Setting the standard
for securitisation

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Dear EBA Team

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Consultation on draft Guidelines on the STS criteria for on-balance-sheet securitisations (EBA/CP/2023/09)

PCS would like to thank the EBA for this opportunity to comment on the proposed new guidelines for on-balance-sheet STS securitisations.

Our comments are set out below.

Requirements related to simplicity (Article 26b)

Requirements on the originator (Article 26b(1))

Q1. Do you agree that it is not necessary to further specify this criterion? If not, please provide reference to the aspects that require such further specification. For example, should additional interpretations of the term 'no less stringent policies' or 'comparable exposures' be provided and if yes, how are these terms understood in securitisation practice?

Broadly, PCS agrees that this criterion does not require, save for the single comment below, any additional guidance. Specifically, the expressions "no less stringent policies" or "comparable exposures" have not, in practice, caused difficulties.

The sole comment we have is whether a branch operating in the EU of a bank that is not authorised in the EU can be an "originator" in its capacity as a branch. In our opinion this should be answered in the positive since a "branch" is an entity for regulatory purposes. This is relevant since the "originator" of an STS transaction must, under article 18 of the Securitisation Regulation, be in the European Union. In examining this question, one turns to the purpose of the article 18 requirement, which PCS believes to be that EU regulatory benefits (such as STS status) must be subject to EU regulatory oversight and enforcement. A branch of a non-EU banking institution within the European Union is subject to such oversight and enforcement. Allowing such a "branch"

to be an “originator” therefore appears to meet both the technical requirement of being an “entity that is authorised or licenced in the Union” and the spirit of the rule.

There would be benefit though in a guideline confirming this analysis.

Origination as part of the core business activity of the originator (Article 26b(2))

Q2. Do you agree that it is not necessary to further specify this criterion? If not, please provide reference to the aspects that require such further specification. Please substantiate your reasoning.

We agree that it is not necessary to further specify this criterion.

Exposures held on the balance sheet (Article 26b(3))

Q3. Do you agree that it is not necessary to further specify this criterion? If not, please provide reference to the aspects that require such further specification. Please substantiate your reasoning.

The expression “balance sheet” could refer to the regulatory balance sheet or the accounting balance sheet. It seems clear both from the intent of the amendments to the Securitisation Regulation which opened STS status to synthetic securitisations and the purpose of synthetic securitisations that the focus of the legislation is on the capital regulatory balance sheet. In other words, the assets are “on the originator’s balance sheet” if they are included in that originator’s RWAs for the purpose of calculating that entity’s required minimum capital under the Capital Requirement Regulation.

However, some degree of discomfort with this criterion has been expressed by competent authorities and market participants in cases where the relevant assets have been disposed of or encumbered notwithstanding that they remain on the relevant entity’s regulatory capital balance sheet. This occurs, for example, when:

- The assets have been sold to an SSPE as part of a true sale securitisation for which no SRT benefit is sought and where the SSPE is consolidated into the regulatory balance sheet of the originator;
- The assets are incorporated in the cover pool of a covered bond;
- The assets have been transferred as part of a repo transaction (for example to a central bank).

It would therefore be useful if the guidelines were to clarify that the only relevant “balance sheet” for the purpose of article26b(3) is the regulatory capital balance sheet. It would also be helpful if the guidelines specifically mentioned the cases

set out above and confirmed that these were compatible with meeting this STS criterion.

No double hedging (Article 26b(4))

Q4. Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

We agree with the interpretations provided.

PCS also believes that there would be benefit in clarifying the treatment of state guarantee schemes which sometimes cover securitised assets.

The purpose of this article is to ensure that STS is only available to institutions seeking genuine insurance against credit loss. In other words, where the securitisation compensates the institution for an actual loss. By prohibiting double hedging, the criterion prevents an institution from writing multiples hedges against the same asset so that a default results in income to the originator in excess of its loss, in effect, allowing it to turn its defaulted receivables into a profit centre. Such potential profit would transform the synthetic securitisation from credit protection into an arbitraged bet on defaults.

