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UniCredit reply to the BCBS/IOSCO consultation paper on “Criteria for identifying simple, transparent and comparable securitizations”

UniCredit is a major international financial institution with strong roots in 17 European countries, active in approximately 50 markets, with almost 8,000 branches and over 130,000 employees. UniCredit is among the top market players in Italy, Austria, Poland, CEE and Germany.

Introduction

UniCredit has closely followed the work undertaken during the last two years by the Basel Committee on Banking Supervision (BCBS) to review the securitisation framework and has provided its input on both the public BCBS consultations of March 2013 and March 2014. UniCredit is also following with interest the work undertaken by the European competent authorities (European Commission, European Central Bank and European Banking Authority) to define regulatory, supervisory and operational frameworks for qualifying securitisations.

It is also worth noting that UniCredit has been leading and supporting the Prime Collateralised Securities (PCS) initiative since inception as well as being involved in the European Data Warehouse project, supported by the ECB. The PCS label has *de facto* introduced, with increasing market acceptance, a qualifying securitisation framework towards best market.

Main Highlights

UniCredit appreciates the effort undertaken by the BCBS in the “Revision to the Basel Securitisation Framework” (December 2014) to integrate **useful modifications** targeted in particular to: i) include as risk drivers the **tranche thickness and maturity**, and at the same time reduce the risk weights for tranches with longer maturities and ii) consider **guarantees by third parties** as risk mitigants that can therefore lead to lower capital requirements.

On the other hand, **UniCredit remains seriously concerned that the level of capital requirements**, despite some limited improvements envisaged in the December 2014, **are still unjustifiably penalizing** when considering historical default rates of securitisations, at least for what concerns the European markets.

The proposed BCBS framework is, therefore, likely to hamper the economic viability and effectiveness of European securitisation with potential detrimental effects on lending to the real economy. Hence, UniCredit welcomes the BCBS and IOSCO intention to identify and define criteria for simple, transparent and comparable securitisations. As a follow up to the above consultation, UniCredit invites the BCBS and IOSCO to:

- **evaluate the introduction of a specific regulatory treatment for “qualifying” securitizations** which would lead to a more reasonable calibration across tranches and, ultimately, to improve the economic viability of this category of securitisations;
- **liaise with the EBA and the European competent authorities** to work at international level in order to i) agree on a specific regulatory framework for qualifying securitisation and ii) ensure a level playing field in the adopted criteria;
- **liaise with the industry participants in the Prime Collateralised Securities (PCS)** initiative to benefit from users’ experience and seek advice on best market practices. PCS could also help in the

implementation of proper forms of certification for qualifying securitisations by private and independent third parties;

- **not to exclude a priori synthetic securitizations** from the framework for simple, transparent and comparable securitizations;
- perform, on a regular basis, a **peer review analysis on the level of adherence** of the various jurisdictions to the proposed criteria.

With reference to the idea of a specific regulatory treatment for “qualifying” securitizations, UniCredit is pleased to share the following suggestions:

- the **risk weight floor** for senior securitisations could be lowered to 10%, versus the current 15%;
- the issue of the **rating ceilings** could be addressed so as to further reduce the mechanistic reliance on external ratings;
- the prominent role given to the **Internal RBA is appreciated**. However, the possibility to **use** such an approach could be enhanced also for those assets which are well-performing but lack required data (e.g. legacy assets issued at a time when data requirements were different compared to current standards). At present, at least 95% of data must be available in order for a bank to apply the IRBA. UniCredit, therefore, suggests the introduction of a **waiver** for these types of assets and especially for granular pools, instead of switching to the more penalising Standardised Approach. The recourse to a Standardised Approach, in fact, is likely to particularly penalize SMEs and retail lending;
- **the calibration of the external rating based approach** shows some limited reductions for risk weights of different notes. For instance, AA- 5yr from 50% to 45%; BB- 5yr from 230% to 225%. These moves are helpful but continue to be overly restrictive and will limit the economic viability of certain securitisation transactions;
- it is suggested to also apply a reduction of the risk weight floor to 10% for qualifying **ABCPs**.

