogeneity based on this criteria.

The draft RTS on homogeneity should take into account the increasing variety of asset classes that underlie on-balance sheet securitizations, as they cannot all be squarely categorized as either SMEs or big corporates.

Using underwriting criteria / risk management process as driver of homogeneity in the corporate exposure class would avoid the need for a standalone project finance bucket, for which there are neither jurisdiction nor asset type sub-requirements.

Based on our proposal,

- banks with a business and credit risk management process specific to Large Corporates will securitise in Large Corporates pool loans granted to all the borrowers belonging to such Large Corporates groups
- the same would apply to banks which have a specific business and risk management process for asset-based finance like project/infrastructure finance whatever the type of obligor, the size and the geography
- banks which don't have a business and credit risk management process specific to large corporates will securitise pools of loans granted to borrowers whatever their consolidated turnover.

As proposed in our response to Q6, we also suggest that the EBA could, if it considers necessary, make the approach articulated above whereby the main driver of homogeneity for corporate exposures is underwriting homogeneity conditional on additional **criteria**.

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

No, the IACPM considers that the grandfathering provisions should apply not only to outstanding STS ABCP and STS non-ABCP securitisations but also to outstanding STS on-balance sheet securitisations. Grandfathering is necessary so that on-balance sheet STS transactions that have already been notified to ESMA (or notified within the next year) remain compliant until the maturity date of the respective transaction, and not only for one year, because it is impossible to restructure existing STS synthetic transactions to suddenly be homogeneous under vastly different rules.

If the EBA continues to take the view that grandfathering is not allowed for synthetic on-balance sheet transactions (we note that others take the opposite view and consider that permanent grandfathering for synthetic on-balance sheet transactions is imperative to give effect to general principles of EU law including legal certainty, legitimate expectations, proportionality and the prohibition on retroactive secondary legislation), the IACPM and its members agree that application must be deferred as envisaged in Article 2. However, this deferred application should be long enough to ensure that as few transactions in the market as possible are impacted.

If there is no appropriate grandfathering nor longer deferred application date provided, we may

expect a wave of regulatory calls and negative impact on the capital that the European banks were able to release via ongoing STS on balance-sheet transactions.

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?

Yes, the IACPM suggests several aspects to be considered with regard to the homogeneity of the STS on-balance-sheet securitisations which have not yet been specified:

- Part of the rationale for the approach suggested above in relation to homogeneity for the corporate exposure class is avoiding the negative impact on transaction granularity/increase in concentration risk (where transactions remain viable at all) that would flow from the EBA's proposals.

Assuming all the loans in the underlying pool are defined in line with a single internal underwriting process, the EBA might consider to cap the overlap between "types of obligors", allowing up to X % (to be defined per transaction at origination) of the obligors in a pool with mostly one "type of obligor" to belong to another type. But this option is difficult to implement in practice and to comply with along the whole lifetime of a transaction.

- An amendment might be missing to Article 1(c) of the original RTS in the case that there is **no SSPE** in synthetic format

Commented [TJ1]: I took out "alternatively", as it's not an alternative anymore
I added that the % has to be defined per transaction at origination, as we will never find the right % valid for all banks and portfolios

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

- One severe unintended consequence is that, by **splitting between Large Corporates and SME obligor types based on consolidated revenue size and not based on underwriting and risk management principles**, banks which have no specific "large corporates" (CIB-type) activity would be forced to separately securitise their portfolios of loans to SMEs which belong - or not - to groups with annual sales higher than EUR €500 million. This constraint will in turn make securitisation much more difficult because of the limited size of their lending portfolio and force them to retain concentrations that would be mitigated by securitisation of mixed pools.
- Another important and severe unintended consequence would come from the absence of **grandfathering** for STS synthetic securitisations executed after approval of the new STS framework. Would the deferred application of the RTS not ensure existing STS deals are not impacted, many STS synthetic securitisations would lose their STS status after one year and affect the amount of capital released by banks on these deals. It does not make sense to provide for only one year of transition on existing transactions that were structured before the rules even existed. We ask here for a level playing field with traditional STS securitisations and implementation dates aligned with CRR3 implementation.

If you have any questions or would like additional information, please contact the undersigned.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Som-lok Leung". The signature is fluid and cursive, with a long horizontal stroke at the end.

Som-lok Leung

Executive Director
International Association of Credit Portfolio Managers