



Inaugural STS Newsletter



Prime Collateralised Securities (PCS) is an independent, not-for-profit initiative set up to revitalise the asset-backed securities market in Europe as a key to generating robust and sustainable economic growth for the region.

In addition to being an authorised Third Party Verification Agent under the STS regulation in which capacity it seeks to assist in the success of the STS regime, PCS is also actively involved in the field of synthetic securitisation and in educational and advocacy work.

Newsletter

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1. Welcome !

Welcome to the first STS Newsletter by PCS. As part of our mission to assist in the renewal of the European securitisation market and as a regulated Verification Agent under the STS Regulation, we thought it would be helpful if we published from time to time a newsletter, to keep stakeholders up to date about market and regulatory developments in the world of STS.

These newsletters will share public market data with some PCS colour to help make sense of the numbers. They will also deal with topical issues affecting current STS issuance and the interpretation of the STS rules as well as broader developments which could impact the STS market's future. These could include new guidelines as well as various regulatory or political proposals.

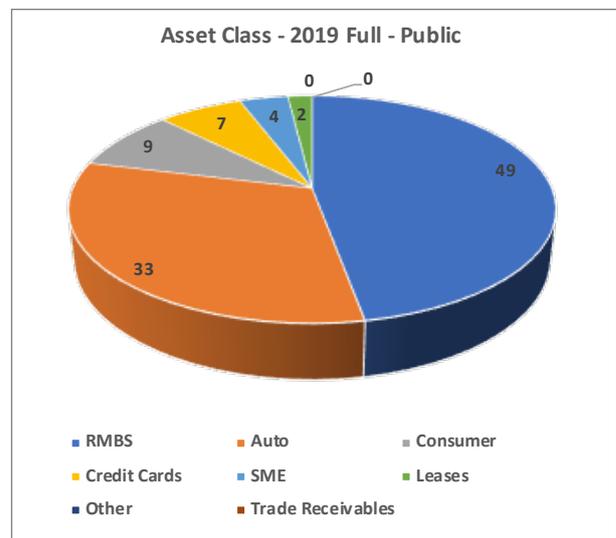
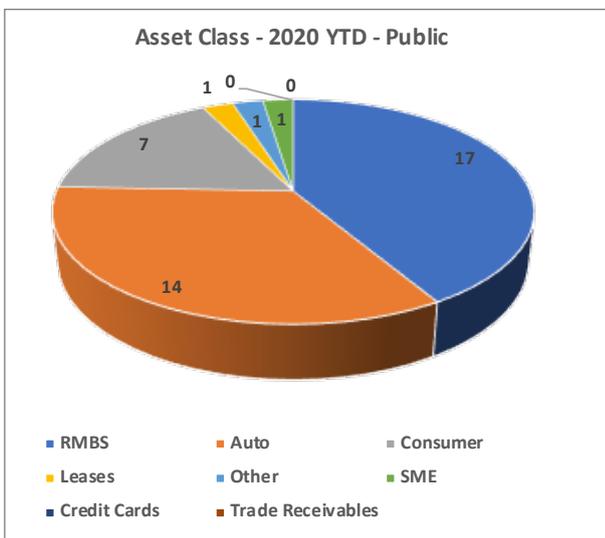
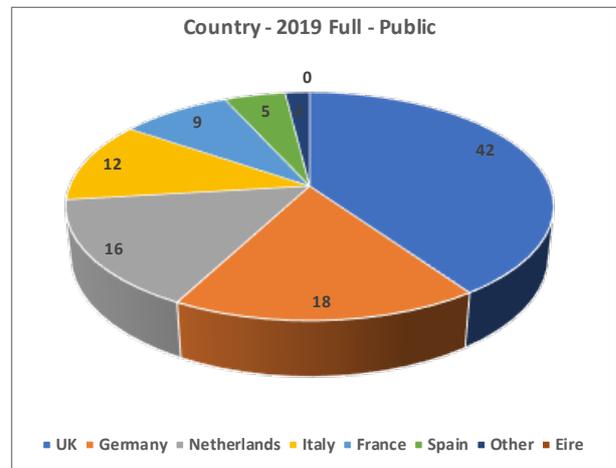
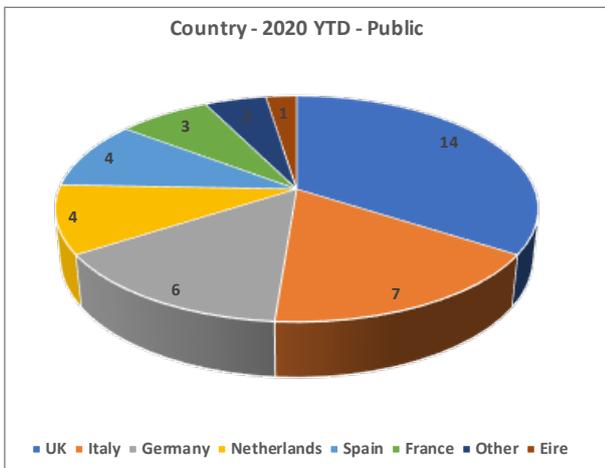
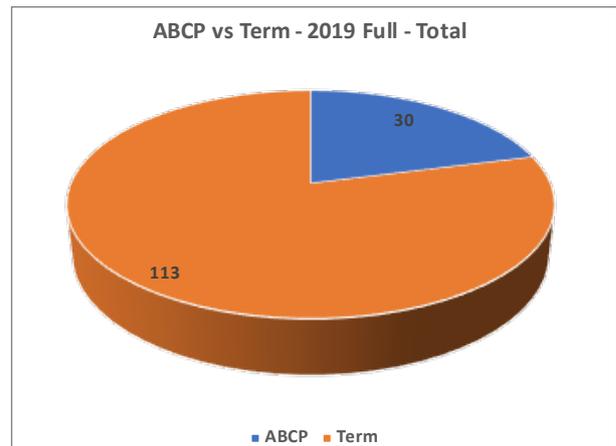
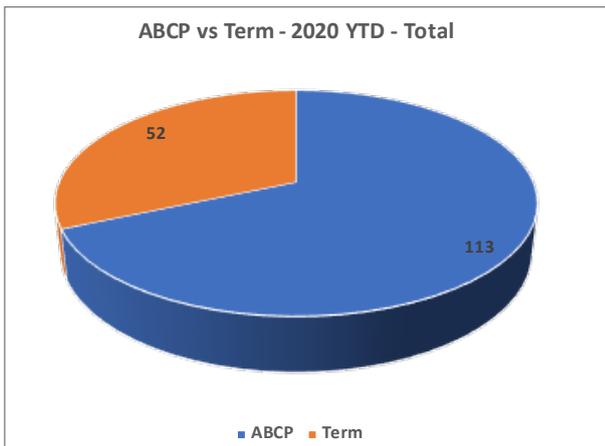
We intend these communications to be short, readable and to the point. Since many of the topics we write about are complex, we also invite our readers to make use of the contact information at the bottom of the newsletter if they wish to discuss any issue in greater depth.