Answers to specific questions

Question 1: Do respondents agree that the criteria achieve the goals they aim to achieve? In particular, do respondents believe that the criteria could help investors to identify “simple”, “transparent” and “comparable” securitisations?

Answer 1

The BCBS and IOSCO consultation states that *“the aim of this exercise is to provide a basis for the industry and the regulatory community to identify certain features of securitisations which may indicate those securitisations that lend themselves to less complex analysis and therefore could contribute to building sustainable securitisation markets. The purpose of these criteria is not to serve as a substitute for investor due diligence but rather to identify and assist in the financial industry’s development of simple and transparent securitisations. These criteria are non-exhaustive and non-binding.”*

The BCBS and IOSCO also state that *“The proposed approach is a modular one: interested parties may complement these criteria with additional and/or more detailed criteria based on specific needs and applications. The criteria are not, of themselves, a prescription for regulatory action, and making recommendations for implementation of the criteria in regulation is out of the scope of this BCBS-IOSCO project. It is noted that the BCBS agreed at its September 2014 meeting to consider in 2015 how to incorporate the BCBS-IOSCO criteria, once finalised, into the securitisation capital framework.”*

UniCredit fully agrees that the proposed criteria should not substitute for investors' due diligence and believes that the criteria proposed contribute to the achievement of the stated goals. In addition, it is worth making a geographical distinction, highlighting the progress made in the European Union in this respect.

In the European Union, the importance of the securitisation role was stressed throughout 2014 by a series of statements, publications or actions supporting the need for a preferential regulatory treatment for "high-quality securitisation (HQS)" as a way forward for contributing to long-term financing of the economy. In April and May, the Bank of England-European Central Bank joint paper and the consultation were released. In October, after the ECOFIN in Milan, the ECB, the EU Commission and the EBA took important actions: the ECB announced the ABS Purchase Program, the Commission released two EU Delegated Acts introducing the concept of HQS in the EU legislative framework and the EBA launched a consultation for different regulatory treatment of simple, standard and transparent securitisations. Also, it should not be forgotten that the self-regulatory Prime Collateralised Securities (PCS) initiative, launched in November 2012 and led by UniCredit since inception, implemented a comparable HQS concept also with a view to influence the regulators to pursue a different regulatory treatment for this sector of the securitisation market.

Against this background, it is important that the BCBS and IOSCO criteria are aimed at ensuring a global level playing field, particularly with reference to the existing European framework.

In addition, **to build sustainable securitisation markets, the proposed criteria should be followed-up by a specific regulatory treatment for "qualifying" securitizations, i.e. those "simple", "transparent" and "comparable" securitisations.**

In case that the enforcement of a specific regulatory treatment in the short term is not viewed as appropriate given the diversified level of development in the securitisation markets across the globe, UniCredit would suggest a transparent **peer review**, which should be regularly performed by the BCBS and IOSCO. This would be of great help to: a) foster best market, b) help investors' decisions around the globe, c) highlight risks of unjustified unlevelled playing field.

Question 2:

Do respondents agree with the STC criteria set out in the annex of this paper? In particular, are they clear enough to allow for the development by the financial sector of simple, transparent and comparable securitisations? Or do respondents think they are too detailed as globally applicable criteria? The annex provides guidance on each criterion. Which additional criteria would respondents consider necessary, if any, and what additional provisions would be useful or necessary to support the use of the criteria? What are respondents' views on the "additional considerations" set out under some criteria in the annex? Should they become part of the criteria? Are there particular criteria that could hinder the development of sustainable securitisation markets due, for example, to the costliness of their implementation?

Answer 2

UniCredit believes that the proposed criteria are clear enough to allow for the development by the financial sector of simple, transparent and comparable securitisations, provided:

- a **specific regulatory treatment for "qualifying" securitizations** will be implemented;
- **an alignment with European standards will be ensured;**
- that ABCPs as well as **synthetic securitizations** are not excluded a priori from the framework for simple, transparent and comparable securitizations.

UniCredit suggests that the BSBC / IOSCO liaise with the EBA and the European competent authorities to work at international level in order to: i) agree on a specific regulatory framework for qualifying securitisation and ii) ensure level playing field in the adopted criteria.

