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COVER NOTE

From:	Ms Christine LAGARDE, President of the European Central Bank
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To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union

Subject:	Opinion of the European Central Bank of 23 September 2020 on proposals for regulations amending the Union securitisation framework in response to the Covid-19 pandemic (CON/2020/22)
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Delegations will find attached the above mentioned opinion.

Encl.: [...]

OPINION OF THE EUROPEAN CENTRAL BANK
of 23 September 2020
on proposals for regulations amending the Union securitisation framework in response to the
COVID-19 pandemic
(CON/2020/22)

Introduction and legal basis

On 27 August 2020 the European Central Bank (ECB) received a request from the Council of the European Union for an opinion on (a) a proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation to help the recovery from the COVID-19 pandemic¹ (hereinafter the 'proposed securitisation regulation'); and (b) a proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards adjustments to the securitisation framework to support the economic recovery in response to the COVID-19 pandemic² (hereinafter the 'proposed regulation amending the CRR') (together hereinafter the 'proposed regulations').

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union, since the proposed regulations contain provisions affecting: (a) the ESCB's contribution to the smooth conduct of policies pursued by competent authorities relating to the prudential supervision of credit institutions and the stability of the financial market system pursuant to Article 127(5) of the Treaty; and (b) the tasks conferred on the ECB pursuant to Article 127(6) of the Treaty concerning policies relating to the prudential supervision of credit institutions. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

General observations

1. Objectives of the proposed regulations

The unprecedented implications of the global crisis triggered by the coronavirus (COVID-19) pandemic have prompted public authorities globally to take swift and decisive actions aimed at ensuring that credit institutions can continue to fulfil their role in funding the real economy and are able to support economic recovery, notwithstanding the increasing losses they are likely to face due to the crisis.

While competent authorities, including the ECB, across the Union have provided temporary capital and operational relief in reaction to the new circumstances, the Union legislative bodies have recently adopted

¹ COM(2020) 282 final.

² COM(2020) 283 final.

Regulation (EU) 2020/873 of the European Parliament and the Council³ which contains targeted amendments to the Union's prudential regulatory framework for credit institutions to maximise the capacity of credit institutions to lend and absorb losses related to the COVID-19 pandemic, while still ensuring their continued resilience⁴.

Against this background, the ECB generally welcomes the Commission's proposed regulations, which contain targeted amendments to the Union securitisation framework with the aim of facilitating the use of securitisation in the Union's recovery through two measures. The first measure is the introduction of a framework for simple, transparent and standardised (STS) balance-sheet synthetic securitisation in order to facilitate lending by credit institutions to the real economy. The second measure is the removal of regulatory obstacles to the securitisation of non-performing exposures (NPEs), in order to maintain the lending capacity of credit institutions, given that an increase in NPEs caused by COVID-19 can be expected. It is based on draft standards proposed by the Basel Committee on Banking Supervision (BCBS) and published for consultation in June 2020 (hereinafter the 'draft BCBS standards')⁵.

2. Clarification of the ECB's supervisory competence

The ECB wishes to recall its view expressed in the previous ECB Opinion on the Union securitisation framework (CON/2016/11)⁶ regarding the ECB's supervisory competences in respect of securitisation⁷. As noted therein, Article 127(6) of the Treaty only permits the conferral of tasks on the ECB in areas relating to the prudential supervision of credit institutions. Accordingly, Article 4(1)(d) of Council Regulation (EU) No 1024/2013⁸ assigns to the ECB, for prudential supervisory purposes, the task of ensuring compliance by significant credit institutions with the relevant Union law which imposes prudential requirements in the area of securitisation.

