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FROM A LITIGATION
PERSPECTIVE . . .

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Basel Committee Proposes Simple, Transparent and Comparable Securitisation Framework for Short-Term Securitisations

*By Timothy P. Mohan and Sumaira S. Shaikh**

The authors of this article discuss the Basel Committee on Banking Supervision's consultative documents entitled "Criteria for Identifying Simple, Transparent and Comparable Short-Term Securitisations" and "Capital Treatment for Simple, Transparent and Comparable Short-Term Securitisations."

On July 6, 2017, the Basel Committee on Banking Supervision ("BCBS") issued two consultative documents entitled "Criteria for Identifying Simple, Transparent and Comparable Short-Term Securitisations" (the "Criteria Document") and "Capital Treatment for Simple, Transparent and Comparable Short-Term Securitisations" (the "Capital Document" and, together with the Criteria Document, the "Consultative Documents").¹ BCBS had previously published criteria for identifying simple, transparent and comparable ("STC") term securitisations in July of 2015 (the "STC Term Securitisation Criteria") and in July of 2016 published revisions to its securitisation capital framework (the "Revised Capital Framework") that incorporated the regulatory capital framework for STC term securitisations. Comments are due on the Consultative Documents on October 5, 2017.

BACKGROUND

The STC Term Securitisation Criteria and Revised Capital Framework explicitly excluded short-term securitisations, including asset-backed commercial paper ("ABCP") programs. It was mentioned, however, that BCBS and International Organization of Securities Commissions ("IOSCO") would separately consider whether specific criteria for exposures to ABCP programs should be issued.

While a significant portion of the bank-financed securitisation market has migrated to direct bank funding of customer securitisation transactions, the use

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¹ The Criteria Document can be found at <https://www.bis.org/bcbs/publ/d414.pdf>. The Capital Document can be found at <https://www.bis.org/bcbs/publ/d413.pdf>.

of the proposed short-term STC criteria would be limited to exposures to qualifying ABCP conduits. ABCP programs are defined as programs that predominantly issue (i) commercial paper with a maturity of one year or less, or (ii) notes to third parties backed by assets or loans held in a bankruptcy remote special purpose entity.

THE CRITERIA DOCUMENT

The Criteria Document sets forth 17 criteria for STC securitisations that are focused primarily on investors in ABCP. The Capital Document supplements the 17 criteria with more specific requirements and adds two additional criteria and provides for more favorable capital treatment for exposures to qualifying ABCP conduits for both investors and sponsors. The criteria address asset risk and quality, structural risk, and fiduciary and servicer risk. A chart summarizing these criteria follows in Exhibit A.

For notes issued by ABCP conduits that meet the short-term STC capital criteria, capital would equal that of STC risk positions of comparable maturity in the Revised Capital Framework. For ABCP investors applying the internal ratings based (“IRB”) approach, the risk weight would be determined by applying a 0.5 scalar to the “p” factor with a “p” factor floor of 0.3, and a risk weight floor of 10 percent for senior positions and 15 percent for other positions. Investors using the external ratings-based (“ERB”) approach to determining capital would apply the following risk weights:

External credit assessment	A-1/P-1	A-2/P-2	A-3/P-3	All other ratings
Risk weight for STC exposures (both term securitisations and ABCP)	10%	30%	60%	1,250%

Banks providing credit or liquidity funding to qualifying ABCP conduits are treated as if they had taken a risk position in an STC term securitisation, and the capital treatment would follow the capital treatment for STC term securitisations in the Revised Capital Framework. As is the case with investors in ABCP for a qualifying conduit, the risk weight would be determined by applying a 0.5 scalar to the “p” factor with a “p” factor floor of 0.3, and a risk weight floor of 10 percent for senior positions and 15 percent for other positions. For banks applying the ERB approach or the Internal Assessment Approach, the risk weight applicable to an equivalent position in an STC term securitisation would be used.

Qualifying swap positions that are exposures to ABCP conduits meeting the short-term STC capital criteria would also be eligible for more favorable risk weights.

THE CONSULTATIVE DOCUMENTS

Importantly, the Consultative Documents take an “all or nothing” approach to qualifying for STC status and capital treatment. All of the conduit level and transaction level criteria must be met for *all* transactions in an ABCP conduit, except that an ABCP conduit need not be fully supported in order for STC capital treatment to apply to exposures of the sponsor bank to the ABCP conduit. BCBS does raise the possibility of separating conduit level and transaction level capital treatment in a final standard and has asked for comment on this issue.