Question 3

What are respondents' views on the state of short-term securitisation markets and the need for initiatives with involvement from public authorities? Do respondents consider useful the development of differentiating criteria for ABCP, in a manner similar to that of term securitisations? The BCBS and IOSCO would particularly welcome any data and descriptions illustrating the state of short-term securitisation markets by jurisdiction and the views of respondents on concrete comparable criteria that could be applied to short-term securitisations.

On ABCP

UniCredit welcomes the recognition that short-term securitisations (e.g. ABCP) are a key and integral part of the securitisation market. Specifically, the link to financing of the real economy is an important facet of ABCP programs in Europe, especially in the context of financing of trade receivables and loan / lease receivables .

As above stated in Answer 2, **UniCredit would invite BCBS and IOSCO to not exclude a priori ABCP and to liaise with the EBA and European Competent Authorities in the context of developing a high quality framework which would also include ABCPs** (particularly for programs funding e.g. trade and lease / auto receivables etc.).

UniCredit considers that requirements presented for true-sale securitisations would need to be slightly adjusted to enable ABCP's to be recognized as "qualifying" securitisations.

The relevance of ABCPs for the real economy

The significance of financing the real economy via ABCP can be highlighted by the following key points which were identified in a study by the True Sale Initiative (TSI) ("Securitisation of real economy receivables continues to gain importance – convincing volume growth and excellent performance of German transactions", September 2014). This study was based on information provided by six leading German sponsors of ABCP programs (including UniCredit) and represents approximately two thirds of the market for underlying transactions in ABCP in Germany (the latter amounts to a securitized volume of €12 billion in ABCP programs)¹:

- trade receivables financed via ABCP have increased in volumes over the last 4 years by circa 73 percent;
- lease receivables financed via ABCP have increased in volumes over the last 4 years by circa 53 percent;
- disclosed information and empirical analysis in the TSI study for German transactions indicated an outstanding performance of transactions with zero losses for the sponsoring banks and the ABCP investor. The TSI study covered a period between 2010 and 2014.

The limited risks of highly standardised ABCPs today

The following additional points are notable with respect to ABCPs, based also on the experience in the German ABCP market: the **expected loss** of the portfolio of underlying assets in the ABCP is by construction reduced thanks to the short-term maturity and the increasingly standardised features for diversification, granularity and security protection. The higher credit quality of ABCP transactions is empirically verified to result in minimal expected losses for sponsoring banks and investors. The expected losses would be generally lower for ABCP transactions when compared to Seller / Originator unsecured lending, (ABCP transactions are in UniCredit experience above investment grade);

- downward **rating migrations** for ABCP transactions are not significant, reflecting the intrinsic quality of portfolio and the efficacy of the structural and credit enhancements protections;
- the experience of real economy assets financed via ABCP is based on **standardized strict eligibility criteria** for the underlying assets in the portfolios which are granular and typically revolving due to the short-term nature of

¹ According to Dealogic Data, European ABCP issuance in Q3 2014 was €68.7 billion. On a year on year basis this represents a growth of 27.2 %.

the assets. The portfolios' credit enhancement protections include Originator/Seller retention (same 5% rule as in the case of true-sale securitisation) of a dynamic first loss (i.e. typical standard credit enhancement structure given the fluctuating amount of financing for trade receivable) as well as a significant over collateralisation; - finally, underlying transactions in **ABCP programs are now exclusively customer – driven** and not arbitrage driven. This fact is a key difference from the pre-crisis situation.

Other benefits of including qualifying ABCPs within the BCBS dedicated framework

UniCredit notes that ABCP transactions are critical for the “real economy”, because they provide entities with limited market access with more favorable financing terms as well as increased diversity of funding sources through economic cycles.

As a result, UniCredit is of the view that the inclusion of qualifying ABCP transactions within a framework for qualifying securitisations is important and the application of criteria for simple, transparent and comparable securitisations is imperative as it would: a) ensure consistency across securitisation funding structures , b) facilitate the continuing development of ABCP as a mean to finance the real economy and c) re-state and ensure the high quality nature of underlying ABCP transactions.