In cases where securitised assets are covered by state guarantee schemes, we believe these schemes should be treated for the purposes of STS as guarantees of the underlying debtors – which are allowed in STS – and not as additional hedging ***provided always and only provided that the documentation explicitly deducts any amount paid under such schemes from the quantification of the loss compensated by the protection seller.*** If that is indeed the case, any "profit" for the originator in addition to pure loss compensation is prohibited. This would align with the spirit of the rule.

PCS believes that confirmation of this approach would be useful.

Credit risk mitigation rules (Article 26b(5))

Q5. Do you agree that it is not necessary to further specify this criterion? If not, please provide reference to the aspects that require such further specification. Please substantiate your reasoning.

PCS agrees that it is not necessary to further specify this criterion.

Representations and warranties (Article 26b(6))

Q6. Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

PCS notes the very helpful commentary appearing on page 10, paragraph 15 of the explanatory text in the Consultation. We suggest that this text should be repeated in the guidelines to avoid any concern that its failure to appear in the guidelines themselves should be interpreted negatively or raise queries.

The status of the information sources listed in paragraph 119 of the proposed guidelines was not clear to PCS. Was this meant to be an exclusive list of sources that would be allowed for originators to meet their obligations under the representations' criterion? It would seem odd to restrict in this manner an originator's "allowable" knowledge if it can make the representation in good faith based on knowledge it has acquired elsewhere. If such restriction was not intended, then we suggest that the EBA indicate that this list is not exclusive.

With respect to 26b(6)(a) – we refer to our response to Question 3. We think the intent of the level 1 text is to ensure that the assets are owned by an entity in the regulatory group. This view is strengthened by the requirements set out in 26b(6)(b). It would therefore be helpful if the EBA clarified that, in 26b(6)(a), "group" was to be defined by reference to the CRR consolidated group and not to formal legal ownership of shares or accountancy standards.

With respect to 26b(6)(a), the expression "full legal and valid title" could benefit from interpretation. This is a common problem with the interpretation of European level 1 regulations: the regulation will use what appears to be a legal term of art, such as "sale", "security", "guarantee", "perfection of legal title" and, in this case, "full legal and valid title". National lawyers tend to give these terms the meaning given to them under their local legal regime. Since these regimes are substantially different across the 27 member states, such local interpretation can result in an EU regulation, rather than harmonising the European legal regime, fracturing it further. This is clearly the reverse of the intent of the co-legislators. This is why, in PCS' view, the better approach is for regulatory authorities, using their powers to write guidelines, to provide a description of what the legal term of art intends ***in the context of the relevant regulation*** and allow local jurists to interpret which local law term best transcribes that description. This seems to be the case here where "full legal and valid title" will cover different concepts in different member states. In some, the expression may even be legally meaningless.

Turning to the intent of the legislation, it seems that this representation is another way to avoid arbitrage transactions. This intent would be met if the guidelines specified that the expression means that the originator (or a group company) has a right of ownership or the right to demand ownership of the exposure and its ancillary rights. This description would clearly cover situations where an originator has equitable but not legal title as defined in Irish law, or where the originator has proffered the assets as repo collateral or as collateral under a legal regime where such collateral implies a legal transfer of title subject to a right of redemption.

The expression "when an underlying exposure is included in the securitised portfolio" could benefit from guideline clarification. This expression is probably derived from "true sale" securitisation when exposures are legally sold to a

vehicle. In the case of synthetics, of course, no such sale occurs and so the expression must be given its most sensible definition in line with the intent of the legislation. As a practical matter and by market practice, representations are given as of a date prior to the protection coming into effect when the originator checks the eligibility criteria against its internal data. The pool that is defined on that date is the pool the protection sellers agree to cover. In that sense, it is the moment an exposure is "included in the securitised portfolio". This date is called "the cut-off date". PCS would therefore recommend that the EBA confirm this interpretation in the guidelines.

Rather oddly, some representations are required to be made as of the date the exposure is included in the securitised portfolio, but others have no date. This could cause some issues when PCS verifies this criterion is met were the originator to propose a date far in the past which felt abusive of the intent of the legislation. It would therefore be useful if the EBA's guidelines gave some guidance on the point, eg by specifying that all the representations should be made as of a date no earlier than the cut-off date.

Eligibility criteria, active portfolio management (Article 26b(7))

Q7. Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

PCS agrees with the proposals in paragraphs 122 to 126, although we are not entirely clear what the EBA was seeking to achieve with paragraph 125 as it did not seem to us to add anything to the original level 1 text.

