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STS INTERPRETATIONS

The table that follows contains the interpretations of the STS Criteria that PCS will use when compiling an STS Report. These reflect PCS' reading of the legislative text and PCS' involvement in the process through which the STS Regulation became law, including numerous interactions with various legislative drafters. They also reflect PCS' own views of a reasonable interpretation that seeks to respect both the legal text and the policy intent of the STS Regulation while, at the same time, recognising high quality market practice.

There can be no guarantee though that the European Banking Authority charged with providing guidelines and recommendations as to the interpretation of the STS Criteria will come to the same conclusions as PCS, nor that any national competent authority, nor any court would do so. These interpretations are ***not*** legal advice.

For a fuller understanding of a PCS STS Report or these interpretations, we strongly recommend that all readers make themselves familiar with the Disclaimer that may be found on the PCS website: www.pcsmarket.org.

As the aim of STS Reporting is to assist market participants in transitioning to the STS regime, PCS reserves the rights to amend these interpretations in the lights of regulatory discussions and developments. The aim will always be to bring our interpretations ever closer to the final regulatory interpretation. In addition, it is PCS' experience from the PCS Labels, that actual market practice often reveals questions that market participants and regulators were not aware existed. We therefore fully recognise that additional interpretations may be needed when unexpected questions present themselves.

The table below contains, in the left-hand column the individual STS criteria. In the right-hand column appear the interpretations. Where a criteria is missing it is because PCS currently considers that it is sufficiently straightforward as to require no interpretation.

February, 2018

STS criteria	Interpretations
1. The title to the underlying exposures shall be acquired by the SSPE by means of a true sale or assignment or transfer with the same legal effect in a manner that is enforceable against the seller or any other third party.	1. We would point out that "true sale" is not a legal term but a term derived originally from rating agency criteria. It has always been used to mean a method of legal conveyance which, in the relevant jurisdiction, results - in the event of the insolvency of the originator - in the securitised assets not being considered as a legal matter as falling within that originator's insolvency estate. For the purposes of "true sale", rules reversing preferential or undervalue transactions are ignored. In the STS rules, this is made explicit. Therefore, PCS will consider all methods of conveyance which achieve removal of the securitised assets from the potential insolvency estate of the originator as being a "true sale". As a point of clarification and consistent with the above approach, PCS confirms that, in its view, "true sale" includes common law equitable transfers (which are valid against the world and recognised as "true sales" by accountants and CRAs).

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2. The transfer of the title to the SSPE shall not be subject to severe clawback provisions in the event of the seller's insolvency.	2. PCS considers this criterion to be jurisdictional – ie do the laws of the jurisdiction governing the sale have such severe clawback provisions. The assessment of this is somewhat subjective. However, PCS pays close attention to the practices of the European Central Bank in its own collateral rules. These rules contain a similar provision. We note that we are not aware that the ECB has rules out any of the major jurisdictions involved in European securitisation on the grounds of "severe clawback" rules. This would be consistent with PCS' own estimation. The determination of this criterion will obviously require a jurisdiction by jurisdiction determination. But currently, PCS is not aware of any jurisdiction within the EU where this criterion would not be met. As we analyse legal opinions case by case, we will be compiling a list of jurisdictions meeting the criterion.
3. Where the seller is not the original lender, the true sale or assignment or transfer with the same legal effect of the underlying exposures to the seller, whether that true sale or assignment or transfer with the same legal effect is direct or through one or more intermediate steps, shall meet the requirements set out in paragraphs 1 to 3.	3. The criterion is of itself straightforward. The originator's challenge will be to demonstrate that it is met as the evidence may well be of a confidential nature – eg legal opinions relating to the original sale which may not be disclosed. As an evidentiary matter, it will be sufficient for PCS' report that the originator confirms that it has had sight of opinions and documents which confirm – subject to usual reservations – the true sale.

