



May 7, 2015

# Proposed Attributes of High-Quality Securitization in Europe<sup>1</sup>

(Annex II of “Revitalizing Securitization for Small and Medium-Sized Enterprises in Europe”)

## Executive Summary and Background

**This Annex introduces a harmonized set of key attributes for high-quality securitization (HQS) (‘General Criteria’), which informs a principles-based definition of simple, transparent, and comparable forms of securitization.**<sup>2</sup> It lays out specific principles for the structure of HQS (exclusion criteria, binding requirements, and alignment of interest) as well as requirements for greater disclosure of underlying asset quality and performance monitoring, which aid compliance efforts, enhance transparency, and help improve the effectiveness of existing regulation and supervision. This proposal also introduces additional criteria for SME loans as securitized assets (‘Additional Criteria’)<sup>3</sup> but does not consider jurisdiction- and asset class-specific criteria for securitized assets. All proposed criteria for HQS are aimed at fostering the convergence of best market practice, creating incentives for originators and issuers to maintain minimum standards of prudent lending and risk management.

**The proposed attributes draw on several existing attempts at defining HQS.** In particular, the specified criteria synthesize and augment elements of critical attributes of HQS presented in existing initiatives and market standards. So far, there have been (at least) four major attempts at defining HQS in Europe, which have been motivated by risk control and mitigation for central banking operations and the revisions to the regulatory treatment of securitization:

- The *European Commission’s* implementation of the regulatory treatment of HQS in the context of (i) the Solvency II regime for insurers (European Commission 2014c) and EIOPA’s recommendation on a “Type 1 standard” for securitization transactions,<sup>4</sup> (ii) the implementation of the liquidity coverage ratio (LCR) and the leverage ratio for

<sup>1</sup> This Annex was written by Andreas A. Jobst.

<sup>2</sup> Some of the proposed attributes and criteria have been formulated with a view to facilitating HQS in the European context. A broader adoption outside the EU would require only minor modifications to this proposal.

<sup>3</sup> In addition, specific criteria suggested by the EIF (Kraemer-Eis, Lang, and Gvetadze 2014, p. 62) regarding HQS in the context of securitizing SME debt finance have informed this section of the proposal.

EU banks under the Capital Requirements Regulation (CRR) (European Commission 2014a and 2014b), and (iii) the development of a (legislative) proposal for HQS as a short-term measure presented in the Green Paper on Building the Capital Markets Union (European Commission 2015a and 2015b) based on the existing regulatory treatment of HQS for banks and insurance companies and the EBA (2014) Discussion Paper on “Simple, Standard and Transparent Securitizations”;

- The collateral eligibility criteria for refinancing operations by the ECB (2010) based on the loan-level data initiative and the Bank of England (2010);<sup>5</sup>
- The joint consultative document by *Joint Task Force on Securitisation Markets* by the Basel Committee on Banking Supervision (BCBS) and International Organization of Securities Commissions (IOSCO) on “Simple, Transparent and Comparable Securitizations”(2014) in consultation with the International Association of Insurance Supervisors (IAIS) and the International Accounting Standards Board (IASB),
- The German securitization standard (“Deutscher Verbriefungsstandard”) by the bank consortium *True Sale International GmbH*.<sup>6</sup>

The proposed criteria also take on board some recommendations presented in AFME’s review of HQS (Hopkin, Bak, and Ulker 2014). These different approaches share several common characteristics, which are reflected in this proposal.<sup>7</sup>

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<sup>4</sup> The European Commission has developed its initial concept of HQS for regulatory changes based on the principles in EIOPA’s (2013) *Technical Report on Standard Formula Design and Calibration for Certain Long-Term Investments*, which defines a “Type 1” standard for long-term investment in securitization transactions.

<sup>5</sup> The requirements by the Bank of England are closely aligned with (but not fully match) the eligible asset classes and eligibility requirements of the *Prime Collateral Securities* (PCS) standard. Further development of HQS has also been advocated by both the ECB and the Bank of England in their joint work on how the functioning of the securitization market in Europe can be improved (Bank of England and ECB 2014a and 2014b).

<sup>6</sup> In 2012, the European Covered Bond Council also launched a transparency initiative for covered bonds in Europe, which mirrors some of developments in the securitization market. The so-called “Covered Bond Label Convention” (CBLF 2014) establishes a clear perimeter for eligible asset classes, highlights the core standards and quality of covered bonds, and improves access to information for investors, regulators, and other market participants.