PCS would also welcome clarification in respect of what we see as an ambiguity in the level 1 text. Based on the intent and the context, we assume that: "…subject to an amendment that is not credit driven, such as refinancing or restructuring" should be read as "subject to an amendment*, such as refinancing or restructuring,* that is not credit driven". In other words, "refinancing" and "restructuring" are examples of amendments that are permissible provided such refinancing or restructuring is not credit driven. The original text, as a matter of the English language, allows both but this interpretation seems to the be what the co-legislators intended.

PCS is aware that other respondents to this consultation are thinking of asking the EBA to add additional non-credit related asset removal circumstances as cases that are not considered to be active portfolio management. Although PCS has no objections to lengthening the list, we also do not see this as essential.

Homogeneity, obligations of the underlying exposures, periodic payment streams, no transferable securities (Article 26b(8))

Q8. Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

PCS agrees with the proposals in paragraphs 127 and 128.

In paragraph 128, PCS suggests adding credit facilities and credit lines provided facility or commitment fees are payable.

No resecuritsation (Article 26b(9))

Q9. Do you agree that it is not necessary to further specify this criterion? If not, please provide reference to the aspects that require such further specification. Please substantiate your reasoning.

PCS agrees that it is not necessary to further specify this criterion.

Underwriting standards, originator's expertise (Article 26b(10))

Q10. Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

PCS agrees with the interpretation provided save as set out below.

We are not sure that, as drafted, paragraphs 130 and 131 are compatible. As we read paragraph 130, it requires a comparison between the securitised assets of the originator and the non-securitised assets of the originator. But, if we read it correctly, paragraph 131 states that there need not be any non-securitised assets. If that were to be the case, it is unclear how the comparison envisaged in paragraph 130 could take place.

A possible solution would be to merge the two paragraphs by adding to paragraph 130 words to the effect that "unless the originator has securitised all the assets of the relevant class, in which case the criterion is deemed to have been met." This would achieve the aim of the criterion which, as we understand it, is to avoid "cherry-picking".

PCS is unclear as to the benefit of the proposal in paragraph 134 to disclose the reason for changes in underwriting criteria. The requirement to disclose changes to earlier criteria has always been somewhat mysterious including in true sale securitisations insofar as it was not specified how far back such disclosure had to go and what investors would or could do with this information. Requirements to disclose, in addition, the reasons for changes are likely to create for originators, their legal counsel and third-party verification agents inordinate amounts of complexity (how much disclosure? how detailed? how specific – eg "we changed the criteria to make more money") for no discernible benefit. As it is not in the original text, we urge the EBA not to add this requirement.

No exposures in default and to credit-impaired debtors/guarantors (Article 26b(11))

Q11. Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

PCS agrees with the interpretations provided in paragraphs 144 to 147 (inclusive) and 149 to 151 (inclusive).

On paragraph 148, we reiterate our comments on Question 6, our first and second paragraphs, namely that the wording in the Consultation document should be incorporated in the guidelines and that the list of sources should not be exclusive.

On paragraph 152, we have much sympathy for the EBA's attempts to provide guidelines, since article 26b(11)(c) has always been exceedingly difficult to understand. Clearly, it is an attempt to prevent cherry-picking the worst credits in a bank's pool but how to measure this is far from clear from the level 1 text.

We are not clear though about the solution provided in paragraph 152. On its face, the proposed guidelines appear to suggest that, so long as there are no defaulted or doubtful exposures in the pool, this requirement is met. This seems odd, since it does not prevent cherry-picking the weakest elements of a bank's book, so long as these have not defaulted or shown signs of imminent default. Yet paragraph 152 does say that meeting either (a) or (b) is sufficient.

Paragraph 152(b) is more helpful but still leaves open the question of what are "comparable exposures". A possible answer would be to provide a definition of "comparable exposures" along the line of "exposures originated using the same underwriting criteria during the same period of time and by the same department or departments of the bank" or "exposures meeting identical eligibility criteria as those securitised" leaving some room for reasonable accommodation such as "or such other assets the bank can demonstrate are comparable using objective criteria that are disclosed to the investors".