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5. The seller shall provide representations and warranties that, to the best of its knowledge, the underlying exposures included in the securitisation are not encumbered or otherwise in a condition that can be foreseen to adversely affect the enforceability of the true sale or assignment or transfer with the same legal effect.	5. Due to the multiplicity of legal terminology within European jurisdictions, PCS is prepared to treat this criterion as met notwithstanding deviation from the exact words of the text so long as the actual text produces an equivalent result.
6. The underlying exposures transferred from, or assigned by, the seller to the SSPE shall meet pre-determined, clear and documented eligibility criteria.	6. The issue with this criterion centres on the meaning of the word "clear". PCS will treat this criterion as met if it is possible, as a matter of law, to determine whether any exposure meets or does not meet the criterion. This avoids an argument that "clear" must be understood as "easily understood by a layperson" which would make the criterion entirely subjective. This criterion, in our view, makes much more sense as one of legal certainty.
7. Which do not allow for active portfolio management of those exposures on a discretionary basis.	7. As a point of clarification, PCS does not believe that this criterion in any way prevents traditional substitution. This is made clear by the fact that Art 21.6. explicitly contemplates substitution as being compatible with STS.
8. Exposures transferred to the SSPE after the closing of the transaction shall meet the eligibility criteria applied to the initial underlying exposures.	8. This criterion is designed to prevent originators from using substitution to worsen the overall quality of the securitised pool. Therefore, consistent with the intention of the criterion, PCS interprets "meets" not as preventing any changes but as requiring eligibility criteria as good or better than the original ones.

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9. The securitisation shall be backed by a pool of underlying exposures that are homogeneous in terms of asset type, taking into account the specific characteristics relating to the cash flows of the asset type including their contractual, credit risk and prepayment characteristics. A pool of underlying exposures shall only comprise one asset type.	9. PCS has stated that the best solution would be to provide a list of categories such that, if all the assets are part of that category, they are ipso facto, "homogeneous". Eg, residential mortgages, auto loans. Each category would have a broad definition. This is very much the strong implication of Recital 27 which PCS believes should form the basis of the EBAs guidance on this topic. However, PCS also notes the consultation paper published by the EBA on December 15th, 2017. This paper suggested a four-part test (same underwriting/same servicing/same asset class/same "relevant factors"). Notwithstanding PCS' concerns over some aspects of this proposals, especially the application of the "relevant factors", in compiling the STS Reports, PCS will use the four-part EBA proposed test. In determining when "relevant factors" are to be held to be applicable, PCS will take into account the market practice used in issuance considered by universal consensus to meet the highest market standards as well as the views expressed by the investor community. ***The use of this approach by PCS in our STS Reports reflects our desire to provide applicants with a conservative yet reasonable approach to interpreting the STS rules. It does not indicate that PCS agrees with this EBA proposal as PCS will make clear in its response to the consultation.***

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10. The underlying exposures shall contain obligations that are contractually binding and enforceable.	10. An "absolutist" reading of this criterion – "every single contract in the pool will be enforced by the courts irrespective of any other facts" - would make this criterion literally impossible of being met. This is because all jurisdictions have complex rules as to when a contractual party can be freed from their obligations. For example, contracts with mentally incompetent persons can be voided even if the other party was not aware of the contracting party's condition. Similar problems could occur where there was a misrepresentation which induced the borrower to enter into the contract but was unknown to the originator. However, this criterion, common to rating agency criteria, standard setting criteria such as PCS' own label criteria and legal opinion drafting has always been interpreted by issuers and investors as meaning that the contracts underpinning the securitised assets are binding and enforceable as a matter of general law and subject to the exceptions of general application commonly found in legal opinions. In other words, the rule deals with the binding and enforceable nature of the exposures as a whole but without reference to the nature or status of individual borrowers or individual courses of conduct. This approach is best summarised by the wording found in legal opinions such as: "the obligations are of a type commonly enforced by the courts".