<sup>7</sup> The most salient common characteristics that support the general properties of HQS are (1) the restriction to asset structures with a real funding need (that is, re-securitization is excluded); (2) minimum credit rating threshold(s); (3) the exclusion of nonperforming loans and loans to self-certifying borrowers or credit-impaired borrowers at the time of loan origination; (4) homogenous cash flows from underlying portfolios (that is, securitization of mixed pools and re-securitizations are excluded); and (5) comprehensive documentation by providing detailed data about securitized assets and the valuation of tranches at launch and on a regular basis.

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# PROPOSED ATTRIBUTES OF HIGH-QUALITY SECURITIZATION IN EUROPE

## I. General Criteria<sup>8</sup>

### A. Asset characteristics: underwriting process and asset eligibility

1. **Sound underwriting practices:** Securitized assets have been originated, or originated and acquired, in the ordinary course of the originator's business, subject to an adequate process for assessing the creditworthiness of the borrower.
  - i. Risk governance: There is an established framework together with necessary operational processes for the management of loan accounts, delinquency procedures and internal audits, which apply to both securitized and non-securitized assets. Securitized assets are selected as part of ongoing balance sheet operations (with seasoned, senior, and fully-disbursed loans only) without affecting the organizational structure and the distribution channel supporting the origination process, including risk management and control.
  - ii. No selection bias: Securitized assets should be subject to the same credit laws, prudential standards, and underwriting practices (that is, lending standards, approval process, and incentives) as non-securitized assets. Securitized assets should not materially differ from non-securitized assets, and their credit process should be within the originator's normal business practice, which also includes comparable credit standards for securitized and non-securitized assets. The securitization process has no bearing on the originator's/issuer's compliance with the minimum prudential standards applicable to the loan origination and the administration of impairment balances, including the relevant risk management and control processes.
  - iii. Prohibition of self-certification: Assets are only eligible for securitization if their origination includes a complete verification of all obligor information relevant for the credit assessment, that is, excluding loans that were marketed and underwritten on the premise that the loan applicant and, where applicable, their intermediaries, were made aware that any information provided might not be verified by the lender ("self-certification"). If the securitized assets are residential loans or consumer credit (such as auto loans or leases, consumer loans or credit facilities, the creditworthiness of the borrowers must be assessed in accordance with the requirements as set out in Art. 14 Par. 1 and Par. 2(a) of the Mortgage Credit Directive (Directive 2014/17/EU) and Art. 8 Par. 1 Consumer Credit

<sup>8</sup> The definition of HQS should be applied equitably to different transactions that are economically the same but might take different legal forms (or involve different contractual agreements) to encourage adoption according to the spirit rather than the letter of what constitutes HQS.

Directive (Directive 2008/48/EC), respectively. This requirement effectively excludes flawed securitization business models, relying on unsound underwriting practices.

2. **Strong funding relation to real economic activity and no re-securitization:** The transaction should directly support funding that satisfies credit demand for investment by nonfinancial corporates and households. In addition, re-securitization involves a layering of structures that introduce complexity and removes the transactions from the risk profile of real economic activity.
3. **Asset eligibility:** Securitized assets (and ancillary rights and financing agreements, if applicable) meet the following eligibility criteria at the time of issuance and at any time after issuance.
  - i. Business relevance: The type of securitized assets (“asset classes”) should represent a material type of asset class of the originator’s balance sheet. The selection criteria for the securitization of a particular type of asset correspond to the general risk characteristics of the same type of asset in the issuer’s overall loan portfolio at the “cut-off date” (that is, the date when the portfolio is selected). Securitized assets exhibit no systematic and/or material differences in terms of credit-specific criteria (for example, funding purpose, maturity tenor, and/or lending conditions) and borrower type. Loan-by-loan level data need to be issued and on a regular basis. The volume of a single transaction cannot exceed one-third of the issuer’s balance sheet for the duration of the transaction.
  - ii. Asset characteristics: The selection of assets should be subject to limits on single group/region/industry and maturity concentration corresponding to the threshold values established by the capital assessment under Pillar II of CRR/CRD-IV (or similar criteria specified by the relevant NCA). Limits on the share of loans featuring balloon payments or switching the interest rate could be incorporated as an additional restriction.
  - iii. Asset quality: Assets should be subject to an external review by an independent third-party that examines their adequate valuation and risk assessment prior to issuance in order to ensure consistency of actual asset quality with existing disclosure and stated selection criteria for the asset portfolio (“pool audit”).
  - iv. Homogeneous cash flows, asset types, and portfolio diversification: The cash flow-generating asset portfolio should comprise only one type of asset in order to increase the soundness, simplicity, and transparency of the transaction. There should be *no general* restriction regarding the type of eligible underlying exposures (“asset classes”), but included loans/leases should not be syndicated and/or inflation-linked. Assets from related parties cannot be included in the reference portfolio. The asset portfolio must be sufficiently granular in accordance with Arts. 261(1) and 261(2) of CRR. Assets from related parties cannot be included in the reference portfolio.