As written it appears that no multi-seller ABCP conduit of which we are aware would qualify for more favorable treatment. Among other issues:

- 1) The all or nothing aspect of the requirements would mean that every transaction would need to qualify for more favorable treatment, which is extremely unlikely.
- 2) The conduit level criteria impose fiduciary-type obligations on conduit sponsors which are not likely imposed under current conduit structures and require sponsors to make representations and warranties to investors that are not currently being made.
- 3) The investor reporting required in the Consultative Documents would appear to impose an obligation on the sponsor to disclose substantially more information regarding the underlying transactions financed by the ABCP conduit than is current practice.
- 4) A qualifying ABCP conduit could only finance receivables of asset originators with relatively long track records of originating and servicing the financed assets, and not all existing asset originators may so qualify.
- 5) All assets financed by a qualifying ABCP conduit must meet certain specific credit quality requirements. This would preclude many trade receivables transactions and other revolving asset pools from being financed by a qualifying ABCP conduit.

The provisions of the criteria that seem problematic for existing conduits are italicized in Exhibit A.

Exhibit A
Basel III Securitisation Criteria and Capital Treatment
 Proposed Capital Treatment for Simple, Transparent and Comparable (“STC”) Short-term Securitisations

Criteria		Capital Treatment
	<i>Conduit Level</i>	<i>Transaction Level</i>
A.		
		<i>Additional guidance for capital purposes</i>
1.	<p>Nature of assets</p> <p><i>Sponsor should provide representation and warranty to investors that assets at transaction and overall level are homogenous.^{1,2}</i></p>	<p>ASSET RISK</p> <p>Underlying assets should (i) be homogeneous, (ii) not be securitisation exposures,³ and (iii) have contractually identified periodic or single payment streams.</p> <ul style="list-style-type: none"> • No materially different legal and/or credit risk factors and risk profile. • Common risk drivers, including similar risk factors and profiles. • Standard obligations with well-defined stream of payments. • Repayment of the securitisation exposure should mainly rely on proceeds from securitised assets with only partial reliance on refinancing or resale of assets securing the exposure. • Conduit can acquire a beneficial interest in the form of a note (which may qualify as a securitisation exposure), as long as it is not subject to further tranching.
2.	<p>Asset performance history</p> <p><i>Sponsor should provide investors with sufficient asset loss performance data with substantially similar risk characteristics and for a time period long enough to permit meaningful evaluation.</i></p>	<ul style="list-style-type: none"> • Sponsor and asset underwriter (lender) have sufficient experience in risk analysis/underwriting exposures similar to those securitised.

¹ In assessing homogeneity, consideration should be given to asset type, jurisdiction, legal system and currency.

² Program-wide credit enhancement should not prevent a conduit from qualifying for STC status, regardless of whether such enhancement creates re-securitisation.

³ As defined in the Basel III securitisation framework at <http://www.bis.org/bcbs/publ/d374.htm>.

Criteria		Transaction Level	Capital Treatment
Conduit Level			<i>Additional guidance for capital purposes</i>
			<ul style="list-style-type: none"> Well-documented policies and procedures regarding underwriting and monitoring of exposure performance. Originators of assets have sufficient experience originating same or similar assets, with management with industry experience. Investors must request confirmation of originator performance history for same or similar assets for an "appropriately long period of time" i.e. seven years or more for non-retail exposures, and five or more for retail.
3.	<p>Payment status</p> <p>Sponsor should provide representation and warranty to investors that at the transaction level assets at the time of inclusion in the pool do not include obligations that are in default, delinquent, or the parties have evidence indicating a material increase in expected losses or enforcement actions.</p>	<p>Sponsor should take reasonable steps to ensure assets underlying each transaction are not at the time of acquisition by the conduit in default, delinquent, or subject to a material increase in expected losses or enforcement actions.</p>	<ul style="list-style-type: none"> Original seller or sponsor should ensure that the assets for each transaction meet the following conditions: (i) no obligor insolvency or debt restructuring process in the three years prior to origination date; (ii) no adverse credit history on a public credit registry; (iii) no credit assessment by an external credit assessment institution or credit score indicating significant risk of default; and (iv) no dispute between obligor and lender. Assessment should be conducted no earlier than 45 days prior to acquisition or replenishment; to the best knowledge of original seller or sponsor there is no evidence of likely deterioration in the performance status; and at least one payment was made on the underlying exposures (except in case of replenishing asset trust structures).