At least one payment made (Article 26b(12))

Q12. Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

PCS agrees with paragraph 153. We would also suggest that the paragraph include a clarification that the first drawing under a commitment that was included in the pool undrawn also qualifies as a "further advance" since, assuming undrawn lines have passed the "one payment test" on inclusion in the securitisation – as to which see below – then the first drawing is, for the purposes of this STS criterion, categorically identical to a further advance on a drawn facility that has also passed the one payment test.

PCS struggles though to understand the rationale behind paragraphs 154 and 155. The Consultation correctly identifies the purpose of the one payment test as an anti-fraud measure. When a borrower obtains a loan by fraud and absconds with the loan proceeds, this only becomes apparent on the first payment when the borrower defaults. Therefore, in situations where a borrower has made payments previously, the risk of fraud can be discounted.

We also note that the wording of the Regulation is quite clear: “Debtors shall, at the time of the inclusion of the underlying exposures, have made at least one payment”. There is nothing in the text of the Regulation that states or requires that one payment to have been made pursuant to the securitised exposure, even less as principal or interest on the securitised exposure.

Therefore, neither the logic of the rule (fraud prevention) nor the actual legislative text justifies the requirement for a new one payment test for new exposures from existing borrowers (paragraph 154).

Nor do the logic of the rule or the legislative text require the limitation of such payment to rental, interest or principal or any other kind of ordinary payment specified in the contractual agreement related to the economic substance of the exposure (paragraph 155.)

Rather, PCS suggests the guidelines explicitly confirm that the following meet the one payment test:

(a) fees in respect of the exposure such as commitment fees and facility fees;

(b) payments by the same debtor in respect of other credits provided by the originator and which are still outstanding or where outstanding within the last calendar year;

(c) “salary loans” where the payments are made by an employer and where payments by such employer have previously been received by the originator from the same employer (on the grounds that, functionally, the employer in the case of such loans is the “debtor”);

(d) payments by the debtor of a down payment in cases where the loan is a consumer loan for a designated purpose (purchase of a consumer good or a vehicle) and the debtor part pays for the goods as a condition of obtaining the loan.

All these cases meet both the spirit and the letter of the Regulation.

PCS is aware that similar guidelines are in place for true sale securitisations. We do not believe that these are appropriate in those cases either but we would draw the EBA's attention to the fact that, in practice, they cause much less difficulty in true sale transactions since corporate loans are not a main asset class in true sale. We suggest that those guidelines be modified to align with the OBS guidelines.

Requirements related to standardisation (Article 26c)

Compliance with risk retention requirements (Article 26c(1))

Q13: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

PCS agrees with the interpretation provided.

Appropriate mitigation of interest and currency risks (Article 26c(2))

Q14: Do you agree with the interpretation provided? Should additional aspects be clarified? More specifically, is there a need to further clarify the term 'appropriate mitigation' of interest-rate and currency risks and further specify any mitigation measures? Please elaborate.

PCS agrees with the interpretation provided and does not believe further clarification is required.

Referenced interest payments (Article 26c(3))

Q15: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

PCS agrees with the interpretation provided and does not believe further clarification is required.

Q16: On reference rates: Is the interpretation on this term deemed helpful for the interpretation of this requirement? Please provide more information on the referenced interest payments used in relation to the transaction in your entity's practice.

We leave this to market participants with better understanding of the matter.

Q17: On complex formulae or derivatives: Is the guidance provided sufficient to clarify the requirement or should the guidance be extended? In case of the latter, please provide suggestions on how to define complex formulae and derivatives.

As a verification agent we have never found this to be a problematic issue. The guidance is, in our view, sufficient.

Requirements after enforcement notice (Article 26c(4))

Q18: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

It is not clear to us what paragraph 161 is trying to achieve. The cash that is trapped in an SSPE post enforcement will be determined by the provisions of the documents agreed with and by the investors. Is paragraph 161 referring to additional cash beyond that contractually agreed which can be trapped with the consent of the trustee? In this case, this is extra-contractual and so cannot, by definition, be part of the STS verification. Or is paragraph 161 suggesting that, in addition to the agreement between the parties, the contract must specify that additionally a trustee must consent at the time. If the later, it is not only unnecessary but would, in practice, make post enforcement resolution exceedingly slow and costly. PCS would suggest removing this paragraph.