- v. Restricted use of derivatives/transferable financial instruments and full funding: The underlying asset portfolio should not include, in whole or in part, actually or potentially, derivatives instruments without genuine hedging interest. Derivatives may only be used for hedging foreign exchange and interest rate risk. The securitized assets must not include transferable financial instruments, except financial instruments issued by the special purpose vehicle (of the transaction) itself in order to accommodate master trust structures.
- vi. Domicile: The securitized assets were originated in, and are governed by the laws of, the same jurisdiction in which the issuer is incorporated. The domicile of securitized assets must be in a jurisdiction with an internationally enforceable credit and securities law.
- vii. Encumbrance and enforceability: Immediately prior to the sale of the securitized assets by the originator, the title to the assets must be owned solely by the originator free from any security interest. Each of the securitized assets is an enforceable payment obligation of the corresponding obligor in accordance with its terms, free from any right of termination, rescission, contractual set off (excluding set-off in relation to off-set or flexible mortgage loans, which are specifically dealt with in the transaction structure), counterclaim or defense. It binds the obligor to pay the sums of money specified in it (other than an obligation to pay interest on overdue amounts). There is no restriction on the transfer of assets which has not been consented to by relevant parties and the associated ancillary rights that is in effect.
- viii. No credit impairment of obligors and guarantors: The securitized assets must not include exposures to obligors (and/or guarantors) that are credit-impaired (that is, not in severe arrears for the past 12 months) or are in default under another financial obligation at the time of issuance of the securitization transaction or when incorporated in the pool of underlying exposures. The assessment of credit impairment of an obligor (or where there is a guarantor, the guarantor) either backward-looking (for example, the obligor/guarantor (i) declared bankruptcy, agreed with his creditors to a debt dismissal (or reschedule) or had a court grant his creditors a right of enforcement (or material damages) as a result of a missed payment within three years prior to the date of origination, or (ii) is on an official register of persons with adverse credit history) or forward-looking (for example, the obligor/guarantor (i) has an assessment of creditworthiness (by a market accepted ECAI or has a credit score indicating significant risk of non-payment relative to the average obligor/guarantor for type of loan in either the relevant industry or jurisdiction (whichever is greater), that is, significantly higher expected losses compared to the average expected losses.<sup>9</sup>
- ix. Positive balance and exclusion of nonperforming assets: Each of the securitized assets has a positive net present value or outstanding principal balance, that is, no securitized asset has

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<sup>9</sup> This definition of credit-impaired obligors draws largely on EIOPA (2013).

more than one scheduled payment outstanding due and unpaid. None of the securitized assets are overdrawn credit facilities, loans in arrears, nonperforming or defaulted loans,<sup>10</sup> restructured loans or loans with delinquent associated payments (for example, insurance premiums), except clearly defined technical overdrafts.

- x. Payment record of the borrower (and guarantor): At the time of issuance of the securitization transaction, each obligor (and guarantor, if applicable) has made at least one scheduled payment under the asset agreement to which it is a party in order to preclude the securitization of newly originated loans (and the acceptance of guarantees) without a payment record.
- xi. Timings: The time between the cut-off date of selecting eligible assets and the closing date of the actual asset portfolio should not exceed three months.