Some suggestions for the harmonized criteria for the BCBS dedicated framework

UniCredit provides **some high-level initial views for the development of harmonized criteria pertaining to ABCP**, taking into account relevant matters with respect to: a) underlying assets / transactions b) ABCP program features and c) investor issues and disclosures (these should cover the key risks in the securitisation process).

1. Identifying the scope

ABCP transactions, which include trade receivables, auto loans/leases and lease receivable transactions, are a cost efficient means of financing which allows a wider group of originators to access funds through securitisations of short-term assets/SME obligations. Typically, these transactions may involve an SPV which purchases underlying receivables and issues ABCP to finance those receivables, or an SPV purchasing underlying receivables, issuing a debt instrument which in turn is financed / purchased by an SPV which issues ABCP.

2. Alignment of Interests (regulatory requirement applicable also to term securitisations)

Underlying ABCP transactions are subject to so-called 5% Retention Rule ruled in the EU Capital Requirements Regulation (CRR). In this respect, underlying transaction structures and tranching technique comply with Article 405 of the EU CRR - whereby the originator retains at least 5% of the tranching risks.

3. On the underlying assets

a. Level playing field on the nature of the Assets (specific to ABCP)

In fully supported ABCP programs, the sponsor bank bears the risk on the underlying transaction via liquidity facilities while the investors in ABCP are exposed primarily and fully to the risk of the sponsor bank itself. This gives enormous simplicity to the analysis of the investment.

As a consequence, any eligibility criteria for selecting the underlying assets in the portfolio shall be applicable to the originators, regardless whether the credit risk takers are investors or other third parties (i.e. guarantors and / or sponsors / liquidity facility providers). This would enable fully supported ABCP programs to fulfil the criteria even if the various pools of such multi-seller programs stem from different originators, asset classes, currencies and legal systems.

In partially supported ABCP programs, investors are reliant on timely payment due to the liquidity facilities. In addition, any “program level credit enhancement” protects the investors from a credit loss over and above those protection mechanisms afforded by the structural features and credit/liquidity enhancements of the underlying transactions.

b. Asset homogeneity criterion (similar as in term securitisation)

The homogeneity criterion for trade and leasing pools of real economy originators shall be deemed met if the asset type is uniform and if any material risks resulting from currency mismatches or different legal systems are covered by adequate measures (such as Forex hedging, guarantee or legal opinions). In EU such criterion should be deemed fulfilled if the securitisation meets the requirement under Art. 13 (2) (g) of the EU Commission Delegated Act from 10/10/2014 (High Quality Liquid Asset HQLA definition).

c. Asset combination criterion (specific to ABCP)

Based on market experience in the auto loan / auto lease and lease securitizations, it is also standard market practice to combine assets from both corporate and retail borrowers in underlying asset portfolios.

To ensure economic viability and create sufficient volumes, the dedicated ABCP framework shall be designed so that it is possible to build eligible diversified portfolios with assets comprising of different currencies and obligors from different jurisdictions, including pan-European countries, subject to the compliance with securitisation laws (e.g. true sale aspects).

d. Assets' interest rate criterion (specific to ABCP)

UniCredit recognizes the need to adopt market-based reference rates but it is neither possible nor appropriate to create a criterion merely based on market interest rates without substantial adjustments.

Firstly, UniCredit notes that a significant percentage of ABCP underlying assets are auto loan and leases which are commonly subsidized by originators. Adjustments to market interest rates, therefore, should be allowed for these assets through the discount rate applied to such asset flows (typically also discounted to bring the yield to a market level).