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	This is therefore the approach that PCS will adopt in compiling its STS Reports. Also, the purpose of this criterion is to make sure the investors can recover their money and, as an ancillary protection, get the benefit of any security they believe attaches to the securitised assets. Consistent with the intention of the rule, therefore, PCS interprets the “obligations” that are binding and enforceable to be limited to the obligation that are relevant to the investors, namely the obligation to pay and provide security. Some minor ancillary obligations being unenforceable should not lead to exposures being ineligible for STS.
12. The underlying exposures shall have defined periodic payment streams, the instalments of which may differ in their amounts.	12. As a point of clarification, despite the slightly unclear wording, PCS interprets this criterion to include single payment exposures which are explicitly eligible for STS as set out in Art 20.12
17. pursuant to underwriting standards that are no less stringent than those that the originator or original lender applied at the time of origination to similar exposures that are not securitised.	17. When determining the meaning of “similar”, PCS does not interpret the expression to mean the similarity necessary to meet the homogeneity criterion. That criterion encompasses wide categories that may be divided into broad sub-classes which are the subject of this “no cherry picking” criterion. Also, as this is a “no cherry picking” rule, as a point of information the criterion is not relevant if there are no other assets originated at the same time as the securitised assets which are not securitised. Not relevant does not mean that the criterion is failed. So an originator securitising its entire portfolio can still issue STS securitisations.

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18. The underwriting standards pursuant to which the underlying exposures are originated and any material changes from prior underwriting standards shall be fully disclosed to potential investors without undue delay.	18. PCS assumes that this criterion applies to new assets added to the securitisations by way of replenishment. Otherwise, it is difficult to see how, for example, a lender in the consumer loan business for a century could disclose all the changes in underwriting standards since the early 20th century. Such an interpretation is also difficult to understand as it is not clear why all the changes in past underwriting standards are relevant to an investor. Finally, this can be the only meaning of "without undue delay" since originators cannot be required to inform unknown future investors in a not yet conceived putative future securitisation of underwriting changes without undue delay. PCS is aware though that views have been expressed that such interpretation was overly narrow and that originators should be required to disclose any changes to underwriting criteria that would affect past data provided to investors regarding their business. In our STS Report, we will use the first approach but flag the second. ***As, in PCS' interpretation, this is an action that can only be taken post-closing, PCS takes the view that the regulators are likely to require that all such post-closing STS requirements are the object of a contractual covenant by the party being required to comply that it will do so. PCS will therefore expect to see such a contractual covenant. (This approach is our "Post-Closing Approach")***

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	Finally, PCS believes the criterion to require that the changes that need to be disclosed are only changes that modify the standards that were originally disclosed in the prospectus. If a minor aspect of underwriting was not sufficiently relevant to be disclosed originally, a modification of this item need not be disclosed. In other words, only need to be disclosed changes which would modify the original disclosures. It would be illogical to tell investors of a change to an underwriting standard they did not know or cared existed when they purchased the securitisation and which the law (including the STS Criteria) did not require to be initially disclosed.
19. In the case of securitisations where the underlying exposures are residential loans, the pool of loans shall not include any loan that was marketed and underwritten on the premise that the loan applicant or, where applicable intermediaries, were made aware that the information provided might not be verified by the lender.	19. The purpose of this criterion is to exclude from STS securitisations “self-certified” products which encourage borrowers to mislead lenders as to their true credit standing. Therefore, consistent with legislative intent, the prohibited unverified information should be limited to income information or, in the case of asset based lending, asset value as many irrelevant items are never checked (eg mobile phone numbers). Also, it is clear to PCS that income being unverified is only an issue where income is a relevant underwriting metric (eg borrower income is not relevant for buy-to-let loans made on the basis of the properties’ revenue potential).