## B. Structural features

4. **Asset transfer**: The securitized assets shall be acquired by means of an asset agreement through a risk transfer agreement that must be enforceable against any third party, and be beyond the reach of the seller (originator, sponsor or original lender) and its creditors including in the event of the seller's insolvency (consistent with "true sale" or any other form of credit risk transfer that ensures bankruptcy remoteness of the securitized assets and collateral access by investors in cases of issuer insolvency). In addition, the following conditions apply:

- i. No severe clawback provisions: There are no severe clawback provisions in jurisdictions where the seller is incorporated, including rules under which the sale of securitized assets can be invalidated by the liquidator solely on the basis that it was concluded within a certain period ("suspect period") before the declaration of insolvency of the seller (or where the transferee can prevent such invalidation only if it can prove that it was not aware of the insolvency of the seller at the time of sale). There are no confidentiality provisions that restrict the issuer's exercise of its rights as owner of the securitized assets.
- ii. Obligor rights: The asset agreement has been concluded in compliance with all applicable consumer protection legislation, to the extent that failure to comply would have a material adverse effect on the enforceability or collectability of any securitized asset. If any securitized asset requires the obligor to consent to the transfer of the rights of the originator as contemplated by the transaction, written evidence of such consent has been, or prior to the issue date will be, received.

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<sup>10</sup> As defined in point 44 of Annex VII to Directive 2006/48/EC and in the banking prudential rules in Article 175 of Regulation (EU) No 575/2013, respectively.

- iii. Validity of transaction: The risk transfer governed by the asset agreement is legal, contractually binding, and irrevocable. It complies in all respects with the laws of the jurisdiction whose laws govern it, to the extent that failure to comply those laws would have a material adverse effect on the enforceability or collectability of any securitized asset(s).
- iv. Modification and fraud: No asset agreement has been/is subject to any modification that adversely affects the terms of any securitized asset and/or has been entered into fraudulently by the obligor.
- v. Limits to risk transfer: Transaction should not transfer to the investor significant market risk (for example, foreign exchange and/or interest rate risk) and/or risks that are unrelated to the risk profile of the underlying asset portfolio.

5. **Risk retention**: The compliance with HQS does not affect the obligation for the originator/issuer should retain sufficient material net economic interest in the contractual performance of securitized assets (“skin in the game”) in full compliance with the provisions under Articles 394-399 of CRR (fmr. Article 122a of CRD-II) and without any exemptions for certain asset structures and types of securitized assets.<sup>11</sup> The original lender or sponsor of a securitization transaction would need to retain, on an ongoing basis, a net economic interest of at least five percent of the securitization in one of the following ways (“minimum retention requirement”):

- i. Vertical slice (that is, retaining no less than five percent of the nominal value of each of the tranches sold or transferred to the investors);
- ii. Pari passu share (that is, retaining no less than five percent of the nominal value of the securitized (revolving) exposures);
- iii. Random selection (that is, retaining randomly selected exposures, equivalent to no less than five percent of the nominal amount of the securitized exposures); or
- iv. First loss piece (that is, retention of the most junior tranche of the transaction) and, if necessary, other tranches having the same or more severe risk profile than those transferred or sold to investors, and not maturing any earlier than those transferred or sold to investors, so that the retention equals in total to no less than five percent of the nominal value of the securitized exposures.<sup>12</sup>

<sup>11</sup> The volume of a single transaction cannot exceed a pre-defined limit of the issuer’s balance sheet for the duration of the transaction.

<sup>12</sup> Note that the retention requirement for European issuers does not apply to: (1) transactions where the securitized exposures are claims (or contingent claims) on or fully, unconditionally and irrevocably guaranteed by: (a) central governments or central banks, (b) regional governments, local authorities, and public sector entities of EU member states, (c) institutions to which a credit risk weighting of 50 percent or less is applied under the standardized approach

(continued)