In particular, in line with the previous ECB Opinion, the ECB remains of the view that directly ensuring the compliance of significant credit institutions acting as originators, sponsors or original lenders with risk retention rules (Article 6 of Regulation (EU) 2017/2402 of the European Parliament and of the Council⁹) and transparency requirements (Article 7 of Regulation (EU) 2017/2402) should be viewed as primarily relating to supervision of product markets. The same applies to the rules relating to the ban on resecuritisation (Article 8 of Regulation (EU) 2017/2402). These rules do not have as their primary objective the prudential supervision of credit institutions. Instead, these rules ensure alignment of

³ Regulation (EU) 2020/873 of the European Parliament and of the Council of 24 June 2020 amending Regulations (EU) No 575/2013 and (EU) 2019/876 as regards certain adjustments in response to the COVID-19 pandemic (OJ L 204, 26.6.2020, p. 4).

⁴ See section 1 of the explanatory memorandum to the Commission's legislative proposal (COM(2020) 310 final).

⁵ Basel Committee on Banking Supervision, 'Technical amendment: Capital treatment of securitisations of non-performing loans', June 2020 (issued for comments by 23 August 2020).

⁶ Opinion of the European Central Bank of 11 March 2016 on (a) a proposal for a regulation laying down common rules on securitisation and creating a European framework for simple, transparent and standardised securitisation; and (b) a proposal for a regulation amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms (CON/2016/11) (OJ C 219, 17.6.2016, p. 2).

⁷ See paragraph 3 of Opinion CON/2016/11.

⁸ Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

⁹ Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 (OJ L 347, 28.12.2017, p. 35).

interests between originators, sponsors or original lenders and investors and allow investors to understand, assess and compare securitisation transactions. Therefore, the ECB considers that such tasks cannot be conferred on the ECB

Against this background, the ECB is concerned that recital (21) of the proposed securitisation regulation unduly assigns prudential character to Articles 6 to 8 of Regulation (EU) 2017/2402 by designating these requirements as prudential obligations and specifically entrusting the competence to ensure compliance with these requirements to competent authorities in charge of prudential supervision, without providing any reasoning why such rules are considered prudential. In this regard, the ECB also notes that recital (21) appears to contradict the objectives of the requirements set out in Articles 6 to 8 of Regulation (EU) 2017/2402, as expressed in recitals (8) and (10) to (13) of that Regulation, which refer to the aim of preserving and protecting the interests of investors.

An interpretation as suggested by recital (21) would imply that the ECB should be responsible for ensuring compliance with the requirements set out in Articles 6 to 8 of Regulation (EU) 2017/2402, which primarily relate to product markets and investor protection. That interpretation would be contrary to Article 127(6) of the Treaty and cannot be followed. A recital cannot affect the requirement for Union legislation to be interpreted in accordance with the Treaty.

Consequently, recital (21) of the proposed securitisation regulation should be amended to ensure that the ECB's competence under the proposed securitisation regulation reflects the tasks conferred on it by Article 127(6) of the Treaty and Regulation (EU) No 1024/2013.

Specific observations

3. STS synthetic securitisations

- 3.1 The Commission proposes, in agreement with the recommendation of the European Banking Authority (EBA) in its report of 6 May 2020 (EBA/OP/2020/07)¹⁰, to introduce a specific framework for STS balance-sheet synthetic securitisations, similar to the existing STS framework for traditional securitisations. The Commission proposal also introduces a preferential risk weight treatment for senior tranches of synthetic STS securitisations that are retained by the originator. The ECB notes that this proposal is not in line with BCBS standards, as BCBS standards do not foresee an STS framework for synthetic securitisations.
- 3.2 The ECB welcomes the proposal to standardise the synthetic securitisation market through the introduction of STS criteria, which are likely to have a positive steering effect. The ECB also acknowledges that the EBA's analysis¹¹ demonstrates the good performance of balance sheet synthetic securitisations over the last ten years. However, as the EBA recognises in the aforementioned report, there are limitations in the data and transactions used in this analysis.
- 3.3 Nevertheless, the ECB recommends that a thorough monitoring of the STS synthetic securitisation market is put in place. The preferential risk weight treatment could be an incentive for credit institutions to increase their reliance on synthetic securitisation for capital management. A future

¹⁰ EBA Report on STS framework for synthetic securitisation under Article 45 of Regulation (EU) 2017/2402 (EBA/OP/2020/07) dated 6 May 2020.

