German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments

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Contact: Olaf Instinsky
Telephone: +49 30 20225- 5439
Telefax: +49 30 20225- 5405
E-Mail: olaf.instinsky@dsgv.de
Az.: VER/SEC

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The German Banking Industry Committee is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent approximately 1,700 banks.

Coordinator:
German Savings Banks Association
Charlottenstrasse 47 | 10117 Berlin | Germany
Telephone: +49 30 20225-0
Telefax: +49 30 20225-250
www.die-deutsche-kreditwirtschaft.de

Comments Legislative proposal on securitisation criteria for simple, transparent and standardised (STS) securitisation

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General remarks

Capital requirements

We expressively welcome the plan to reduce risk weights for qualifying securitisations compared to those in the securitisation framework by the Basel Committee that has to be implemented by 1 January 2018. It should nevertheless be borne in mind that the capital requirements for STS securitisations will be considerably higher than today.

This applies, inter alia, to the floor risk weight for senior tranches. Even a reduction from 15% to 10% for qualifying securitisations in the IRB approach would mean an increase of the floor from 7% to 10% compared to the current situation (see Article 260 CRR-R).

In this context, we would like to draw attention to the following table, which has been taken from the EBA's consultation paper on the mapping of ECAI's credit assessments for securitisation positions:

Table 2 three-year CDR per asset class (July 2001-Jan 2010, S&P, Moody's and Fitch)

	AAA	AA	A	BBB	BB	B	CCC	CC	% of benchmark sample
All SF	2.1%	10.9%	12.9%	18.2%	25.0%	36.2%	54.4%	67.9%	
US sub-prime	4.8%	22.4%	28.4%	36.6%	47.8%	55.8%	60.9%	82.6%	34%
US CDO	5.8%	10.1%	9.6%	10.7%	11.8%	18.6%	33.8%	46.4%	8%
US RMBS ex sub-prime	0.6%	7.1%	12.0%	18.0%	25.7%	29.8%	52.9%	64.6%	27%
US CMBS	0.3%	1.9%	3.3%	6.9%	15.0%	25.4%	65.4%	66.3%	10%
EU CMBS	0.3%	0.7%	0.9%	3.1%	6.8%	15.6%	31.0%	22.7%	1%
EU CDO	0.4%	0.7%	0.7%	1.2%	1.7%	4.3%	22.0%	20.6%	1%
US ABS	0.0%	0.6%	0.8%	2.2%	9.0%	15.9%	26.3%	24.0%	7%
EU ABS	0.0%	0.0%	0.1%	0.7%	1.9%	8.5%	51.7%	45.7%	1%
EU RMBS	0.0%	0.1%	0.1%	0.6%	4.0%	8.8%	22.8%	18.5%	3%
Current CQS	1	1	2	3	4	5	5	5	

Source: CEREP data, EBA calculations.

Considering the very good performance of European ABS in general in the past, with three-year cumulative default rates for triple A and double A-rated European ABS bonds of 0.0%, we believe it would send

out the wrong signal if the floor risk weight for triple A-rated ABS were increased from 7% to 10% for STS-securitisations. Moreover, the increase in the floor capital requirement was, inter alia, motivated by model risk and risk as to the structure. Yet model and structure risks are significantly reduced if a securitisation is simple, transparent and standardised. In addition, notably the capital requirements for junior bonds with STS eligibility would extremely rise compared to the current capital requirements. For example, the risk weight for single A+ rated STS junior bonds with 5 year maturity and a tranche thickness of 5% would rise from 18% to 105% under the External Ratings Based Approach and thus around 5 times.

From our point of view, there should be a greater reduction in risk weights for STS securitisation compared to non-STS. This holds true for ABCP transactions that securitise exposures with longer maturities. For example, a liquidity facility provided by a sponsor for a granular leasing transaction with a maximum maturity of the underlyings of three years, with an internal risk assessment of A+ would, under the current regulations, receive a risk weight of 10 percent. If this transaction is non-STS this risk weight would be increased to 36 percent under the Commission's proposal. If the transaction is STS it would, admittedly, experience a considerable reduction of the risk weight to 23 percent but nevertheless be more than twice as high as today.