## 6. Payment process

- i. Self-liquidating asset portfolio and no reliance on borrowings and asset sales: Scheduled payment obligations must be fully met by the predicted cash flows from the asset portfolio, with included assets generating payments at least semiannually. The repayment should not be dependent, in whole or in part, actually or potentially, on borrowings and/or the sale of assets securing the underlying exposures; however, this shall not prevent such exposures from being subsequently rolled over or refinanced.
- ii. Payment structure and portfolio management: The payment structure should be simple and transparent, with a limited amount of cash proceeds from securitized assets being retained by the issuer. The cash reserve should cover both principal and interest payments of the senior tranche of the transaction for at least two interest payment dates (IPDs). While the level of payment balances can be flexible for revolving exposures (for example, such as in a master trust securitization), structures with non-revolving exposures should be amortizing and not be actively managed (“managed portfolios”); non-revolving structures with bullet payments would not comply with this pass-through profile. Revolving structures must sufficiently protect investors from the risk that principal amounts may not be fully repaid by including provisions for early amortization of all payments at the occurrence of pre-defined adverse events, which shall include, at a minimum, all of the following:
  - The failure to generate sufficient new assets of at least similar credit quality as the existing asset portfolio underlying the structure,
  - The deterioration in the credit quality of the underlying exposures, and
  - The occurrence of an insolvency-related event with regard to the originator or the servicer.
- iii. Payment priority: Noteholders are paid sequentially in order of the highest external credit rating after the occurrence of a transaction-specific acceleration event.
- iv. Circularity of support mechanisms: The transaction should not benefit from intragroup funding or committed/uncommitted contingent credit/liquidity arrangements with related parties in order to avoid that an originator/sponsor of a transaction can also act as provider of structural support.

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of the revised Basel framework (and CRD-IV and CRR in the European context) for banking regulation; (d) multilateral development banks; (2) transactions based on a clear, transparent, and accessible index, where the underlying reference entities are identical to those that make up an index of entities that is widely traded, or are other tradable securities other than securitization positions; and (3) syndicated loans, purchased receivables, or credit default swaps where these instruments are not used to package and/or hedge, in whole or in part, actually or potentially, securitization transactions covered by the retention requirements described above.

- v. **Taxation:** If some or securitized assets are subject to withholding tax in the relevant jurisdiction, this tax has been disclosed in the prospectus and the transaction is structured and the cash flows calculated in such a way as to fully account for such tax.

7. **Continuity provisions for servicing, derivatives counterparties and liquidity providers:**

The servicing of the securitized assets shall remain the responsibility of the originator (or a pre-determined third-party agent), subject to the pre-defined servicing standards, which comprise the credit process, including relationship management and insolvency proceedings. The terms and conditions of servicing should be the same for securitized and non-securitized loans, including servicing continuity provisions to ensure that the default and/or insolvency of the originator should not lead to the termination of servicing. The documentation governing the transaction should also include continuity provisions for the replacement of the servicer, derivatives counterparties (for interest rate and foreign exchange hedges), and liquidity providers upon their default or insolvency (“back-up servicing and counterparty replacement mechanism”). Default is defined as missed payments of more than nine months. A suspension of interest payments is not allowed.

8. **Investor rights and collateral access:** All voting and enforcement rights related to the securitized assets are transferred from the issuer to the investors of the securitization transaction, and there is a clearly defined seniority structure that governs all rights associated with the liabilities of the securitization transaction. If the cash flows from the asset portfolio are secured by collateral, investors in the securitization transaction must have the most senior claim on the collateral. The workout process of impaired assets involves pre-defined rules, control mechanisms, and internal audits, which apply equally to both securitized and non-securitized assets.

**C. Comprehensive documentation and reporting requirements**

9. **Scope of disclosure:** Readily available and sufficiently detailed information on the securitized assets, the transaction structure, and the payment process is essential for both the valuation of securitization transactions and the assessment of associated investment risks. The documentation of a securitization transaction should aim to avoid undisclosed or hidden risks to investors. Transactions must comply with the disclosure requirements for securitization transactions under Article 409 of CRR and the Regulatory Technical Standards (RTS) (ESMA, 2014) under Article 8b(3) of the Credit Rating Agency Regulation (EU) No. 1060/2009 (CRA3), which specifies (i) the information the issuer/originator must publish relating to the securities and the securitized assets, (ii) the frequency with which this information is to be made available, and (iii) the presentation of the information by means of a standardized disclosure template. The issuer, originator or sponsor of the securitization should publish information on the credit quality and performance of the securitized assets, the asset structure of the transaction, the cash flows and any collateral supporting any exposure contained in the underlying asset portfolio as well as any information that is necessary to conduct comprehensive and well-informed stress tests on the cash flows and collateral values. If they are not incorporated in the EU, originator or sponsor of the securitization required to disclose

comprehensive loan-level data in compliance with generally accepted standards<sup>13</sup> must be made available to existing and potential investors and regulators at issuance and on a regular basis. The following information should be provided publicly free of charge: (i) final version of the offering circular, (ii) the new issue and presale reports of the involved external credit assessment institutions (ECAIs) (if available and approved for publication by the respective ECAIs), (iii) all investor reports. The disclosure obligations also provide for standardized investor reporting and disclosure of transaction documents.