PCS agrees with paragraph 162.

Allocation of losses and amortisation of tranches (Article 26c(5))

Q19: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

We believe that it would be useful to clarify the interaction between paragraph 163 and 167. Specifically, if the transaction does contain additional triggers leading to sequential amortisation as allowed by the latter, upon those additional triggers being hit, can the transaction revert back to non-sequential amortisation at a later time (provided always that none of the triggers specified in the derogation in article 26(c)5 have been hit) or are those additional triggers also subject to the prohibition on reversion set out in paragraph 163?

Early amortisation provisions/triggers for termination of revolving period (Article 26c(6))

Q20: Do you agree that it is not necessary to further specify this criterion? If not, please provide reference to the aspects that require such further specification. Please substantiate your reasoning.

PCS agrees that it is not necessary to further specify this criterion.

Transaction documentation (Article 26c(7))

Q21: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

PCS agrees with the interpretation provided and does not believe further clarification is required.

Servicer's expertise and servicing requirements (Article 26c(8))

Q22: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

PCS agrees with the interpretation provided and does not believe further clarification is required.

Reference register (Article 26c(9))

Q23: Do you agree that it is not necessary to further specify this criterion? If not, please provide reference to the aspects that require such further specification. Please substantiate your reasoning.

PCS agrees that no further clarification of this criterion is necessary.

Timely resolution of conflicts between investors (Article 26c(10))

Q24: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

In a synthetic securitisation it is not uncommon that there is only one protection seller. This leaves the originator with a dual role: as protection buyer/counterparty and as "investor" in the senior tranche. The original criterion was designed to address true sale securitisations with potential conflicts between investors and especially investors in different classes. This is not relevant in cases where there is only one real investor.

Therefore, PCS suggests that the EBA clarifies in the guidelines that, when there is only one protection seller, the protection buyer should not be considered an "investor" and therefore none of the requirements set out in paragraph 176 need be fulfilled.

Requirements relating to transparency (Article 26d)

Data on historical default and loss performance (Article 26d(1))

Q25: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

PCS agrees with the interpretation provided. We would also suggest that the EBA clarify in its guidelines that ratings migration data (whether of internal or external ratings) can be included in the definition of "historical default and loss performance such as delinquency and default data" for corporate loans. Such data is market practice. It is so because it is considered by protection sellers as more relevant, for internally rated SME loans as well as for externally rated investment grade corporate names that have a close to zero default history on the originators books, than classical vintage type default data.

Verification of a sample of the underlying exposures (Article 26d(2))

Q26: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Q27: In particular, do you agree with the interpretation of the scope of the verification, in particular with the specification on how the size of the representative sample should be determined? Should additional aspects/parameters for determining the sample be clarified? Please substantiate your reasoning.

We agree with the provided interpretations. In particular we agree with what we believe is the intent of paragraph 185 but would suggest that the consequences of the approach be made more explicit.

Our rationale for a more explicit approach to paragraph 185 is driven by differences of approach that we have seen adopted by originators across Europe with respect to the AUP and resulting uncertainty amongst competent authorities. We are also aware that some commentators have focused on the difference in wording between the AUP requirements for true sale securitisations (set out in article 22(d) of the Regulation) and the AUP requirements for synthetic securitisations. Although PCS also believes the difference in wording is key, we believe commentators who conclude that this difference drives a lower level of audit for synthetics misunderstand the purpose of the differing words.

Article 22(d) reads:

"A sample of the underlying exposures shall be subject to external verification prior to issuance of the securities resulting from the securitisation by an appropriate and independent party, ***including verification that the data disclosed in respect of the underlying exposures is accurate***."

In contrast, Article 26d(2) reads:

"A sample of the underlying exposures shall be subject to external verification prior to the closing of the transaction by an appropriate and independent party***, including verification that the underlying exposures are eligible for credit protection under the credit protection agreement***. "

The difference in the language, in our view, reflects the fact that the AUP is designed to protect a different party depending on the type of securitisation.

In true sale securitisation, the AUP is designed to protect the investors who take the risk of the assets once the transaction is closed. The AUP therefore needs to provide the investors with comfort that what they were told they were buying really is what they bought.