Secondly, given the short-term nature of ABCP investments, ABCP transactions commonly have a reference to cost of funds of the ABCP program (whose components are not linked directly to a market-based reference rate) and this market feature should be expressly allowed.

e. Asset selection and transfer (specific to ABCP)

Underlying ABCP transactions are commonly structured to enable revolving pools of receivables to be financed. In other words, additional assets may be transferred to replace maturing receivables or to replace ineligible receivables. Requirements shall focus on several aspects including inter alia the obligors, the individual assets and overall portfolio characteristics. The process of asset selection for term and ABCP securitisations is similar. This activity should not be considered active management on a discretionary basis. Revolving periods typically include provisions for appropriate early amortisation events and/or revolving period termination triggers based on: a) a deterioration in the credit quality of the underlying assets and b) the occurrence of an insolvency-related event with regards to the originator or the servicer. Since originators generally are not obligated to transfer eligible assets into an underlying securitisation, ABCP transactions should enable the financing of fluctuating amounts of receivables. This is commonly the case in trade receivables securitisations.

f. Asset true sale and enforceability (similar as in term securitisation)

Similar to term securitisations, ABCP transactions also adhere to the principles of true sale and have the same enforceability of the underlying assets, and reflect the same differences and impediments in jurisdictions e.g. equitable assignment, notification, transfer taxes etc. UniCredit is of view that a criterion defined around Art. 13 (2) and (d) of the EU Commission Delegated Act from 10 October 2014 (the HQLA definition) should address these jurisdictional differences.

g. Asset performance history, initial and ongoing data (specific to ABCP)

Given the nature of fully supported ABCP programs, the sponsoring banks rather than investors primarily assume the credit risk on the underlying assets. Therefore, the type of required information should be designed so as to meet the supporting banks needs rather than those of the investor.

It is worth noting that ABCP investors are provided information on materially relevant data with respect to the credit quality and performance of underlying assets. ABCP programs provide reports on a pool-by-pool

basis providing asset description, performance, compliance with triggers and credit enhancement. Furthermore, bank supported ABCP program provide information regarding the nature of the full support by the sponsor bank. As a result of the ongoing changes in ABCP programs (additions/removals of pools, permanent replenishment in each pool) and the coverage (at least 100% through liquidity support by the sponsor bank), historical data of single pools is neither practically available from the companies nor relevant for ABCP investors.

4. Payment features

a. Payment Status

As a standard matter, requirements for transferring assets in underlying transactions shall include the requirement for representations and warranties made by the originator that assets being transferred are not subject to any condition or encumbrance that can be foreseen to adversely affect enforceability in respect of collections due.

As for trade receivables from a corporate originator, requirements shall allow for the inclusion of receivables which are usually subject to dilutions (e.g. credit notes, rebates, customer discounts) that are ordinarily part of the original lender's business. As such the criterion should be deemed to be fulfilled if the securitisation meets the requirement under Art. 13 (2) (i) and (j) of the EU delegated act from 10/10/2014 (HQLA definition).

As for trade/lease receivable transfers from an originator or an underlying obligor, such transfers should only be referred to as credit-impaired if the originator has positive knowledge of circumstances that make it highly unlikely that the borrower will be able to pay its obligation in full. It should also be taken into account that trade receivables often receive credit support that covers losses by a commercial credit insurance company. It is also generally common market practice to include a seasoning based criteria in securitisations. This should not apply, however, for certain asset classes in particular trade receivables, overdrafts and credit cards.

b. Payment Priorities and observability

UniCredit observes that a criterion based on payment priorities and observability as outlined in the Annex should be modified as ABCP investors should rely on the liquidity facility providers for repayment in a timely manner and as such not suffer unexpected repayment profiles.

5. Currency and interest rate asset to manage liability mismatches

In ABCP programs and underlying transactions, the use of derivatives to hedge market related risks is a standard and well-functioning practice. Requirements shall **allow the possibility to use derivatives for hedging purposes**.

6. Cash-flow modelling and reporting

ABCP programs have constantly changing assets and liabilities.

UniCredit would suggest that **cash-flow models and statements should not be obligatory**. Any reporting of cash flow information should be made in a reasonable and sufficient manner to enable the investor to have a clear picture of all materially relevant aspects regarding the risk position or investment. In particular, in fully supported multi-seller ABCP programs with trade or lease receivables from various real economy companies, certain data may be kept confidential subject to the provision to investors of information memoranda and reporting with all materially relevant information for assessing the risk position of the investor.

It is also important to note that, given the fully supported nature of most ABCP programs, from an investor perspective this creates simplicity and therefore **cash-flow modeling should not be a requirement**.