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20. The assessment of the borrower's creditworthiness shall meet the requirements set out in Article 8 of Directive 2008/48/EC or paragraphs 1 to 4, point (a) of paragraph 5, and paragraph 6 of Article 18 of Directive 2014/17/EU or, where applicable, equivalent requirements in third countries.	20. In respect of third countries, for reasons of comity and sense, PCS interprets this provision to be met when loans are originated in accordance with local rules. Comity since otherwise the originator and regulator would need to do a full equivalence analysis in each case and sense since, otherwise, assets originated under strict regimes would not be STS eligible if the regimes are not identical to those of the EU but assets originated in countries with no rules at all would be STS eligible. This cannot be a correct reading of this provision. Also, some assets are neither mortgages or consumer loans to which these legislative provisions are relevant. Therefore, PCS assumes the words “where relevant” must be read in the provision.
21. The originator or original lender shall have expertise in originating exposures of a similar nature to those securitised.	21. On its face, “expertise” is a subjective notion. In order to make the STS rules capable of objective determination, PCS will apply the following approach: “expertise” can be attributed to any entity: (a) regulated within the EU to perform the relevant business by a prudential regulator which, as part of its mandate, supervises competency, since this must be part of the NCA’s licensing process; (b) for unregulated businesses, that has been in the business of originating similar assets for a specified period of 5 years. In addition, expertise will be ascertained at group level to cover corporate restructurings. The expertise will, however, be limited to a given jurisdiction so that an originator cannot claim expertise in one country based on lending in another.

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	(c) for new and unregulated originators, provisions can be made to demonstrate that the underwriting managers employed by the originator have, at a personal level, expertise over a 7 year period. In these circumstances, it is important in our view that the underwriting managers be employed or under the direct control of the originator to ensure alignment of interest – ie retention should be connected to underwriting. Expertise in assets of a "similar nature" should be judged against the list of asset classes appearing in Recital 27 or of a similar breadth.
22. The underlying exposures, at the time of selection, that are transferred to the SSPE without undue delay…	22. On the basis that the STS rules are supposed to identify best practices in European securitisation rather than create a new level, PCS will treat the standard delay in most European securitisations as meeting the no-undue delay criterion. Based on our extensive knowledge, we believe that three and a half months is not an undue delay. Also. It would be useful if the guideline clarified that "debtor or guarantor" should be read to mean "debtor or (when the debt is guaranteed) the guarantor". In other words, if the debtor falls into a prohibited category, this is not a problem if the guarantor does not

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24. or exposures to a credit-impaired debtor or guarantor, who, to the best knowledge of the originator or original lender:	In line with Recital 26, PCS will interpret “best of knowledge” to mean the actual knowledge of the originator and does not require the originator to take every legally possible step to determine the borrowers credit status. This is consistent with the notion that STS securitisations should not include “sub-prime” business but that a prudent lender conducting a prudent lending business will take prudent steps to ascertain the creditworthiness of its borrowers. The criterion is designed to prevent such lender deliberately securitising bad assets within the STS regime, not to “catch” lenders retrospectively for an ex post facto discovery that some assets were bad. PCS also notes that the legal text clearly states that are excluded from STS only “credit impaired debtors” who, in addition to being “credit impaired debtors” also meet conditions (a), (b) or (c). In other words, conditions (a), (b) or (c) are not relevant if the debtor in question is not already a “credit impaired debtor”. So the first question the criterion requires us to answer is: “irrespective of (a), (b) or (c), is this debtor “credit impaired?” The definition of “credit impaired debtor” is, of course, subjective as different lenders have different views and appetite for risk. To seek to make the criterion capable of objective analysis, PCS will seek to determine whether the debtor is of such credit standing that it would have been able to obtain a similar loan or credit facility on roughly similar terms from most traditional lenders out of their everyday lending platform. Such a debtor cannot in any reasonable sense of the word be considered “credit impaired”.