In a synthetic securitisation, the investor/protection seller does not care, prior to closing the transaction, that the exposures meet the eligibility criteria. In fact, and somewhat perversely, the best outcome for the investor/protection buyer is that none of the securitised exposures meet the eligibility criteria. If this turns out to be the case, this will only become apparent on default of an exposure and this lack of conformity with the eligibility criteria will result in the protection buyer being freed from the requirement to make a payment. So, the investor/protection buyer gets no benefit from the AUP.

The originator/protection buyer gets some benefit as the AUP confirms it will get paid in cases of default. However, to the extent the AUP verifies the originator's own systems, the originator may see this benefit as minor since it presumably has confidence in its own systems and/or uses other checking methods to ensure its systems' integrity.

Therefore, the real beneficiary of the AUP is neither the protection seller nor the protection buyer. It is the regulator that has provided SRT benefit to the protection buyer. And behind the regulator, the ultimate beneficiary are the citizens of Europe who have a vested interest in banks being properly capitalised.

This reality lies behind the wording differences between articles 22(d) and 26(d)(2). The latter wants the AUP to provide confidence that, when called upon to compensate the protection buyer, the protection seller will be contractually required to do so.

So, what does this mean for the scope of the AUP under article 26(d)(2)?

Basically, to fulfil its purpose, the AUP must check all the items that are necessary to trigger a payment obligation by the protection seller. Those items will vary from transaction to transaction. They will have been negotiated between the protection seller and the protection buyer. They will be set out in the contractual documents as the items that must be checked by the verification agent before it certifies a payment falls due from the protection seller.

It is therefore not sufficient that the AUP only checks that the eligibility criteria are met according to the protection buyer's systems and internal central records ***unless those records are the only item a verification agent is required to check to confirm payment by the protection seller is due.***

If the contract requires the verification agent also to check, for example, that a certain form was signed by a credit committee as a condition for a payment, then the AUP should also cover the existence of that form.

We note that some market participants have said that such intrusive AUPs would be extremely costly. We would point out that it is open to the parties to tailor by contract the items that must be verified by the verification agent so that the AUP becomes more manageable but still covers the crucial question of whether the protection payment will be due in the event of a default.

Without ensuring this coverage by the AUP though, the exercise loses pretty much all purpose. We therefore invite the EBA to extend the explanation in paragraph 185 to make it clear that this is the proper scope of AUPs.

Liability cashflow model (Article 26d(3))

Q28: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

We agree with the interpretation provided.

We would also suggest that the EBA clarify what the Regulation means by "on an ongoing basis". The language allows either that the model should be created at the outset of the transaction and simply be available to investors, unchanged, through the life of the transaction or that the model should be regularly updated and the updated version available to the investors.

PCS believes that the latter interpretation – regular updates – fits the language of the regulation better and is the better outcome and the guidelines should reflect this approach. But, either way, we believe the issue should be clarified.

Environmental performance and sustainability disclosures of the assets (Article 26d(4))

Q29: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

We agree with the proposed interpretation save for the last sentence of paragraph 190. That sentence provides that, when an originator has sustainability data only on a part of the pool, it should disclose that partial data. PCS is concerned that this could be misleading and lead to greenwashing claims. This would occur for example if the originator had data on 20% of a mortgage pool and disclosed that all the mortgages for which such data was available had A or B EPC certificates. This could lead investors to assume that the 20% was representative of the whole and that they were investing is a "green pool". If it later transpired that the remaining 80% were all D or below, accusations of greenwashing would be levelled.

Maybe partial disclosure could be available if data was available for a minimum amount such as 80%. We would point out though that there is currently very little data available on sustainability. Therefore, we strongly suspect that, in the case of almost all banks and pools of assets, there is no overlap between the percentage of current available sustainability data and a percentage that would be high enough to avoid accusations of greenwashing. So, fixing a minimum percentage before disclosure is required/allowed may be somewhat of an academic exercise as of today.

Compliance with disclosure requirements under Article 7 (Article 26d(5))

Q30: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

PCS agrees with the interpretation provided.