7. Documentation disclosure and confidentiality issues

Unless publicly offered or listed, ABCP programs and the underlying typically bilateral transactions shall not be subject to the Prospectus Directive. Any information memorandum (or similar document) should be

satisfactory if it contains materially similar information to that which would be required under the Prospectus Directive.

Any formal requirement to create a prospectus in underlying transactions would have negative impact on the economic viability of ABCP used by smaller originators.

Where investors rely on the support of a third party, they may only be entitled to request documentation that is materially relevant to understand the risk position and profile. Such reasonable requests for information should not breach the confidentiality of the originators and other third parties.

For the securitisation of inter alia , trade and lease receivables, the relevant originator / credit institution may contractually define ex-ante which information is to be protected as business secrets and whether there is information that may be disclosed. In fact, even where a disclosure is legally possible, disclosure could require the release of confidential portfolio data which, when combined with the name of the originator, could allow competitors of the company to extract or have access to sensitive data (such as payment terms accepted by the company, distribution of the customer base (e.g. high turnover/low turnover), etc.).

On Synthetic Securitisation

From UniCredit's experience, the technique **of synthetic securitisation** offers significant added value in the bank management of risk and capital. In Italy, for instance, this is evidenced through the positive experience with so called "tranché cover" which represents an important risk-sharing and credit risk mitigation instrument. In fact, in a "tranché cover", credit protection is directly bought from investors, in the form of a financial guarantee backed by cash collateral or personal (direct/unfunded) guarantees as credit enhancement, without issuing notes and tranching the underlying portfolio using the Supervisory Formula Approach (SFA). This structure can also cover the risk of a new origination portfolio, hence facilitating new securitizations, which, in turn, would provide substantial new lending to the real economy. In this case, the underlying portfolio is built under certain assumptions (rating distribution, geographical area, sector concentration) pre-agreed between the bank and the "protection provider".

This instrument ensures also certain degree of flexibility (e.g. no need to create a Securitisation Special Purpose Entity (SSPE), no need to sell the underlying loans, no need to issue notes). Moreover, in the new regulatory environment, where capital costs have substantially increased to supervised entities given the additional regulatory requirements, any financial instrument is very "sensitive" to regulatory changes. International financial institutions or standard setters which include or exclude certain forms of synthetic securitizations from its consideration have therefore the potential of affecting the economic viability and incentives for lenders to deploy new lending and for investors to share aggregated credit risk, with a positive impact on financial stability.

Based on these considerations and the positive experience with the "tranché cover" technique, UniCredit strongly believes that **synthetic securitizations should not be excluded a priori from the framework for simple, transparent and comparable securitizations**. Rather, UniCredit suggests to identify an framework **specific** where synthetic securitizations **shall be subject to the following high-level conditions, to be subsequently elaborated into eligibility criteria:**

Simplicity

a. Simple legal framework

HQS Synthetic securitizations shall be structured without the need of a SPV, using simple structures and contractual frameworks (financial guarantee fully funded or unfunded if the protection provider is a Supranational Entity). For example, "tranché cover" transactions are characterized by features that ensure simplicity of transaction documentation which may consist of one single contract constituted by no

more than 20 pages.

b. Simple alignment of interest

HQS synthetic securitizations shall be subject to the retention rule, under which the originator, the sponsor or the original lender has explicitly disclosed that it will retain a material net economic interest of at least 5% (the “Requirement for Retention”) all tranches according to current regulation (Regulation (EU) No 575/2013 and Bank of Italy, Circular 285).

c. Portfolio held by the originator

In order to ensure that synthetic SST securitisations are not solely arbitrage products, the reference portfolio shall be held by the originator (with the above mentioned requirement for retention). This is to avoid so called “gaming” and “model optimisation” that also emerged in the re-securitisation segment before the financial crisis.

d. Same asset rules as for true sale

Rules pertaining to the assets being securitised in “true sale” transactions would also apply to assets in synthetic securitisations.

e. Simple cascading of investor losses

HQS synthetic securitizations shall deploy a simple and sequential process of amortization of the tranches. The amortization should affect firstly the senior tranches and after that, when the senior is repaid, the mezzanine and after the junior.