2. Market data

As a regular feature of our newsletter we will publish some statistics regarding the STS market together with a few thoughts as to what these may mean.

All data from ESMA as of 6 July 2020.





Commentary:

Although current STS notifications at 165 already outstrip 2019's numbers, the charts above leave no doubt that this is thanks to the substantial influx of ABCP notifications.

Totalling only 30 for the whole of 2019, they have already reached 113 just past 1H2020.

In some way though, these ABCP numbers can be misleading and, to make sense of the data, three things need to be understood :

- The ABCP sponsors did not “come late to the party”. Having an ABCP transaction notified as STS allows the conduit's sponsor to obtain the better CRR capital requirements for the liquidity facility it provides to the conduit. However, the new CRR requirements for conduits only came into force on 1st January 2020 – one year later than the rules for bank investors in STS securitisations. Therefore, for conduit sponsors, the “party” started a year later, which explains why few deals were notified in 2019.
 - Looking at ABCP STS notifications it is important to understand that very few of these transactions are new financings. Almost all notified ABCP transactions are for financings in place before STS came into force. These transactions are reviewed, amended and updated at regular intervals and the market is seeing conduit sponsors using these reviews to adapt their transactions to the STS rules. This explains why these notifications are coming through the year – they are done as and when reviews are conducted, not as new finance is put in place.
 - The number of notifications substantially overstates the number of ABCP financings that are becoming STS. This is because many ABCP financings involve one borrower syndicating a facility across a number of conduits. The way the STS Regulation is drafted though, requires each sponsor separately to notify their conduit's share of the transaction.
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3. COVID-19, moratoria and STS – interpreting the “default” criterion

The STS rules disallow “defaulted” receivables. But with COVID-19, many borrowers are not paying thanks to moratoria. Where does that leave these receivables in an STS context ?

A securitisation containing “defaulted” receivables cannot obtain STS status. More specifically, Article 20.11 of the STS regulation states that the pool may not contain “exposures in default within the meaning of article 178(1) of Regulation (EU) No 575/2013”. Article 178(1) of that regulation – which is, of course, the CRR – tells you that an exposure is in “default” if it is 90 or 180 days “past due” (or considered “unlikely to pay”).

