



October 14, 2022

Re: EBA Consultation Paper on Draft Regulatory Technical Standards on Exposure Value of Synthetic Excess Spread

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 Exposure Value of the Synthetic Excess Spread (SES EV).

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 banks, credit investors and credit insurers who have responsibility for managing credit portfolios, including actively controlling concentrations, adding diversification, managing the return of the portfolio relative to the risk, and releasing risk and capital to new lending growth.

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.

The IACPM strongly disagrees with the “full model approach” as well as the “simplified model approach” proposed by the EBA, because:

- Both proposed approaches breach the **one-year time horizon** principle which is the foundation of the capital requirements calculation in CRR prudential regulation.
The UIOLI SES of synthetic on balance-sheet transactions is designed and calibrated by issuing banks to cover the expected losses of the underlying portfolio, and capped at one year: would real losses exceed expected losses, the additional losses would impact the capital structure.
- They do not fully reflect the mandate and seem to one-sidedly focus on Article 248(1)(e)(iv), but ignores that – as highlighted in the Appendix:
 - The introduction specifies that “*excess spread shall include as applicable, the following: [...]*”
 - After item (iv), the regulation specifies that “*any amount of SES that is already subject to an own funds requirement shall not be included in the exposure value*”;

- EBA shall develop draft regulatory technical standards “*to specify how originator institutions are to determine the exposure value referred to in point (e) of paragraph 1, taking into account the relevant losses expected to be covered by the synthetic excess spread*”
- Both lifetime approaches conflict with the 1-year approaches within Basel, CRR and IFRS9, by creating an **inconsistency** between the proposed exposure value of SES – calculated on a multi-year horizon, and
 - Basel/CRR, calibrated on a 1-year approach (modifying the approach would require recalibration)
 - and
 - the offsetting accounting provisions in IFRS9 which, for a performing portfolio (stage 1), are calculated on one-year expected losses, deducted from earnings and available capital. IFRS9 Stage 1 provisions do reduce the capital charge for the securitisation originator, but if SES adds, as proposed, a charge similar to lifetime losses there will be a significant mismatch (for up to 5 years) which is not covered by IFRS9 Stage 1 provisions.

Neither Basel, CRR nor IFRS9 are designed to work with lifetime losses in normal circumstances. A consistent, multi-year approach is already part of SREP/ICAAP. If a lifetime analysis of securitisations is deemed necessary, it would be more robust to include it within the Pillar 2 rather than Pillar 1 analysis.

- The **scalar** is intended to match the calculation result obtained by the simplified model approach to the results obtained by the full model approach “plus X”, X being a margin of conservatism. However, this scalar (or rather one single scalar) would only work under overly simplified assumptions. Any change in the distribution of the losses for UIOLI SES would reduce the SES EV under the full model approach significantly, while it would be constant with the simplified model approach. Therefore the use of one scalar only results in significant gaps between the two approaches.
- The proposed approaches do not address the risk of **regulatory arbitrage** identified by the EBA. SES in synthetic securitisations is perceived at risk of arbitrage because the originator bank retains the senior tranche and therefore SES might be overstated by not recognising an adequate equivalent cost of funding for the retained senior tranche. This concern was lost in Regulation (EU) 2021/558 and therefore a useful discussion on how to evaluate and mitigate the risk of an overly generous SES is missing.
 However, on the contrary, the “full model approach” exacerbates this arbitrage risk, as it would only capitalise the amount of SES that the originator estimates to be used over time, irrespective of the committed amount. The committed excess spread could thereby be inflated to an unreasonably high amount, while the capital charge would still remain unchanged. (This is only an issue for non-STS deals, because in STS deals the SES is limited to the 1y EL).

Therefore, **any – even adjusted – approach based on lifetime deduction would make transactions uneconomic for capital release and redeployment into new lending**. It would imply a double counting of reserves, as the one-year expected losses are already counted in the bank credit provisions and deducted from the credit spread revenues of the underlying loans retained on balance-sheet.