In total, the attractiveness of STS securitisation should not be undermined by capital requirements that are significantly higher than the current capital requirements for bank investors. Thus, capital requirements should not be increased for STS securitisations compared to the current situation. This would be more than justified given the good historical performance of European securitisations even during the last financial crisis.

Hierarchy of approaches

The hierarchy for the calculation of capital requirements entails a ranking of approaches reflecting the risk sensitivity of these approaches (SEC-IRBA, SEC-ERBA, SA). This hierarchy should be retained also for calculation of the capital requirements for high-quality securitisations. This is necessary for three reasons in particular:

1. Retention of the hierarchy for the calculation of the capital requirements for securitisations – also for high-quality securitisations – keeps the securitisation framework as a whole relatively simple.

2. The SEC-ERBA is more risk-sensitive than the SA and should therefore rank above the SA in the hierarchy. On no account should the SEC-ERBA be removed from the hierarchy. While rating errors were found to have been made by credit rating agencies during the financial crisis, measures were taken by regulators to address the flaws of the approach. These measures comprise the supervision of such CRAs and rules for determining ratings for securitisations. In addition, the reliance on external ratings was reduced through a change in the hierarchy of regulatory approaches.

3. The SEC-ERBA is, not least, a precondition for the application of the Internal Assessment Approach (IAA). Under this approach, banks rate their securitisation exposures to ABCP programmes in a manner consistent with CRAs' methodologies. They determine the risk weights by applying the self-determined ratings to the SEC-ERBA. Dropping the SEC-ERBA would mean

that, in particular, liquidity facilities which sponsors provide for multi-seller ABCP programmes would have to be treated under the SEC-SA or even deducted from capital.

Any change to the hierarchy for calculating the capital requirements for high-quality securitisations compared to other securitisations would further unsettle the securitisation market. This is at odds with a revitalisation of the securitisation market. We are therefore firmly in favour of retaining the hierarchy under the Basel Committee's proposals also for calculation of the capital requirements for high-quality securitisations.

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Specific comments

General remarks on maximum risk weights

Referring to the risk weights of the underlying exposures under the Standardised Approach may deliver ambiguous results with respect to qualifying as STS for the purposes of art. 260, 262 and 264 CRR-R. The risk weights of the underlying exposures may differ between institutions as institutions may nominate different numbers and different names of ECAIs to be used for the determination of risk weights (art. 138 CRR). As a result, a position in a securitisation considered as STS with respect to STS-R may qualify for reduced risk weights (art. 260, 262 and 264 CRR-R) in one institution and may fail to qualify for reduced risk weights in another institution.

We regard this implication as non-conforming to the original idea of STS securitisation.

Maximum risk weights for STS ABCP (art. 243 par. 1 (a) CRR-R)

Article 243 par. 1 (a) CRR-R requires for ABCP transactions that the risk of the securitised exposures under the Standardised Approach shall not be higher than 100 percent for any non-retail exposure.

This criterion is very problematic as the real economy originator will normally not be able to detect the risk weight of his receivables under the Standardised Approach.

What is more, it could preclude the securitisation of corporate exposures including SME corporate exposures as STS securitisation altogether and should not be adopted.

At present, a risk weight of 100 percent would mean that obligors with an external rating of B or worse (according to the rating scale of S&P) would have to be excluded from securitisation. The result would be that many corporate SME exposures that are successfully securitised today would have to be excluded. This problem is likely to compound at a later stage. Based on the recent consultative paper by the Basel Committee of December 2014 on the revision of the Standardised Approach to credit risk, for instance, all corporate SMEs with revenues less than 5 m. EUR and an equity ratio of less than 33% would have to be excluded from STS securitisations irrespective whether there is a significant single risk or not.

Not allowing real economy originators to securitise riskier exposures via a multi-seller ABCP programme would raise the funding costs for these corporates. This can lead to higher prices for riskier customers. Moreover, it is likely to lead to a concentration of risky exposures on the originators balance sheet. This can reduce the creditworthiness of the company an increase its funding costs even further.
Article 12 par. 5 STS-R already requires that the exposure must be originated in the ordinary course of the seller's business pursuant to underwriting standards that are not less stringent than those the seller applies to origination of similar exposures not securitised. In addition, according to Article 8 par. 7 STS-R excludes credit-impaired exposures. Thus, we don't see the need to exclude further exposures.