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28.(c) has a credit assessment or a credit score indicating that the risk of contractually agreed payments not be made is significantly higher than for comparable exposures held by the originator which are not securitised	28. "Significantly higher" is a subjective test. But beyond this, it is not clear how you compare a single loan's credit score against a pool of exposures. Do you compare against the average score or the worst score or some other metric? Bearing in mind the purpose of the criterion – avoiding the "cherry picking" of bad assets from an otherwise quality pool, PCS believes this criterion can best be met by the originator demonstrating that it has performed a random selection out of the wider pool of assets to securitise.
30. The repayment of the holders of the securitisation positions shall not have been structured to depend predominantly on the sale of assets securing the underlying exposures.	30. The criterion is taken from the PCS' own criteria. In interpreting this criterion, PCS notes that it allows "residual values" in transactions but with a limit. Sensible limits to avoid the problem of embedded maturity transformation which this criterion seeks to address are a function of granularity and the liquidity of markets. A higher residual value allowance makes sense for second car autos – mass produced identical items with a deep market, whereas a pcsPsmaller one or none may be sensible for a single large shopping mall – a unique item in a unique location with a single function and a limited number of potential buyers. PCS has not yet set a list of assets and residual values which it feels are a reasonable interpretation of the criterion other than for auto and equipment transactions where, in the context of the PCS Label and after discussions with market participants on both the buy and sell side we concluded that a reasonable allowable residual value was 65%.

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	As a point of information, PCS believes that there are very strong arguments as to why "interest only residential mortgages" are not caught by the prohibition. These are set out in some detail in our PCS Label "Interpretations Guidebook" (page 11) to be found on our website: www.pcsmarket.org .
32. The interest rate and…	32 and 33. PCS believes that "appropriately" is to be understood in a market based manner – i.e. no unusually limited hedging. Again, this is consistent with the view that the STS regime was always designed (a) to encompass existing market practices universally considered to be of the highest quality and (b) be capable of an objective assessment. To determine this, PCS would consider looking at the hedging analysis of an independent third party such as a CRA and the special risks section of the prospectus to determine whether a concern existed about an unusual deficiency in the hedging of the transaction. As a point of information, PCS notes that the provision requires "mitigation" without specifying the types of mitigation. "Mitigation" need not be limited to swaps and derivatives but can cover excess spread, cash accounts or any variety of effective methods.
33. currency risks arising from the securitisation shall be appropriately mitigated	See 32 above

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37. Those derivatives shall be underwritten and documented according to common standards in international finance.	37. Clearly if the derivative has been drafted on an ISDA form, it has been underwritten and documented as required by the criterion. In case of non-ISDA hedging agreements, PCS would take a case by case approach.
38. Any referenced interest payments under the securitisation assets and liabilities shall be based on generally used market interest rates, or generally used sectoral rates reflective of the cost of funds, and shall not reference complex formulae or derivatives.	38. PCS notes that "referenced" interest payments mean interest rates calculated "by reference" to another rate. Therefore, unreferenced rates – such as a bank's self-set mortgage rate - are not covered by this criterion and PCS will analyse it accordingly.
39. Where an enforcement or an acceleration notice has been delivered: (a) no amount of cash shall be trapped in the SSPE beyond what is necessary to ensure the operational functioning of the SSPE or the orderly repayment of investors in accordance with the contractual terms of the securitisation, unless exceptional circumstances require that amount is trapped in order to be used, in the best interests of investors, for expenses in order to avoid the deterioration in the credit quality of the underlying exposures;	39. The "best interest of the investors" is a subjective concept. However, a good proxy for "best interest" would be the decision or assent of a trustee since the trustee is legally required to act in the best interest of the investors. It therefore follows, in PCS' estimation, that a provision allowing cash to be trapped if agreed by, or to the extent agreed by, the trustee will meet this criterion. Also, consistent with this criterion is cash trapped in the form of a "reserve" for future use, so long as the only two ways in which the reserve could be disbursed is to meet the purposes set out in Art 21.4(a) or to be paid to the investors. In the case of other arrangements, PCS would have to take a case by case view.