This formulation, from an STS point of view, begs the question of “past due” what date. Is it to be considered “past due” the normal payment date or should we interpret article 178(1) as “past due” the first “post-moratorium” date when the lender requires the borrower to resume payments? Does it matter that the moratorium is voluntary or that it is mandatorily imposed by law? If it is imposed by law, is the wording of the law relevant: does it matter that the law speaks of debts being “suspended” versus “unenforceable”?

For originators seeking to issue STS securitisations, there is some qualified good news. On April 2nd, the EBA issued a “guideline on legislative and non-legislative moratoria on loan payments applied in the light of the COVID-19 crisis”. (On 25th June, these guidelines were amended but only to extend some provisions to 30th September.)

This guideline explicitly deals with article 178(1) and broadly states that “past due” shall be calculated from the post-moratorium date on which the borrower is required to resume payments. Although this guideline was issued primarily to address banks’ overall Basel capital requirements, since it covers article 178(1), it is directly applicable to the STS rules. So, as a general matter, a securitisation may be issued backed by exposures whose borrowers have not paid as a result of a moratorium.

However, this is only “qualified” good news because, as often with STS rules, these are more complex than the headline would suggest. First, not all “moratoria” qualify. To take the benefit of this guideline, the moratorium must meet a far from straightforward six part definition. Secondly, the guideline imposes mandatory documentation requirements. Thirdly, the guidelines contain anti-avoidance provisions and an originator will need to be able to demonstrate that none of the securitised receivables subject to moratoria fall foul of these.

So, before an originator seeks to notify a securitisation containing receivables under moratoria as STS, it would be wise to take expert advice on how to navigate the many complexities that remain.



4. New LCR eligibility rules : it's AAA STS only for the moment

The new rules regarding eligibility for inclusion in bank liquidity cover ratios (LCR) came into force on 30 April 2020. Since they did not contain any “grandfathering” provision, from that date onward, any securitisation that wishes to be counted by a bank as part of its liquidity cover ratio pool will need to be STS.

However, unnoticed by pretty much all market participants was the fact that only AAA securitisations were eligible. This is the consequence of an EBA guideline originally designed to target a very different part of the CRR regime.

Under the new rules, the credit quality steps (“CQS”) required to be assigned to asset-backed securities for them to be LCR eligible, were amended to refer to CQS 1 in accordance with Article 264 of Regulation (EU) 575/2013 (the “CRR”).

The CRR was also amended to require the European Commission to publish an implementing technical standard (the “CQS ITS”) setting out the applicable new mapping of such CQS. No such implementing technical standards have yet been published. In January 2019, the EBA issued a Q&A response (2018_4274) to fill the gap stating that, until the CQS ITS is formally adopted, a new definition of CQS is to be used for article 264. This Q&A sets out a different CQS grid than that used for most other CRR purposes and which is the subject of a full regulatory technical standard (rather than only a guideline).

Under this different EBA guideline grid, only AAA is CQS1 – whereas under the grid published by the Commission as an RTS and with which the market is very familiar, CQS1 includes ratings down to AA-. Article 264 is primarily used for capital requirement purposes and calculations under SEC-ERBA.

PCS has good reasons to believe that the regulatory authorities did not intend it to define LCR eligibility and that its impact on that eligibility may well be an unintended consequence of the complexity of the statutory drafting. There is therefore hope that a solution may be found to return to the market's previous understanding on LCR eligibility as extending to AA.



5. Our people

PCS is a compact organisation with a total staff of 11. In each newsletter we will introduce one of them so that people get to know us. This time, Mark Lewis, Head of the Analytical Team. The people in the Analytical Team are the direct contacts of issuers and their arrangers and lawyers in the process of verification. They are also available at any time to answer investors' or potential investors' questions about any PCS verified transaction.

Mark Lewis



“After getting my degree at Downing College, University of Cambridge, I started work in 1983 and have worked in the financial markets since, although in those early days the securitisation market did not yet exist. My first securitisation was in 1989 and the transaction I am most proud of was organising the first ever whole business securitisation in the mid-1990's. I have been Head of European

Securitisation at UBS and Global Head of Structured Capital Markets at Unicredit. I served as chair of AFME's securitisation committee and joined PCS at its inception back in 2012, making for a total of 31 years in this industry.

On a personal level, I am married and have two daughters. My hobbies include animals and sport. Escape Animal Sanctuary is a registered charity to help abandoned, abused and neglected animals (mainly horses but also other animals) which I founded, still help to manage and which I am passionate about. In 2017 I completed the London Marathon”.

Contact information

For any questions or comments on this STS Newsletter you can contact the PCS staff.

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