In recital 14 the EU Commission correctly points out that STS securitisations are neither free of risk, nor do they indicate anything about the credit quality of the underlying exposures. Instead the STS label should be understood to indicate that a prudent and diligent investor will be able to analyse the risk involved in the securitisation.

Last but not least, the delegated acts to the LCR and Solvency II do not contain such additional requirements, too.

For most high granular ABCP transactions no external ratings may be expected for the underlying exposures with high confidence. Nevertheless, a mandatory verification of the rating status for every single exposure in all transactions may not be delivered with reasonable effort by any party of the transaction.

We therefore propose to delete article 243 par. 1 (a) CRR-R.

Granularity criterion for ABCP (art. 243 par. 1 (b) CRR-R)

Article 243 par. 1 (b) CRR-R requires that positions in ABCP programmes can only qualify as STS securitisation if at the time of inclusion in the securitisation, the aggregate exposure value of all exposures to a single obligor in the pool does not exceed 1% of the exposure values of the aggregate outstanding exposure values of the pool of underlying exposures. For the purposes of this calculation, loans or leases to a group of connected clients, as referred to in point (39) of Article 4 (1), shall be considered as exposures to a single obligor.

We would like to point out that the proposed 1% ceiling for the exposure to a single obligor at the programme level is not viable for multi-seller ABCP programmes. As no common ID or unique labeling for obligors over the various transactions exists, it is technically neither possible for a sponsor bank to aggregate obligors over all transactions nor to check if groups of connected clients exist. Setting the ceiling at the transaction level would be no solution either as it would extremely limit the ability to securitise e.g. auto leases with guaranteed residual values. This would have adverse effects on the funding conditions of the respective manufacturers. We would, therefore, strongly suggest to limit the scope of the requirement. As it is neither possible to aggregate obligors over all transactions or to check for groups of connected clients the 1 % ceiling should be applied to the largest exposure of every transaction pool. For the purpose of this calculation, loans or leases to the same obligor in various transactions do not have to be aggregated. Article 4 par 39 should not apply.

We explicitly welcome that the requirement shall not apply to trade receivables where the credit risk of that receivables is fully covered by eligible credit protection. We propose to expand this exemption to residual leasing values that are not exposed to refinancing or re-sell risk due to an effective undertaking by a third party to repurchase or refinance the exposure at a certain amount.

Granularity criterion for term STS (art. 243 par. 2 (b) CRR-R)

Article 243 par. 2 (b) CRR-R envisages that positions in a securitisation will qualify as positions in an STS securitisation if, at the time of inclusion in the securitisation, the aggregate exposure value of all exposures to a single obligor in the pool does not exceed 1% of the exposure values of the aggregate outstanding exposure values of the pool of underlying exposures. For the purposes of this calculation, loans or leases to a group of connected clients, as referred to in point (39) of Article 4 (1), shall be considered as exposures to a single obligor.”

We agree that this threshold is appropriate for retail transactions. However, the requirements with respect to the group of connected clients should be formulated a little less restrictively to the effect that it applies “to the best of the knowledge” of the originator. The reason is that, to reduce the workload in the retail bulk business, thresholds are sometimes in operation to identify a group of connected clients. This practice does not compromise the identification of single risks, but could result in small exposures not being identified as belonging to a group of connected clients. Although it is very unlikely that the granularity threshold would be exceeded, the possibility cannot be fully ruled out that it might be exceed slightly in a very few cases. To avoid securitisation failing to qualify as STS in such cases, we believe the wording should be softened in the way of according to the best knowledge of the originator in retail transactions.

With respect to wholesale transactions we are of the opinion that the threshold is too low. In our view, a threshold of 5% is necessary. To allow for a sufficient diversification, we propose the following: a second aggregate threshold of 20% should be introduced where the concentration of a single group of connected clients may not exceed a proportion between 3% and 5% in relation to the securitised portfolio. For the other 80%, we propose a threshold of 3% to diversify the exposures in the less granular sub-portfolio.

Maximum risk weights for term STS (art. 243 par. 2 (c) CRR-R)

Article 243 par. 2 (c) CRR-R requires a maximum risk weight of the underlying exposures under the Standardised Approach for any other exposures, 100% on an individual exposure basis.

This criterion is very problematic and could preclude the securitisation of corporate exposures including SME corporate exposures as STS securitisation and should not be adopted.