¹¹ EBA Report on STS framework for synthetic securitisation under Article 45 of Regulation (EU) 2017/2402 (EBA/OP/2020/07) dated 6 May 2020.

systemic shock could potentially cause several synthetic securitisation structures to fail at the same time, putting pressure on capital positions of credit institutions and reducing their ability to lend to the real economy. Monitoring the risk of such an event would be prudent.

4. Securitisation of NPEs

- 4.1 The ECB supports the Commission's proposal to adjust the prudential treatment of NPE securitisations, in line with the recent consultation by the BCBS, and recommends that the draft BCBS standards are reflected faithfully unless there is a strong reason to deviate. In that respect, the ECB recommends that the Commission's proposal should be adjusted, if necessary, to reflect the final BCBS standards. NPE securitisations are a useful tool for credit institutions to reduce NPE ratios, while transferring NPE risk away from the banking system. The regulatory framework should facilitate this process, while ensuring adequate capital is held for positions in NPE securitisations that remain in the banking system.
- 4.2 The current rules for the computation of risk weights for securitisation positions, if stringently applied, can lead to excessively high risk weights for positions in NPE securitisations. In order to facilitate the reduction of NPEs by credit institutions, one important element is to ensure that the resulting securitisation positions are subject to appropriate risk weights. The draft BCBS standards strike a good compromise between risk sensitivity and simplicity by defining a fixed 100% risk weight for senior tranches of qualifying NPE securitisations.
- 4.3 The definition of NPE securitisations in the proposed securitisation regulation deviates from the definition proposed in the draft BCBS standards. Whereas the draft BCBS standards define NPE securitisations as those where the parameter W (defined in Article 261(2) of the CRR) is greater than 90%, the Commission's proposal defines NPE securitisations as securitisations where 90% of the underlying assets are non-performing as defined in Article 47a(3) of Regulation (EU) No 575/2013 of the European Parliament and of the Council¹² (hereinafter the 'CRR'). The ECB supports the approach proposed by the Commission for the following reasons. Credit institutions established in the Union apply the NPE definition as set out in Article 47a(3) of the CRR for regulatory reporting and risk management purposes; the definition in Article 47a(3) of the CRR is more closely aligned with associated economic risks and bank practice than the parameter W. In addition, the definition of NPEs in Article 47a(3) of the CRR captures unlikely-to-pay exposures, in contrast to the definition proposed in the draft BCBS standards; some Union credit institutions have significant stocks of unlikely-to-pay exposures and would benefit from the proposals.
- 4.4 Further, the Commission's proposal contains amendments to the eligibility of unfunded credit protection as set out in Article 249(3) of the CRR. While the current CRR is not fully in line with BCBS standards¹³ on this issue, the Commission's proposal would also not be fully aligned with BCBS standards. The ECB proposes amending Article 249(3) of the CRR to be fully aligned with the BCBS standards, meaning that no minimum rating requirements are imposed on most of the

¹² Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

¹³ BCBS standard describing the capital requirements calculation for credit risk Chapter 22, paragraph 90 of the Basel Framework (CRE 22.90).

unfunded credit protection providers, while requirements are imposed on unfunded credit protection provided by unregulated private entities in line with the BCBS standards.