		Capital Treatment		
Criteria		<i>Transaction Level</i>	<i>Additional guidance for capital purposes</i>	
4.	Consistency of underwriting	<p><i>Conduit Level</i></p> <p>Sponsor should provide representation and warranty to investors that (i) it has verified and can explain how the assets have consistent underlying standards and (ii) it will receive from sellers' disclosure about timing and purpose of any changes.</p>	<p><i>Transaction Level</i></p> <p>Sponsor should ensure sellers demonstrate that: (i) transaction assets were originated in the ordinary course of business to materially non-deteriorating underwriting standards, and such standards were no less stringent for assets the seller maintains on its own balance sheet, and (ii) the obligors have the ability and volition to make timely payments. Sellers should disclose timing and purpose of any underwriting standard changes.</p>	<p><i>Additional guidance for capital purposes</i></p> <p>All assets must be originated with sound and prudent underwriting criteria assessing whether the obligor has the "ability and volition to make timely payments" and sponsor should ensure that any assets bought from third parties satisfy this criterion.</p>

		Criteria		Capital Treatment	
		Conduit Level	Transaction Level	Additional guidance for capital purposes	
5.	Asset selection and transfer	<p>Sponsor should: (i) provide a representation and warranty to investors about the nature and frequency of checks conducted regarding enforceability of assets; (ii) disclose to investors the receipt of representations and warranties from sellers that the assets are not subject to any condition or encumbrance that can be foreseen to adversely affect enforceability in respect of collections due.</p>	<ul style="list-style-type: none"> • Sponsor should ensure that assets: (a) satisfy clearly defined eligibility criteria, and (b) are not actively selected, managed or cherry-picked after the closing date. • Sponsor should assess the credit risk of the asset pool prior to its decision to provide full credit support to transaction or conduit. • Sponsor should ensure conduit transactions effect true sale. • Sponsor should ensure material obstacles preventing true sale, contingent asset transfers, or factors affecting timely perfection are disclosed. • Sponsor should receive a representation and warranty from sellers that the assets are not subject to any condition or encumbrance that can be foreseen to adversely affect enforceability in respect of collections due. 	<p>An independent third-party legal opinion must support the claim that the true sale and transfer of assets under applicable laws comply with points (a) and (b) at the transaction level.</p>	
6.	Initial and ongoing data	<p>Sponsor should provide potential and current investors with sufficient aggregated data regarding relevant risk characteristics of the underlying assets in accordance with applicable laws. Sponsor should ensure standardized investor reports are readily available to current and potential investors at least monthly.</p>	<p>Sponsors should receive from seller/servicers timely and sufficient asset-level/summary stratification data before transferring assets to underlying pool. The seller may delegate some of these tasks but must ensure appropriate supervision of outsourced arrangements.</p>	<p>The standardized investor reports should include the following information: (i) materially relevant data on the credit quality and performance of assets; (ii) cash flow data of assets; (iii) form and amount of credit enhancement provided by seller and sponsor transaction and conduit levels; (iv) relevant information on sponsor support; and (v) status and definitions of relevant triggers, i.e. performance, termination or counterparty replacement.</p>	

Criteria		Capital Treatment	
Conduit Level	Transaction Level	Additional guidance for capital purposes	
	STRUCTURAL RISK		
	(-)		
7. Full Support	<p>Sponsor should provide the liquidity facility and credit protection support for any ABCP program issued by a conduit to ensure investors are fully protected against credit, liquidity, and any material dilution risks from the assets. Investors should be able to rely on sponsor for timely and full repayment of the commercial paper.</p>		<ul style="list-style-type: none"> Under the baseline approach, an exception from full support is provided whereby exposures may qualify for STC capital treatment if the sponsor provides support covering 100 percent of the notional value of the notes even if the support contains any provisions that preclude the ability to fund against defaulted assets (i.e. partial support). Full support provided should irrevocably and unconditionally pay the ABCP liabilities in full and on time. Under the terms of a liquidity facility agreement, (a) the sponsor shall be obliged to collateralize its commitment in cash or re-place itself with another liquidity provider, and (b) if sponsor does not renew its funding commitment for a transaction or the conduit, sponsor shall collateralize its commitments in cash at the latest 30 days prior to the expiration of the liquidity facility, and no new receivables should be purchased under the affected commitment. Sponsor should provide full disclosure regarding the liquidity facility and credit support to investors.