In addition, it should be noted that many originators have not nominated ECAIs. The reason is, that originators often use the assessments of ECAIs in the credit process as additional piece of information but not universally, because also originators that apply the credit standardised approach usually use internal applications scorecards and internal rating models that are validated regularly. Thus, such originators cannot use external ratings in the Credit Standardised Approach, because Article 138 sentence 4 of the CRR does not allow a selective use of external ratings. Furthermore, the obligation to use the assessment of ECAIs would contradict the aim to reduce reliance on external ratings and thus the assessment of ECAIs. It would increase again the dependencies on external ratings.

If originators were forced to nominate an external rating agency solely for the purpose to comply with such minimum credit criteria then this would mean to force originators to use external ratings continuously throughout the group worldwide also for those corporate exposures that are not intended to be securitised although they are used for the time being only on the case by case basis. An obligation to use external ratings on a continuous basis including the permanent updates would raise the costs for originators significantly and deteriorate the deal economics dramatically because they would have to pay additionally for such external ratings for the securitised and non-securitised portfolios.

A risk weight of 100% would further mean that obligors with an external rating of B or worse (according to the methodology of Moody’s, S&P or Creditreform in Germany) would have to be excluded from securitisation. The result would be that many corporate SME exposures that are successfully securitised today

would have to be excluded from securitisation and thus from financing means which would be detrimental to such corporate SMEs.

The problem might be further heightened at a later stage. Based on the recent consultative paper by the Basel Committee from December 2014 on the revision of the credit standardised approach, for instance, all corporate SMEs with revenues up to 5 m. EUR and an equity ratio of 33% would have to be excluded from qualifying securitisation irrespective whether there is a significant single risk or not.

If major parts of the originated portfolio were excluded from securitisation that are linked with higher risk weights then we believe that the intended effects to boost the financing opportunities for SMEs to create growth and jobs will not be achieved. Due to limited capital resources of credit institution due to Basel III and increased capital requirements by EBA and ECB to augment the resilience of credit institutions, capital is a scarce resource in credit institutions in the meantime which limits the expansion of the lending business. Thus, many banks focus their lending to customers who absorb rather lower levels of capital. However, these companies generally do not experience problems in obtaining funding by means of, for example, loans. Hence, it seems more important that also loans can be securitised as qualifying being originated in the normal course of business based on transparent underwriting standards of the credit institution that must not be less strict than the underwriting standards that apply for the exposures that are not securitised. This would enable the transfer of credit risk and free up capital for new credit business and support the real economy.

Article 8 par. 6 sentence 1 STS-R already requires that the exposure are originated in the ordinary course of the originator's business pursuant to underwriting standards that are not less stringent than those the originator applies to origination of similar exposures not securitised. In addition, according to Article 8 par. 8 STS-R at least one payment has to be made and Article 8 par. 7 STS-R excludes defaulted and credit-impaired exposures. Thus, we don't see the need to exclude further exposures. Also the delegated acts to the LCR and Solvency II do not contain such additional requirements.
We propose to delete article 243 par. 2 (c) CRR-R.

Application of the 1,250% risk weight (art. 244 par. 1 (b) CRR-R)

Article 244 par. 1. (b) CRR-R allows the originator institution to apply a 1.250 % risk weight to all securitisation positions it holds in the securitisation or deducts these securitisation positions from Common Equity Tier 1 items in accordance with Article 36 (1) (k) CRR.

Par. 37 of the Securitisation Framework of the Basel Committee issued in December last year stipulates that "originator banks can offset 1,250% risk-weighted securitisation exposures by reducing the securitisation exposure amount by the amount of their specific provisions on underlying assets of that transaction and non-refundable purchase price discounts on such underlying assets." The new Article 248 CRR-R is not catered for first loss securitisation positions of originator banks from traditional securitisations comprising the cash reserve and additional underlying exposures for the purpose of overcollaterisation to be considered according to Article 244 par. 1 (b) CRR-R. In cases where a significant risk transfer has been recognised but where the SSPE has still to be included in commercial consolidation according to IFRS 10, the specific provisions from the underlying securitised exposures cannot be released and are still available

on the group level. Thus, it shall be further possible to deduct such specific provisions from the first loss position.