- 4.5 The ECB recommends an amendment to the proposed definition of non-refundable purchase price discount (NRPPD). The Commission's proposal defines NRPPD as the price discount incurred when NPEs are transferred to a special purpose vehicle (SPV) in exchange for securitisation notes below their outstanding nominal amount. This definition does not however cover the additional discount that is realised when the originator sells these notes to investors below their nominal amount¹⁴. In order to capture the economic substance of NPE securitisations, the definition should be extended also to capture discounts which are realised when notes are sold to investors at origination. The ECB further recommends expressly excluding refundable purchase price discounts, which can undermine the risk transfer as the originator is still exposed to the performance of the NPEs.
- 4.6 The Commission proposes an amendment to the calculation of the maximum capital requirements defined in Article 268 of the CRR for NPE securitisations by allowing the deduction of NRPPD from expected losses when computing maximum capital requirements. The ECB notes that while there are arguments to support the view that the application of this deduction is consistent with the BCBS standards¹⁵ on this issue, it is not expressly stated in those standards.
- 4.7 Finally, the ECB recommends clarifying, for the avoidance of doubt, that the 100% risk weight floor for NPE securitisations overrides the so-called 'look-through approach' risk weight cap for senior securitisation positions pursuant to Article 267 of the CRR (if the cap results in a risk weight below 100%), as expressly stated in the draft BCBS standards (see CRE 45.5).

Where the ECB recommends that the proposed regulations are amended, specific drafting proposals are set out in a separate technical working document accompanied by an explanatory text to this effect. The technical working document is available in English on EUR-Lex.

Done at Frankfurt am Main, 23 September 2020.



The President of the ECB

Christine LAGARDE

¹⁴ NPE securitisations are often executed as illustrated in the following example: (1) the originator owns an NPE portfolio with an outstanding value of 100 and a book value of 60; (2) the originator then transfers the NPE portfolio to an SPV at a value of 60; (3) the SPV issues notes with a nominal value of 60 (i.e. junior notes with a nominal value of 20; mezzanine notes with a nominal value of 20; senior notes with a nominal value of 20), which it transfers to the originator in exchange for the NPE portfolio; (4) the originator sells the junior and mezzanine notes to investors for a sale price of 10 (i.e. junior notes sold for 2; mezzanine notes sold for 8 – on the basis of the simplifying assumption that the originator is not required to comply with risk retention requirements) and retains the senior notes, attributing to them an accounting value of 20. A narrow definition of NRPPD would lead in this example to a value of 40%, while a wider definition, which better reflects economic reality, would lead to a value of 70%. A wider definition therefore allows a wider range of NPE securitisations to benefit from the fixed risk weight of 100%.

¹⁵ BCBS standard describing the capital requirements calculation for credit risk Chapter 40, paragraph 54 of the Basel Framework (CRE 40.54).



Technical working document
produced in connection with ECB Opinion (CON/2020/22)¹
Drafting proposals

Text proposed by the European Commission	Amendments proposed by the ECB ²
Amendment 1 Recital 21 of the proposed securitisation regulation	
Member States should designate the competent authorities that would be responsible to supervise the requirements that on-balance-sheet synthetic securitisation have to meet in order to qualify for the STS designation. The competent authority could be the same as the one designated to supervise the compliance of originators, sponsors and SSPEs with the requirements that traditional securitisations have to meet in order to acquire the STS designation. Like in the case of traditional securitisations, such competent authority could be different from the competent authority responsible to supervise the compliance of originators, original lenders, SSPEs, sponsors and investors with the prudential obligations incumbent under Articles 5 to 9 of Regulation (EU) 2017/2402, and the compliance of which, given the prudential dimension of those obligations, was specifically entrusted to the competent authorities in charge of the prudential supervision of the relevant financial institutions.	Member States should designate the competent authorities that would be responsible to supervise the requirements that on-balance-sheet synthetic securitisation have to meet in order to qualify for the STS designation. The competent authority could be the same as the one designated to supervise the compliance of originators, sponsors and SSPEs with the requirements that traditional securitisations have to meet in order to acquire the STS designation. Like in the case of traditional securitisations, such competent authority could be different from the competent authority responsible to supervise the compliance of originators, original lenders, SSPEs, sponsors and investors with the prudential obligations incumbent under Articles 5 to 9 of Regulation (EU) 2017/2402, and the compliance of which, given the prudential dimension of those obligations, was specifically entrusted to the competent authorities in charge of the prudential supervision of the relevant financial institutions.
<u>Explanation</u> <i>As explained in paragraph 2 of the ECB Opinion, obligations incumbent under Articles 6 to 8 of Regulation (EU) 2017/2402 primarily relate to supervision of product markets with the aim of protecting</i>	

¹ This technical working document is produced in English only and communicated to the consulting Union institution(s) after adoption of the opinion. It is also published on EUR-Lex alongside the opinion itself.