- i. Asset and transaction performance: Transaction-related data should be disclosed to investors, potential investors and firms that generally provide services to investors through comprehensive pre-origination due diligence and quality assurance processes. Detailed summary statistics on asset characteristics and performance would need to be updated on a periodic basis (with quarterly frequency as a minimum) in standardized formats that satisfy all requirements listed in the “disclosure to investors” under Article 409 of CRR and the Regulatory Technical Standards (RTS) under Article 8b (3) of the CRA3 Regulation and are approved by national competent authorities (NCAs), including making transaction-related data more widely available in standardized machine-readable formats, and more reliable through tighter pre-origination due diligence and quality assurance processes of securitization transactions.<sup>14</sup> Comprehensive loan-level data in compliance with standards generally accepted by market participants are made available to existing and potential investors and regulators at issuance and on a regular basis until the final maturity date. The originator/issuer has to receive an “A1” compliance score by the European Datawarehouse (EDW).
- ii. Initial disclosure: Prior to the issue date, the issuer publicly discloses (i) when the information about the transaction will be made available, (ii) where such information will be made available, and (iii) how investors will be able to access it; and confirms that, once made available, such information will remain available until the final maturity date. The issuer also discloses the amount of the securities it intends to (i) pre-place privately with investors that are not a related party, (ii) retained by a related party, and (iii) publicly offered to investors that are not a related party. In relation to any amount initially retained by a related party but subsequently placed with a non-related party, the issuer will (to the extent permissible) disclose such placement in the next investor report.
- iii. Investor due diligence: Detailed disclosure of asset pool characteristics and regular performance monitoring at both asset and transaction levels facilitate investor due diligence and align the interests of investors and issuers. Reporting should be consistent

<sup>13</sup> In 2017, the European Securities and Markets Authority (ESMA) will set up a website centralizing the publication of information regarding structured finance instruments (SFIs), which requires the publication of this information.

<sup>14</sup> Providing investors (including central banks) and credit rating agencies with timely and consistent access to loan-level information that is needed to update credit and cash flow models for ABS products.

with the CRA3 Regulation, the ability of investors to make an informed assessment of investment risks is improved if investors are provided with sufficient information on those instruments.

10. **Structural integrity and quality assessment:** All tranches above the lesser of the applicable minimum retention requirement and the most junior tranche would need to have been assessed by two or more external credit assessment institutions (ECAIs) and should comply with the following *rating* and *subordination* requirements.

- i. Rating requirement. The most senior tranche of the transaction is expected to be rated to the highest level achievable in the relevant jurisdiction of the registered transaction on issuance and at any time thereafter; the amount of structural subordination supporting the senior tranche<sup>15</sup> should receive an external credit assessment consistent with the minimum credit quality for collateral assets governed by the risk control standards of the Eurosystem.
- ii. Subordination requirement. The designation of HQS is *not limited to senior tranches only* (recognizing that it is also important to support more junior tranches of robust structures, especially via improvement of data and analytics eventually allowing a broad investor base and risk transfer between bank and non-bank sectors); it can include all tranches above the greater of the first loss provision (that is, the most junior tranche) and the regulatory minimum retention requirement as long as (i) the credit quality of the respective tranche is indeed enhanced as compared to the credit quality of the entire pool of underlying exposures, and remains so at all times, and (ii) relative seniority of the tranche remains unaffected by the delivery of an enforcement or acceleration notice (or any other event of similar effect). This may result in *additional* structural criteria, such as limits on the expected life of a particular tranche level (for example, senior tranches with a legal maturity of no more than five years), excess spread trapping in favor of the senior tranche on collateral deterioration, and/or the minimum coverage period for senior expenses for a certain number of interest payment dates (IPDs).
- iv. Portfolio assessment: The credit quality (including tenor) of securitized assets is not lower than that of comparable assets retained by the originator or previously securitized. Assets should be subject to an external review by an independent third-party that examines their adequate valuation and risk assessment prior to issuance in order to ensure consistency of actual asset quality with existing disclosure and stated selection criteria for the asset portfolio ("pool audit") according to agreed procedures of a random sample as follows:
  - *Static asset portfolios:* (i) a review of the securitized assets on or about the issue date, or (ii) a general review of the originator's overall portfolio (or a randomly selected sample)