Definition mezzanine tranche (art. 244 par. 3 CRR-R)

Article 244 sentence 4 CRR-R proposes a definition of mezzanine securitisation position which differs from the current Article 243 par. 3 of the CRR.

As far as we understand the amendments of the current CRR result from the implementation of the new requirements of the changed securitisation framework from Basel or from the new securitisation regulation proposed by the European Commission. After due analysis of these documents, it appears that no changes of the definition of mezzanine securitisation are proposed. Therefore, we propose to maintain the current rules.

Legal opinions (art. 244 par. 4 (h), art. 245 par. 4 (g) CRR-R)

Articles 244 par. 4 (h) and 245 par. 4 (g) CRR-R requires an opinion from a qualified legal counsel that shall confirm compliance with the conditions set out in subparagraphs (b) to (g) / (f) of paragraph 4.

This would extend the current requirement to compile a legal opinion to conditions set out in Article 244 par. 4 (b), (d)-(g) / 245 par. 4 (b), (c), (e), (f) CRR-R.

We appreciate that regulators wish to establish greater legal certainty by extending the requirement for legal opinions. Given, however, that supervisors have to approve individual transactions involving a transfer of risk under the EBA's Guidelines on Significant Credit Risk Transfer (EBA/GL/2014/05 of 7 July 2014), they already have access to the entire documentation associated with the securitisation. It should also be borne in mind that extending the legal opinion requirement will increase the cost of transactions. Together with the higher capital requirements, this will make transactions less efficient, which runs totally counter to the Commission's wish to revive the securitisation market. Therefore, we propose to maintain the current rules.

Determination of tranche maturity (art. 257 par. 2 CRR-R)

Article 257 par. 2 CRR-R requires, by derogation from paragraph 1, institution shall use the final maturity of the tranche in accordance with point (b) of paragraph 1 where the contractual payments due under the tranche are conditional or dependent upon the actual performance of the underlying exposures.

Article 257 par. 1 (a) CRR-R determines that the tranche maturity can be measured on the basis of the weighted-average maturity of the contractual payments due under the tranche. We fully agree that this is the right approach to measure the tranche maturity. Unfortunately, paragraph 2 of Article 257 CRR-R stipulates that the final legal maturity of the tranche shall be used in accordance with point (b) of paragraph 1 where the contractual payments due under the tranche are conditional or dependent upon the actual performance of the underlying exposures. However, it is in the nature of securitisation tranches that they are conditional with regard to the rank of the payment stream in the waterfall and depend upon

the actual performance of the underlying exposures. Thus, if the conditions in paragraph 2 are not amended, the tranche maturity would have to be calculated in all cases on the basis of the final legal maturity which would be overly conservative and not justified from a risk perspective. At least for senior and junior securitisation positions that are supported by a mezzanine and a first loss position it should be envisaged to calculate the tranche maturity based on the weighted-average maturity of the contractual payments. This is notably justified for rated medium term securitisation positions. In contrast to long term securitisation positions that benefit from the 5 years maturity cap in Article 257 (3) CRR-R and where it makes no difference due to the maturity cap whether the tranche maturity is calculated on the basis of the weighted-average maturity of the contractual payments or the final legal maturity of the securitisation position, the difference and thus the impact on the risk weights is notably very big for rated junior bonds of medium term ABS. Eventually, the calculation of the tranche maturity in the SEC-ERBA should be based on the residual maturity, because the degree of certainty increase with decreasing residual maturity.

Treatment of STS securitisations under the SEC-IRBA (art. 260 CRR-R)

The floor for p of 0.3 for securitisation as set by the Basel Committee in its securitisation framework from December 2014 and implemented in Article 259 par. 1 CRR-R has not been reduced for STS securitisations in Article 260 CRR-R. Given the reduced agency and structural risks of STS securitisations, the floor which determines the floor capital surcharge in terms of non-capital neutrality compared to the capital requirements for the underlying assets should be reduced as well to reduce the undue level of non-neutrality.

Due to the outstanding performance of senior European ABS we propose to keep the risk weight floor for senior securitisation position at 7% for STS securitisations.

In addition, we propose to review the constant term of 0.5 for STS securitisations which could be too conservative and to complement it by a further review factor that should be less than 1.0.