² Bold in the body of the text indicates where the ECB proposes inserting new text. Strikethrough in the body of the text indicates where the ECB proposes deleting text.

Text proposed by the European Commission	Amendments proposed by the ECB ²
<i>the interests of investors and not to prudential supervision. Thus, the ECB proposes a clarification in this regard, which is also in line with recitals (8) and (10) to (13) of Regulation (EU) 2017/2402, ensuring an interpretation of Regulation (EU) 2017/2402 in accordance with Article 127(6) of the Treaty which provides for the conferral of tasks on the ECB only in areas relating to the prudential supervision of credit institutions.</i>	
Amendment 2 Article 1(1) of the proposed regulation amending the CRR (Article 249(3) of the CRR)	
Regulation (EU) No 575/2013 is amended as follows: (1) in Article 249(3), the first subparagraph is replaced by the following: “By way of derogation from paragraph 2, the eligible providers of unfunded credit protection listed in point (g) of Article 201(1) shall have been assigned a credit assessment by a recognised ECAI which is credit quality step 3 or above.”	Regulation (EU) No 575/2013 is amended as follows: (1) in Article 249(3), the first subparagraph is replaced by the following: “By way of derogation from paragraph 2, the eligible providers of unfunded credit protection listed in point (g) of Article 201(1) shall have been assigned a credit assessment by a recognised ECAI which is credit quality step 2 or above at the time the credit protection was first recognised and credit quality step 3 or above thereafter.”
<u>Explanation</u> <i>As the Commission’s explanatory memorandum notes, the current wording of Article 249(3) of the CRR is inconsistent with the Basel III framework in imposing a minimum rating requirement for all providers of unfunded credit protection. The Basel standard describing the capital requirements calculation for credit risk, chapter 22 on the standardised approach for the recognition of credit risk mitigation, paragraph 90, (CRE 22.90) requires an external rating of at least A- at inception and BBB- throughout the lifetime of unfunded credit protection provided by private entities which are not prudentially regulated. As explained in paragraph 4.4 of the ECB’s Opinion, in order to be consistent with Basel CRE 22.90, Article 249(3) of the CRR should require an unregulated provider of unfunded credit protection to have credit quality step 2 at inception and credit quality step 3 thereafter.</i>	