f. No dependence on rating agencies

HQS synthetic securitizations originated by banks applying the Advanced Internal Rating Approach (AIRB) may perform tranching using the Supervisory Formula Approach set forth by regulation, therefore, eliminating external dependence on credit ratings.

g. No hampering of investors rights and contractual recourse to assets

HQS synthetic securitizations shall ensure that investor rights are safeguarded and pre-agreed between the parties; investors shall be granted i) the right to appoint a verification agent, ii) subrogation rights as well as iii) the possibility to have the recourse on assets in case of default of the originator, if these conditions have been *a priori* contractually agreed;

h. Simple recourse to safe guarantees

HQS synthetic securitizations shall ensure that guarantees are provided by protection sellers, so that they may be triggered quickly upon the occurrence of a credit event, which has to be clearly and univocally defined.

i. No counterparty risk

HQS synthetic securitizations shall ensure that guarantees provided by protection sellers are fully cash-collateralized and, therefore, bear no counterparty risk from the perspective of the protection buyer (i.e. the bank). Personal guarantees should be provided by Supranational entities.

Transparency

a. Before the execution of the transaction

In order to meet the transparency principle of the HQS definition, synthetic securitisations shall include an extensive due diligence during which the bank provides all the engaged counterparties, which have previously signed Non-Disclosure Agreement (NDAs), with a pre-defined minimum set of information regarding:

- the underlying loan portfolio
- detailed information regarding its credit policies and
- detailed information regarding **credit risk parameters**.

b. Following the execution of a transaction

HQS synthetic securitizations shall:

- provide detailed investor regular reports which shall contain all information about portfolio performance;
- provide the same data package to the new eligible investor, if current investors/noteholders decide to trade their synthetic securitization exposures on the secondary market.

Comparability/Standardisation

Since the inception of the **synthetic securitisation market** more than a decade ago, the structural features have moved from the initial phase of a completely bespoke nature (bilateral negotiations between the parties within the limits set by the European regulatory framework) to a more mature phase, also reflecting the market reaction to the financial crisis.

At present, certain structural aspects are widely accepted by market participants and can be deemed as market standard in accordance with industry best practice.

In order to consolidate this market progress towards standardisation, **the transaction documentation of HQS synthetic securitizations shall:**

- clearly specify the cascading of investor losses, avoiding mechanisms that prevent charging of losses to most junior tranches;
- clearly define the amortization payment priority, whereby the seniority of the tranches determines the sequential order of payments;
- be written or approved by an external counterparty (i.e. external auditors) in order to manage the potential conflict of interests among all the investors and the originator.

If these conditions are met for the three above principles, qualifying synthetic securitizations can be defined as meeting the “standard” principle of the HQS synthetic securitisation.

In order to further support the BCBS and IOSCO in their analysis, UniCredit reports below the **main objections² which have been raised by the European Commission on synthetic securitization** for their recognition as high quality securitisations. For each objection, UniCredit provides its viewpoint.

1. Complex

Synthetic securitizations are often structured without the need of a SPV, using a simple contractual framework. For example, “tranching cover” transactions are characterized by specific features that ensure

² The EU Commission expressed objections to the inclusion of synthetic securitisation in the High Quality Liquid Assets definition for the Liquidity Coverage Ratio (see FAQ for delegated acts http://europa.eu/rapid/press-release_MEMO-14-579_en.htm?locale=en). In section 26.1.2. , it is stated that “re-securitisations are explicitly excluded [from high quality liquid assets], as they are **[1] typically complex** and **[2] less transparent structures**, where the **[3] cascading of investor losses is very difficult to understand** due to re-tranching. The same goes for **synthetic securitisations**, where the underlying exposures are not transferred to the special purpose vehicle. Instead, the transfer of risk is achieved by the use of credit derivatives or guarantees, while the exposures being securitised remain with the originator. The transfer of the assets to be securitised ensures that securitisation investors have recourse to those assets should the Securitisation Special Purpose Entity (SSPE) not fulfil its payment obligations. **[4] Such recourse cannot be granted in synthetic transactions**, due to the fact that only the credit risk associated with the underlying assets, rather than the ownership of such assets, is transferred to the SSPE. Such a structure also **[5] adds counterparty risk on derivatives or guarantees**, and **[6] hampers investors' rights to the proceeds of the underlying exposures**. In addition, most synthetic structures add to the complexity of the securitisation in terms of **[7] risk modelling**”.