Criteria		Capital Treatment	
	<i>Conduit Level</i>	<i>Transaction Level</i>	<i>Additional guidance for capital purposes</i>
8.	<p>Redemption cash flow</p> <p style="text-align: center;">(-)</p>	<p>Sponsor should ensure that the assets do not need to be refinanced over a short period of time in order to repay the conduit, unless the asset pool is sufficiently granular, has sufficiently distributed repayment profiles, and repayment does not rely on the drawing of an external liquidity facility.</p>	<p><i>Additional guidance for capital purposes</i></p> <ul style="list-style-type: none"> • Sponsors cannot use support provided by their own liquidity and credit facilities. • Requirement that repayment shall not primarily rely on an external liquidity facility does not apply to notes issued by the ABCP conduit.
9.	<p>Currency and interest rate asset and liability mismatches</p>	<p>Sponsor should ensure (i) any interest rate and foreign currency risks are appropriately mitigated; (ii) that derivatives are used for genuine hedging purposes only; and (iii) are documented through industry-standard master agreements.</p>	<ul style="list-style-type: none"> • "Appropriately mitigated" does not mean a perfect hedge. • Appropriateness can be demonstrated by making available, in a timely and regular manner, quantitative information including the fraction of notional amounts that are hedged and sensitivity analysis illustrating the effectiveness of the hedge under extreme but plausible scenarios. • Other risk-mitigating measures other than derivatives are only permitted if specifically created and used for the purpose of hedging an individual and specific risk, but must be fully funded and available at all times.

Criteria		Capital Treatment	
	Conduit Level	Transaction Level	
10. Payment priorities and observability	<p><i>The ABCP issued should not include extension options, or other features which may extend the final maturity of the ABCP. Sponsor should: (i) make a representation and warranty to investors to such effect at the transaction level and that it has the ability to analyze the cash flow waterfall for each transaction that qualifies as a securitisation position. Sponsor should provide to investors a summary of how the waterfall functions and the credit enhancement at the program and transaction level.</i></p>	<p>Sponsor should ensure that (i) payment priorities are clearly defined at the time of acquisition by conduit; (ii) appropriate legal comfort regarding enforceability is provided.</p>	<p><i>Additional guidance for capital purposes</i></p> <p>(-)</p>
11. Voting and enforcement rights	<p><i>Sponsor should make sufficient information available to investors regarding their enforcement rights for the assets in the event of insolvency of sponsor.</i></p>	<p>Sponsor should ensure that all voting and enforcement rights related to the assets are (i) transferred to the conduit; and (ii) clearly defined under all circumstances.</p>	<p>(-)</p>
12. Documentation disclosure and legal review	<ul style="list-style-type: none"> Sponsor should ensure that sufficient initial offering documentation is provided to current and potential investors within a reasonably sufficient period of time prior to issuance. Investor should have full disclosure of the legal information and risk factors. Sponsor should ensure terms and documentation are reviewed and verified by an appropriately experienced and independent legal practice prior to publication and in cases of material changes. Sponsor should notify investor of any material changes that impact structural risk. 	<p>Sponsor should ensure it receives sufficient initial offering documentation for each transaction, which is provided within a reasonably sufficient period of time prior to inclusion in the conduit with full disclosure of the legal information and risk factors.</p>	<p>(-)</p>

Criteria		Capital Treatment
	Conduit Level	Transaction Level
13. Alignment of interest	<ul style="list-style-type: none"> ■ A material net economic exposure should be retained by the sellers or the sponsor at transaction level, or conduit level. ■ Sponsor should disclose to investors how and where the material net economic exposure is retained and demonstrate the existence of a financial incentive in the performance of the assets. 	(-)
14. Cap on maturity transformation	<i>Maturity transformation should be limited, and sponsor should verify and disclose to investors that the weighted average maturity of all the transactions financed is set at a value between one and three years or less.</i>	(-)
FIDUCIARY AND SERVICER RISK		
15. Financial institution	Sponsor should be a financial institution that is licensed to take deposits from the public, is subject to appropriate prudential standards and levels of supervision.	(-)