Criteria specific for on-balance-sheet securitisation (Article 26e)

Credit events covered under the credit protection agreement (Article 26e(1))

Q31: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

PCS agrees with the interpretation provided.

Credit protection payments (Article 26e(2))

Q32: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Q33: Do you agree with the interpretation of the determination of interim credit protection payments? Do you agree with the interpretation of the criterion with respect to the 'higher of' condition? Should the interpretation be amended, further clarified or additional aspects be covered? Please substantiate your reasoning.

PCS agrees with the interpretation provided.

Debt workout and credit protection premiums (Article 26e(3))

Q34: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

PCS agrees with the interpretation provided**.**

Third-party verification agent (Article 26e(4))

Q35: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

We believe that this is an oversight but paragraph 198 deals with a pre-closing verification – the AUP – whereas article 26e(4) deals with the post-closing verification of individual defaulted assets. We suggest that this paragraph be removed from this section.

PCS also notes that in many transactions, especially with larger pools of smaller exposures such as SMEs, the verification is done on a sample basis. It would be useful if the guidelines could confirm that this sample verification is allowed.

Early termination events by originator (Article 26e(5))

Q36: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

Although PCS is aware that the rule of disregarding pre-payments in the calculation of the WAL is consistent with other regulatory provisions connected to SRT, we would like nevertheless to comment that this does not strike us as a reasonable approach, especially for very long dated assets with substantial pre-payment rates (eg residential mortgages). We would invite the EBA to reconsider.

More problematic is the provision in paragraph 201 that the time call should not occur before a date calculated by adding the replenishment period and the WAL of the pool calculated at the end of this replenishment period. This means that it is not possible for either the protection buyer or the protection seller to know at the outset of the transaction when the time call will arise. This uncertainty will have pricing implications and will make STS more difficult to achieve. STS was introduced with the aim and hope that it would create standardisation at a high level of quality in the European securitisation market. That STS cannot be achieved because STS products are less predictable than non-STS products appears to contradict the purpose of the legislation. Since, it is unlikely that, not being to achieve STS due to the uncertainty of the time call, protection buyers would nevertheless seek to meet all the other criteria without deriving any benefit from this, the likely consequence of this rule is the overall decrease in the quality of the synthetic securitisation market as it drifts away from an unrealistic (and unnecessary) standard.

We would therefore recommend that, in line with current practice, the time call be fixed at the replenishment period plus the WAL of the original pool.

As a minor point, it would be useful to clarify that in article 26e(5)(b), a reference to the “investor” is a reference to the protection seller or sellers who are obligated to make payments under the securitisation. This would ensure that, when the synthetic securitisation is achieved through the issuance of credit linked notes, this provision covers failures by the SSPE to meet material obligations since it is with the SSPE that the protection buyer contracts and not the ultimate holders of the CLNs.

Q37: Do you consider necessary to provide interpretation of the term 'breach by the investor of any material obligation? Please provide information on such material breaches applied in securitisation practice.

PCS does not believe this would be necessary or helpful. It would be extremely difficult and almost guaranteed to introduce substantial amounts of uncertainty for little to no discernible benefit.

Early termination events by investor (Article 26e(6))

Q38: Do you agree that it is not necessary to further specify this criterion? If not, please provide reference to the aspects that require such further specification. For example, do you consider it necessary to provide interpretation of the term 'material breach' of contractual obligations by the originator? Please substantiate your reasoning.

We agree that it is not necessary to further specify this criterion. As for Question 37, we do not believe it necessary or helpful to seek to provide a definition of "material breach".

We also note that some market participants wish to insert "illegality" as a termination event. Although in our view not necessary, since illegality will terminate the contract anyway, as a verification agent it would make our task easier if the EBA could confirm that inserting "illegality" as an investor termination event, although a statement of the obvious, is also not a violation of the STS requirements.

Synthetic excess spread (Article 26e(7))

Q39: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

We do not have a view on the interpretation provided but note that the matter of synthetic excess spread is the subject of a draft RTS and that there is an ongoing discussion in relation to that draft. It is therefore tricky to comment on the proposed guidelines without knowing where the RTS will land.

However, as a general comment, there are no reasons to have different rules for the treatment of STS and non-STS securitisations when it comes to excess spread. The rules – to be set out in the RTS – are designed to avoid hidden credit support by the originator. If all credit support is indeed removed or capitalised under the RTS for all on-balance-sheet securitisations, it is hard to see what more could be required of STS securitisations.