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40. principal receipts from the underlying exposures shall be passed to investors via sequential amortisation of the securitisation positions, as determined by the seniority of the securitisation position;	40. For information, it is clear that that this provision merely prohibits non-sequential payments of principal and does not mandate the exclusive use of principal to repay investors. Otherwise, this would prohibit replenishment, which is not the intention of this provision as made clear by Art 21.6.
49. The transaction documentation shall clearly specify: (a) the contractual obligations, duties and responsibilities of the servicer and the trustee, if any, and other ancillary service providers;	49, 50 and 51. This is a difficult criterion to interpret since it is not clear how it is not met by definition: if these parties have obligations, etc…they must be found in the documents. If the criterion turns on the adverb "clearly" then it will become extremely difficult to determine objectively. The better way to interpret this criterion is that it is a disclosure criterion and seeks to prohibit hidden/undisclosed obligations and duties. Therefore, in interpreting this criterion, PCS takes the view that it is met if there are no other undisclosed documents setting out obligations relating to the functioning of the securitisation. (This would avoid the disclosure of items such as fees letters which are not relevant to the repayment of the investors.)
50. (b) the processes and responsibilities necessary to ensure that a default by or an insolvency of the servicer does not result in a termination of servicing, such as a contractual provision which enables the replacement of the servicer in such cases; and	See 49 above.

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51. (c) provisions that ensure the replacement of derivative counterparties, liquidity providers and the account bank in the case of their default, insolvency, and other specified events, where applicable.	See 49 above.
52. The servicer shall have expertise in servicing exposures of a similar nature to those securitised	52. Same approach as in 21 above.
53. and shall have well documented and adequate policies, procedures and risk management controls relating to the servicing of exposures.	53. In approaching this criterion PCS takes the view that all regulated servicers can be deemed to have well documented and adequate policies and procedures since this should be part of their regulatory oversight. For unregulated entities, proof will need to be provided in some other manner.
60. The transaction documentation shall include clear provisions that facilitate the timely resolution of conflicts between different classes of investors, voting rights shall be clearly defined and allocated to bondholders	60. This criterion is challenging since terms like "facilitate" and "timely" are highly subjective. Consistent with the view that the STS regime was always designed (a) to encompass existing market practices universally considered to be of the highest quality and (b) be capable of an objective assessment, PCS will approach this criterion by looking at the provisions that appear in high quality standard European securitisations. It will deem the criterion to be met if these provision all appear in the relevant securitisation on basically similar terms.

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67. The originator or the sponsor shall, before the pricing of the securitisation, make available to potential investors a liability cash flow model which precisely represents the contractual relationship between the underlying exposures and the payments flowing between the originator, sponsor, investors, other third parties and the SSPE	67. PCS understands the term "precisely" to mean accurately and with a good level of fineness. Almost all cash flow models allow for permutations regarding possible pre-payment rates, defaults, interest rates, etc… PCS takes the views that these are not prohibited by this criterion, as this would render meeting this criterion literally impossible to be met
68. and shall, after pricing, make that model available to investors on an ongoing basis and to potential investors upon request.	68. To clarify, PCS interprets "potential investor" as someone who can demonstrate that it meets the requirements for being an investor under the Regulation.
69. In case of a securitisation where the underlying exposures are residential loans or car loans or leases, the originator and sponsor shall publish the available information related to the environmental performance of the assets financed by such residential loans or car loans or leases, as part of the information disclosed pursuant to point (a) of the first subparagraph of Article 7(1).	69. PCS (and the market) is still formulating proposals to this criterion. Realistically, it is unlikely that clarification will become available until the regulatory authorities have made their views clearer. Until such time, PCS will flag the uncertainty surrounding this criterion.
75. all underlying documentation that is essential for the understanding of the transaction, including but not limited to, where applicable, the following documents: (i) the final offering document or the prospectus together with the closing transaction documents, excluding legal opinions;	75. In interpreting this criterion, PCS has taken the view that "essential" documents cannot encompass a document that are not referred to in the prospectus or the information memorandum since, if it were an essential document, the issuer would be in breach legal disclosure requirements by not referring to it. In the case of a document is referred to in the prospectus but not disclosed, PCS would have to take a case by case approach.