As model calculations show the capital requirements of the whole securitisation is often negatively impacted by the floor capital requirements for senior bonds, because the calculated risk weight before the floor is often significantly lower than the floor risk weight. This applies also in the case of a 7% risk weight floor. On the other hand, the risk weight for junior tranches will partly increase significantly even if it is a STS-securitisation. Thus, it should be considered to attenuate the impact on the capital requirement of the securitisation by allowing to use the entire excess capital requirement of the senior tranche or a proportion of it to reduce the capital requirement for the junior tranche. To be prudent a relative floor could be introduced for junior tranches to ensure that the capital requirement for a junior tranche is higher than the capital requirement of the senior tranche.

Treatment of STS securitisations under SEC-ERBA (art. 262 CRR-R)

The risk weights of table 4 should be reduced significantly to avoid that the capital requirements increase significantly in the SEC-ERBA compared to the current capital requirements even it is a STS securitisation. This applies especially for non-senior tranches.

In addition, it is proposed that the risk weights for STS-securitisation positions should generally be calculated on the basis of the weighted–average maturity of the contractual payments due under the respective tranche of the securitisation. This would also contribute to the reduction of risk weights and would be justified given the better predictability of simple, transparent and standardised securitisations.

Senior positions in SME securitisation (art. 270 CRR-R)

SME as underlying (art. 270 (c) CRR-R)

As currently worded, Article 270(c) requires the underlying pool to be made up exclusively of exposures to SMEs. This is excessively restrictive, in our view. The reference to Article 501 of the CRR, which defines SME on the basis of Commission Recommendation 2003/361/EC of 6 May 2003, means that underlying pools could only include exposures to companies with a staff of less than 250, an annual turnover of no more than €50 million and total assets of no more than €43 million. This would automatically exclude a large number of businesses (e.g. midcaps).

The intention of this provision, as we understand it, is to ensure that securitisations backed by real-economy exposures may receive preferential treatment in the calculation of risk weights. Many companies which exceed the above criteria, such as midcaps, are nevertheless an integral part of the real economy. Their automatic exclusion runs the risk of undermining the creation of SME securitisations in the absence of sufficient underlying exposures capable of satisfying the envisaged criteria.

What is more, the number of eligible exposures will be further restricted by the need to also meet the requirements of Articles 8-10 STS-R.

To ensure that the objective of promoting the real economy can really be achieved, we would suggest broadening the definition of exposures eligible for securitisation along the lines of the Deutsche Bundesbank's list of assets eligible for use in the ESCB's refinancing system:[1]
"The debtor must be a commercial undertaking (including business partnerships and one-man-businesses) in the non-financial sector or public sector. The borrower must be headquartered in a participating country. The above requirements also have to be met by all further joint debtors (if any). This point notwithstanding, multilateral development banks and international organisations are always eligible debtors."

Guarantor (art. 270 (d) and (e) CRR-R)

Article 270 CRR-R permits originators to apply risk weights for STS securitisations to retained senior tranches in synthetic securitisations as long as the conditions of Articles 8 to 10 STS-R are met (with the exception of the true sale criterion).

[1] Deutsche Bundesbank: Allgemeine Geschäftsbedingungen der Deutschen Bundesbank, Bankrechtliche Regelungen 5, Section V. 10. 3. (General Terms and Conditions of the Deutsche Bundesbank of 1 July 2015, in German only).

Under Article 270(e) CRR-R, however, this only applies to transactions where the guarantor would qualify for a 0% risk weight. This will normally only be the case if the securitisation is agreed bilaterally between the originator and investor. Transactions will be excluded, by contrast, if the risk associated with the mezzanine tranche (the senior tranche being retained) is transferred to an SPV which then issues credit-linked notes (CLNs) for purchase by “normal” external investors. Under this structure, the proceeds from the CLN issue are pledged to the originator. Should the investor default, the originator consequently has protection in the form of cash collateral deposited, for instance, at the KfW (risk weight: 0%).

Given the objective of reviving the securitisation market, “normal” investors should not be placed in a less favourable position than are central governments, etc. If the risk of the investor’s default is covered by cash collateral, the risk is identical in both cases, in our view, and the regulatory treatment of both cases should also be identical. We therefore consider it appropriate to also apply risk weights for STS securitisations to retained senior positions collateralised in the manner described above.