Types of credit protection agreements (Article 26e(8))

Q40: Do you agree that it is not necessary to further specify this criterion? If not, please provide reference to the aspects that require such further specification. Please substantiate your reasoning.

PCS agrees that it is not necessary to further specify this criterion.

Specific type of credit protection agreement (Article 26e(9))

Q41: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

We note that paragraph 205 of the proposed guidelines has added some words to the legislative text regarding the scope of the legal opinion: namely that the credit protection agreement "complies with the law". PCS does not see how this adds to the opinion that the agreement is valid and enforceable. But, in addition, this terminology of "compliance with laws" is not, to our knowledge, used by law firms in opinions generally and so we are not clear what such an opinion would or should say. On balance we would suggest deleting paragraph 205.

We also suggest deleting paragraph 206. That paragraph requires the law firm providing the opinion to be qualified in the relevant law – which is already in the level 1 text – and have "the necessary legal expertise". This latter formulation appears to introduce a subjective aspect beyond being qualified in the jurisdiction which goes to the individual expertise of the lawyer in the field of securities and securitisation law. This is basically impossible to due diligence or verify and will add substantial uncertainty to whether the criterion is met.

Requirements for recourse to high-quality collateral (Article 26e(10))

Q42: Do you agree with the interpretation provided? Should additional aspects be clarified? Please substantiate your reasoning.

PCS agrees with the interpretation provided.

It would be useful if the guideline could confirm, where there are references to CQS ratings, how to deal with institutions with more than one rating. In particular, whether one can rely on the short term rating rather than the long term rating and whether one must take the highest, lowest or (where there are more than two ratings) the second best rating.

STS criteria not specified above (i.e. early termination event by investor (Article 26e(6)) etc.)

Q43: Do you agree that no other requirements are necessary to be specified further? If not, please provide reference to the relevant provisions of the STS requirements and their aspects that require such further specification. Please substantiate your reasoning.

One issue that requires some guidance is the question of “grandfathering”. The STS criteria for on-balance-sheet securitisations are numerous (145 to 160 depending on the transaction) and complex. The STS standard is also unforgiving in that each and every criterion must be met and with no *de minimis* infractions allowed.

The publication of guidelines by the EBA is welcome and, as we have seen from the proposals, often deal with points that are highly technical yet subject to some subjectivity. It is precisely the fact that the different possible interpretations of the criteria are subject to some subjectivity and fine judgment that makes the guidelines so necessary and welcome.

Yet, this also results in the possibility of originators, working in good faith with their legal counsel and, in some cases, independent verification agents, having reached a different subjective conclusion from that ultimately chosen by the EBA. It seems a departure from the principles of natural justice that such originators be punished and subjected to possibly considerable costs for an honest choice that, only in retrospect, can even be called an honest “mistake”.

PCS believes that fairness would require that transactions closed prior to the publication of the guidelines which would now fail one or more STS criteria solely as a result of the new interpretation, should be allowed to fix the issue if it is fixable but otherwise maintain their STS status.

It is also difficult to see that such an approach would create much (if any) harm. These transactions will, in all likelihood, have failed one or two of the new interpretations. With 145 to 160 criteria, this will mean that all of them meet over 99% of the STS rules and only fail one or two at the margin of interpretation.

Amending guidelines

Q44: Do you agree with the proposed amendments to the Guidelines EBA/GL/2018/09? Should additional aspects be clarified? Please substantiate your reasoning.

Where the amendments track amendments set out in the proposed on-balance-sheet guidelines, we would refer to our earlier responses.

Paragraphs d. and j. relate to the regulatory authorities and, although on their face unobjectionable, we do not feel it is our place to comment.

On the other paragraphs, we had no comments.

Q45: Do you agree with the proposed amendments to the Guidelines EBA/GL/2018/08? Should additional aspects be clarified? Please substantiate your reasoning.

For paragraphs a, b and c, we refer to our earlier responses which are also applicable here.

We have no comments on paragraph d.

We hope these comments have been useful and stand ready to answer any questions you may have.

Ian Bell
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