<sup>15</sup> This refers to the notional amount of one or more tranches above the most junior tranche (which covers expected losses) below the most senior tranche of the transaction.

from which the securitized assets were selected within the last 12 months prior to the issue date;

- *Revolving asset portfolios* (single issuance):<sup>16</sup> a review of the securitized assets either (i) on or about the issue date or (ii) at the earlier of 12 months following the issue date and the date on which 40 percent or more of the asset portfolio is replenished; and
- *Revolving asset portfolios* (repeat issuance): a review of the securitized assets on or about the issue date if either no review has taken place in the 12 months prior to the issue date or no audit of the securitized assets was required since no new issuance or replenishment of the relevant asset pool had occurred in the preceding 12 months.

11. **Listing and trading requirement:** The transaction shall be listed on a regulated market/recognized exchange, tradable on generally accepted repurchase markets, or admitted to trading on another organized venue, with a robust market infrastructure in jurisdictions with an internationally recognized supervisory authority deemed sufficiently compliant with international standards and codes based on the most recent IMF FSAP assessment or by a peer assessment of a supra-regional association of supervisory authorities.

12. **Prospectus:** The prospectus is a listing and trading requirement, which ensures sufficient information on the transaction and the securitized assets, is readily available to existing and potential investors at a minimum level of standardization at the time of issuance. It should meet the requirements of the Prospectus Directive (Directive 2003/71/EC) combination with Article 4 of Directive 2010/73/EU on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market. The preliminary prospectus ('red herring') must be available to investors at least two weeks before the closing date and should contain all information required for the comprehensive valuation of the envisaged transaction and the assessment of investment risks.

- i. Structure and payment process: The prospectus provides an overview of (i) the transaction structure, (ii) the characteristics of any credit enhancement mechanisms, (iii) the mechanics of the payment process ("cash flow waterfall"), including the payment frequency of the securitized assets, and (iv) the processes and standards (that is, administration, collection, recovery and back-up servicing) applied in servicing securitized assets.
- ii. Underwriting of securitized assets: The prospectus describes the criteria, processes and standards applied in originating the securitized assets, that is, materially relevant policies and procedures along the credit process chain.
- iii. Asset and risk transfer: The prospectus contains sufficient information about the risk transfer together with a description of the securitized assets (based on available loan-level

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<sup>16</sup> or pools capable of being replenished and are not a repeat issuance.

data) and associated investment risks in accordance with the Prospectus Directive (2003/71/EC).<sup>17</sup>

- iv. Role and assessment of relevant parties: The rights, responsibilities and obligations of all relevant parties to the transactions are described in detail. The prospectus discloses those entities that will have an ongoing involvement and should state whether or not the participation of one (or more) of these parties (and their impact on the external assessment of the transaction) is contingent on its (their) respective external assessment of creditworthiness. In respect of each such entity the prospectus either discloses the change in the external assessment of creditworthiness that will trigger a requirement for the provision of (i) collateral, (ii) a third-party guarantee, or (iii) the provision of a replacement or confirms that no such rating triggers exist. The prospectus should also outline the type, scope and timing of remedial measures that would apply if the external assessment of any relevant party drops below the desired (and/or required) minimum threshold level.
- v. Lead managers: A minimum of two joint lead managers is mandatory for each transaction, and the lead managers also explicitly mentioned by name in the prospectus.
- vi. Trading: The transaction shall be admitted to trading on a regulated market in jurisdictions with an internationally recognized supervisory authority deemed sufficiently compliant with international standards and codes based on the most recent IMF FSAP assessment or the membership of supra-regional association of supervisory authorities. The issuer confirms that it believes that secondary market trading activity will occur in compliance with all applicable regulatory requirements relating to trading transparency. The registration for trading does not mean that the securitization is actually listed.
- vii. General representations, warranties and undertakings:<sup>18</sup> The prospectus discloses all relevant general representations, warranties and undertakings given by the originator/issuer in respect of the securitized assets (including, but not limited to, corporate and asset matters, for example, eligibility criteria, title and ownership and validity of asset transfer). In particular, the following areas are important:

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<sup>17</sup> Prospectus Directive (Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003) on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC.