Moreover, using a lifetime approach would also bring upfront and capitalize lifetime provisions, which imply an even more unfair double counting of reserves. The proposed approaches factually prohibit the use of SES, as most of the transactions with SES will become uneconomic.

To define a **capital charge for SES**, it is hopefully agreed from the above that UIOLI SES up to a level equal to annual EL at the time of origination should be considered as adequate and incur no capital charge.

We therefore advocate for an alternative approach based on a slight adaptation of the current supervisory practice (the “rolling window” approach proposed by the EBA, **whereby the SES exposure value would be calculated on a rolling basis as one year SES** (i.e., the SES committed for the next year). Article 248 (1)(d) of the CRR then allows for the **deduction of this credit exposure of credit provisions**.

Should credit provisions exceed the SES EV, the difference will be deducted from the junior tranche.

This approach has the following benefits, contrary to the two life-time based proposals:

- It is simple and clear : SES exposure value is estimated based on EL, while the capital structure covers UL,
- It cannot be arbitraged as it is not sensitive to model risk, and ensures homogeneity across all banks and JSTs,
- It allows investors who do not have the appetite to invest in first losses to use excess spread as a powerful tool to improve the pricing of the other tranches without adding additional credit enhancement,
- Transactions with SES calculated on a rolling basis would be economic for banks aiming at capital release and redeployment, and
- This approach will also be recommended by the EIF, the largest European investor in synthetic securitizations with synthetic excess spread.

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

Yours sincerely,



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Appendix - Regulatory text :

Amendments to Regulation (EU) No 575/2013

Regulation (EU) No 575/2013 is amended as follows:

(1)in **Article 242**, the following point is added:

‘(20)“synthetic excess spread” means a synthetic excess spread as defined in point (29) of Article 2 of Regulation (EU) 2017/2402.’;

(2)**Article 248** is amended as follows:

(a)in paragraph 1, the following point is added:

‘(e)the exposure value of a synthetic excess spread shall include, as applicable, the following:

- (i)any income from the securitised exposures already recognised by the originator institution in its income statement under the applicable accounting framework that the originator institution has contractually designated to the transaction as synthetic excess spread and that is still available to absorb losses;
- (ii)any synthetic excess spread that is contractually designated by the originator institution in any previous periods and that is still available to absorb losses;
- (iii)any synthetic excess spread that is contractually designated by the originator institution for the current period and that is still available to absorb losses;
- (iv)any synthetic excess spread contractually designated by the originator institution for future periods.

For the purposes of this point, any amount that is provided as collateral or credit enhancement in relation to the synthetic securitisation and that is already subject to an own funds requirement in accordance with this Chapter shall not be included in the exposure value.’;

(b)the following paragraph is added:

‘4. EBA shall develop draft regulatory technical standards to specify how originator institutions are to determine the exposure value referred to in point (e) of paragraph 1, taking into account the relevant losses expected to be covered by the synthetic excess spread. EBA shall submit those draft regulatory technical standards to the Commission by 10 October 2021. Power is delegated to the Commission to supplement this Regulation by adopting the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010.’;

(3)in Article 249(3), the first subparagraph is replaced by the following:

‘3. By way of derogation from paragraph 2 of this Article, the eligible providers of unfunded credit protection listed in point (g) of Article 201(1), shall have been assigned a credit assessment by a recognised ECAI which was credit quality step 2 or above at the time the credit protection was first recognised and is currently credit quality step 3 or above.’;

(4)in Article 256, the following paragraph is added:

‘6. For the purposes of calculating the attachment points (A) and detachment points (D) of a synthetic securitisation, the originator institution of the securitisation shall treat the exposure value of the securitisation position corresponding to synthetic excess spread referred to in point (e) of Article 248(1) as a tranche, and adjust the attachment points (A) and detachment points (D) of the other tranches it retains by adding that exposure value to the outstanding balance of the pool of underlying exposures in the securitisation. Institutions other than the originator institution shall not make this adjustment.’;