simplicity of transaction documentation which may consist of one single contract constituted by no more than 20 pages. Correspondingly, the relevant underlying assets may consist of loan assets such as SME loans which are critically important to the European economy. Synthetic securitizations are also characterized by the absence of an active portfolio management on a discretionary basis and/or the absence a “cherry picking” practice.

Generally speaking, transaction complexity is unrelated to the fact that a transaction is synthetic. Synthetic transactions are a means of transferring risk and are not different from other forms of securitisation.

2. Less transparent

UniCredit believes that regardless of their private and bespoke nature, synthetic securitizations can still be considered transparent for the following reasons:

- Synthetic securitization process typically includes an **extensive due diligence** during which the bank provides all engaged counterparties, who have previously signed Non-Disclosure Agreements (NDA), with necessary information not only regarding the **underlying loan portfolio** but also detailed information regarding its **credit policies** and disclosure regarding **credit risk modelling**.
- **Ongoing transparency** is also ensured in the form of detailed investor reports, containing all information about portfolio performance.
- If investors/noteholders decide to trade their synthetic securitization exposures on the **secondary market**, UniCredit will, subject to similar NDA commitments, provide the same data package to the new eligible investor as the one that was provided to the original investor.

3. Investor losses difficult to understand

This is untrue because the transaction documentation clearly specifies the cascading of investor losses and more recent transactions avoid mechanisms that prevent charging the losses to the most junior tranches. In fact, the market and the current legislative framework discourage the creation of very complex transactions.

4. Recourse cannot be granted

This is untrue because it is possible to have the recourse on assets in case of default of the originator, if contractually agreed.

5. Additional counterparty risk

This is untrue because in some cases, from an originator point of view, the counterparty risk is minimal: guarantees provided by protection sellers can be called quickly upon the occurrence of a credit event, considering that they are typically fully **cash-collateralized** and therefore bear no counterparty risk for the bank/originator. In addition, as noted above, security interest and segregation may in fact be features of synthetic transactions so originator risk/exposure may be no different in a synthetic transaction than more conventional structures.

6. Hampering of investor's rights

Investor's rights are safeguarded and pre-agreed between the parties of a synthetic transaction; typically an external auditor is appointed for the benefit of the investors. Investor's rights are specifically defined in transaction documents and structures, regardless whether they are synthetic or otherwise.

7. Additional risk modelling

This is untrue. Synthetic securitizations can be, and generally are, structured in a simple and transparent way. They are often structured as private transactions in the form of “tranching cover” e.g. whereby credit protection is directly bought by investors as a financial guarantee backed by cash collateral or personal guarantee as credit enhancement without issuing any notes. This structure ensures some advantages and a certain degree of convenience in comparison to traditional securitizations (e.g. no need to create a SSPE,

no need to sell the underlying loans, no need to issue notes).

Modelling requirements are generally defined by the structures and the underlying assets of transactions rather than their synthetic nature.

Question 4

What are respondents' views on the level of standardisation of securitisation transactions' documentation? Would some minimum level of standardisation of prospectuses, investor reports and key transaction terms be beneficial? Do respondents think there are other areas that could benefit from more standardisation? Would a standardised template including where to find the relevant information in the prospectus be helpful? The BCBS and IOSCO would particularly welcome a description, by jurisdiction, of the extent to which different elements of initial documentation are standardised.

As for the other areas that could benefit from more standardisation and some relevant information that could be included in the standardised template, please refer to reply to question 3 and specifically the section dedicated to synthetic securitisation.

Main Contributors

Please find below the list of the key areas involved in this work, whose contribution made possible to coordinate and provide UniCredit answers to this Consultation. Some other have been involved alongside the UniCredit Group, but are not listed below.

Coordination Team

European and Regulatory Affairs - Public Affairs

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