Text proposed by the European Commission	Amendments proposed by the ECB ²
Amendment 3 Article 1(2) of the proposed regulation amending the CRR (Article 269a of the CRR (new))	
Regulation (EU) No 575/2013 is amended as follows: ... (2) the following Article 269a is inserted: Article 269a Treatment of non-performing exposures (NPE) securitisations 1. The risk weight for a position in an NPE securitisation shall be calculated in accordance with Article 254, subject to a floor of 100%. 2. By way of derogation from paragraph 1, institutions shall assign a risk weight of 100% to the senior securitisation position in a traditional NPE securitisation, provided the exposures in the pool backing the securitisation have been transferred to the SSPE with a non-refundable price discount of at least 50% on the nominal amount of the exposures. 3. Institutions that pursuant to Chapter 3 of this Title are not permitted to use own estimates of LGD and conversion factors with respect to the exposures of the pool shall not be permitted to use the SEC-IRBA for the calculation of risk weighted exposures amounts for a position in an NPE securitisation. 4. For the purpose of Article 268(1), expected losses associated with positions in an NPE securitisation shall be included after deduction of the non-refundable price discount as referred to in paragraph 2 of this Article and, where applicable, any additional specific credit risk adjustments. 5. For the purposes of this Article, 'NPE securitisation' means NPE securitisation as defined	Regulation (EU) No 575/2013 is amended as follows: ... (2) the following Article 269a is inserted: Article 269a Treatment of non-performing exposure (NPE) securitisations 1. The risk weight for a position in an NPE securitisation shall be calculated in accordance with Article 254, subject to a floor of 100%. 2. By way of derogation from paragraph 1, institutions shall assign a risk weight of 100% to the senior securitisation position in a traditional NPE securitisation, provided the exposures in the pool backing the securitisation have been transferred to the SSPE with a that the resulting non-refundable purchase price discount is of at least 50% on the nominal amount of the exposures. For the purposes of this Article, 'non-refundable purchase price discount (NRPPD)' means the result of 100% minus the quotient of: • the sum of the sale price of the tranches (or part of a tranche) of an NPE securitisation sold to third party investors, and the nominal value of the tranches (or part of a tranche) retained by the originator, • divided by the nominal amount of the underlying exposures. If a discount, on the transfer either of the underlying exposures or of a tranche (or part of

Text proposed by the European Commission	Amendments proposed by the ECB ²
in point (24) of Article 2 of Regulation 2017/2402.	a tranche), is structured in such a way that it can be refunded in whole or in part to the originator, such discount shall be treated as refundable and shall not count towards the NRPPD for the purposes of this Article. 3. Institutions that pursuant to Chapter 3 of this Title are not permitted to use own estimates of LGD and conversion factors with respect to the exposures of the pool shall not be permitted to use the SEC-IRBA for the calculation of risk weighted exposures amounts for a position in an NPE securitisation. 4. For the purpose of Article 268(1), expected losses associated with positions in an NPE securitisation shall be included after deduction of the non-refundable purchase price discount as referred to in paragraph 2 of this Article and, where applicable, any additional specific credit risk adjustments. 5. For the purposes of this Article, 'NPE securitisation' means NPE securitisation as defined in point (24) of Article 2 of Regulation (EU) 2017/2402. 6. Notwithstanding the provisions of Article 267, where the maximum risk weight for a senior position in an NPE securitisation calculated in accordance with Article 267(1) results in a risk weight lower than 100%, a risk weight of 100% shall be used instead.
<u>Explanation</u> <i>As explained in paragraph 4.5 of the ECB Opinion, the ECB proposes a definition of non-refundable purchase price discount (NRPPD) and clarifies the precedence of the 100% risk weight floor over the look-through approach.</i> <i>The definition of NRPPD proposed in paragraph 2 reflects the experience of ECB Banking Supervision. In practice, NRPPD is usually realised in two ways: the NPE portfolio may be transferred to an SPV at a discount and/or the securitisation notes may be sold to external investors at a (further) discount. The ECB's drafting proposal ensures that both discounts are captured and that the definition of NRPPD</i>	

Text proposed by the European Commission	Amendments proposed by the ECB ²
	<i>reflects the economic reality of the transactions encountered in practice. To note, tranches or parts of tranches retained by the originator shall be treated as having no NRPPD on them; such tranches or parts of tranches may be subject to discounts but such discounts are refundable in the event that the NPEs return more than expected and should therefore not count towards NRPPD.</i> <i>The priority accorded to the 100% risk weight floor proposed in paragraph 6 reflects the approach taken in the draft Basel standard in CRE 45.5. That draft standard expressly provides that where the look-through approach (Basel CRE 40.50 and Article 267 of the CRR) leads to a risk weight of less than 100%, a risk weight of 100% should instead be applied for a senior position in an NPE securitisation. For the avoidance of doubt, the ECB proposes that the CRR should explicitly provide that a minimum 100% risk weight rather than a lower risk weight under Article 267 applies for a senior position in an NPE securitisation.</i>