<sup>18</sup> This section reflects most of the criteria for general representations, warranties and undertakings set put in the PCS certification of securitization transactions.

- *Compliance with eligibility and replenishment criteria:* The securitized assets (with the related collateral, ancillary rights and financial guarantees, if applicable) meet the general asset eligibility requirements and replenishment criteria (if applicable) defined in the transaction documentations and the requirements above.
- *Origination and servicing:* The securitized assets meet the standard origination and underwriting criteria and servicing procedure of the originator.
- *Title and ownership:* The issuer has full right, good and valid title to the securitized assets (with the related collateral, ancillary rights and financial guarantees, if applicable).
- *Validity of asset/risk transfer and no untrue information:* There are no restrictions on the asset/risk transfer (unless consented by the relevant parties), and the assignment of assets and their associated ancillary rights, if applicable, from the originator to the issuer complies with the laws applicable in the relevant jurisdiction. There is no untrue information on the particulars of the securitized assets (with the related collateral, ancillary rights and financial guarantees, if applicable) in the sales agreement.
- *Validity and enforceability of claims:* The transfer of risk and/or assets (with the related collateral, ancillary rights and financial guarantees, if applicable) constitutes a valid sale and is enforceable against the creditors of the originator, and is neither prohibited nor invalid under the laws applicable in the relevant jurisdiction. Any financing agreement governing the securitized assets are in full force, and constitute legal, valid, binding, and enforceable obligations of all parties thereto except when enforceability may be limited by consumer law. It has been entered into in accordance with all applicable legal requirements in the relevant jurisdictions to the extent that failure to comply would have a material adverse effect on the enforceability or collectability of the claim(s).
- *No adverse claims or other pledges:* The securitized assets (with the related collateral, ancillary rights and financial guarantees, if applicable) are not subject, either totally or partially, to any lien, assignment, charge, or pledge to any third parties.
- *No credit impairment of obligors:* The originator/issuer is not aware of any obligors in material breach, default, or violation of any obligations under the any loan agreements.

## II. Additional Criteria for SME Securitization Transactions

13. Securitization transactions where the underlying assets are SME loans should comply with the following additional criteria:

### A. Definition of asset class

14. **SME obligor and minimum standard:** The asset portfolio comprises loans to firms that meet the EC definition of SME with a standalone credit assessment (that is,  $\leq 250$  employees,  $\leq \text{€}50$  million revenues, and  $\leq \text{€}43$  million balance sheet size) in accordance with EU recommendation 2003/361. Securitized assets would conform to the terms and conditions for EIB-intermediated lending to SMEs.

15. **Type of SME lending:** The type of SME-related credit obligation is clearly defined to be of one or more of the following types: (i) financing leases to SME borrowers without residual value (that is, other forms of leases are not permissible), (ii) credit lines and guarantees, (iii) promissory note bonds, (iv) debentures/certificates of indebtedness, (v) development/ concessionary loans, and/or (vi) other loans that meet the above requirements of SME-related lending with a real investment purpose.

16. **Ongoing balance sheet operation and creditor track record:** The asset portfolio should only include loans that were originated to obligors with whom the originator maintained an uninterrupted borrowing relationship over at least one annual reporting period.

### B. Structural characteristics

17. **Granularity and diversification:** At the cut-off date the asset portfolio satisfies the following conditions: (i) it comprises loans to at least 100 different obligors; (ii) the aggregate outstanding principal balance from any a single obligor does not exceed an amount equal to 0.75 percent of the aggregate outstanding principal balance of the securitized asset portfolio; and (iii) securitized assets exhibit no systematic and/or material differences in terms of credit-specific criteria relative to the general risk characteristics of the same type of asset in the issuer's overall loan portfolio.

18. **Payment profile:** The aggregate outstanding principal balance of the securitized assets without any scheduled principal payments up to five years after issue date is not greater than an amount equal to 25 percent of the aggregate outstanding principal balance of all securitized assets at time of issuance.



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