		Capital Treatment		
Criteria		Transaction Level	Additional guidance for capital purposes	
16.	Fiduciary and contractual responsibilities	<p style="text-align: center;"><i>Conduit Level</i></p> <ul style="list-style-type: none"> Sponsor should make a representation and warranty to investors that it has taken adequate steps to ensure that: (i) the various criteria at the level of each transaction are met, and explain how, (ii) seller's policies, procedures and risk management controls are well documented, adhere to good market practices and comply with relevant regulatory regimes, and (iii) that strong systems and reporting capabilities are in place to ensure appropriate origination and servicing of underlying assets. The sponsor should satisfy the above clauses (i)–(iii) in its own capacity as well. Sponsor should demonstrate expertise in providing liquidity and credit support for ABCP conduits, and have management with industry experience. Parties with fiduciary responsibilities should act on a timely basis in the best interests of the investors. 	<p style="text-align: center;"><i>Transaction Level</i></p> <ul style="list-style-type: none"> Sponsor should ensure that the sellers and other parties responsible for origination and servicing: (i) act in accordance with reasonable and prudent standards and have well documented procedures and policies in place to ensure appropriate servicing; (ii) have expertise in the origination of assets that are the same or similar; (iii) have extensive servicing and workout expertise, thorough legal and collateral knowledge, and a proven track record in loss mitigation for same or similar assets; (iv) have expertise in the servicing of the assets; and (v) are supported by management with industry experience. 	<p style="text-align: center;"><i>Additional guidance for capital purposes</i></p> <ul style="list-style-type: none"> The criteria can be substantiated by third-party review for sellers that are non-banking entities. Banking entities are subject to ongoing assessment of their systems, accordingly, non-bank originating entities should provide proof of an independent assessment of their reporting capabilities.

Criteria		Capital Treatment
Conduit Level	Transaction Level	Additional guidance for capital purposes
<p>17. Transparency to investors</p> <ul style="list-style-type: none"> • Sponsor should ensure that the contractual obligations, duties and responsibilities of all key parties are clearly defined in initial offering and other documentation, and the sponsor should make a representation and warranty to investors to such effect. • Sponsor should disclose to investors adequate provisions regarding counterparty replacement, non-performance, insolvency or other deterioration of counterparty creditworthiness, and sponsor should make a representation and warranty regarding the replacement of key counterparties. • Sponsor should provide sufficient information to investors about the liquidity facility and credit support provided. 	<ul style="list-style-type: none"> • Sponsor should conduct transaction due diligence on behalf of the investors. • Sponsor should be provided with all information regarding all contractual obligations, duties and responsibilities of all key parties. • Sponsor should ensure adequate provisions exist regarding counterparty replacement, non-performance, insolvency or other deterioration of counterparty creditworthiness. • Sponsor should ensure receipt of key performance data regarding the transactions. 	<p>(-)</p>
D. ADDITIONAL CRITERIA FOR CAPITAL PURPOSES		
<p>18. Credit risk of underlying exposures</p>	<ul style="list-style-type: none"> • As of date of asset acquisition, the underlying exposures must meet the conditions under the Standardized Approach for credit risk. • <i>After account is taken of any eligible credit risk mitigation, exposures are assigned a risk weight equal to or smaller than: (i) 40 percent on a value-weighted average exposure basis for the portfolio where the exposures are loans secured by residential mortgages or fully guaranteed</i> 	<p>(-)</p>

Criteria		Capital Treatment	
	Conduit Level	Transaction Level	Additional guidance for capital purposes
19.	Granularity of the pool	residential loans; (ii) 50 percent on an individual exposure basis where the exposure is a loan secured by a commercial mortgage; (iii) 75 percent on an individual exposure where the exposure is a retail exposure; or (iv) 100 percent on an individual exposure basis for any other exposure.	
	As of date of acquisition of any assets securitised by one of the conduits' transactions, the aggregated value of all exposures to a single obligor at the date shall not exceed one percent ⁴ of the aggregated outstanding exposure value of all exposures in the program.	(-)	(-)

⁴ In jurisdictions with structurally concentrated loan markets, subject to ex ante supervisory approval and only for corporate exposures, the applicable maximum concentration threshold could be increased to two percent.