

Chapman Client Alert

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Current Issues Relevant to Our Clients

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

On May 14, 2018, the Basel Committee on Banking Supervision (“BCBS”) issued two standards documents entitled “Criteria for Identifying Simple, Transparent and Comparable (“STC”) 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 “Standards Documents”). The Criteria Document can be found [here](#) and the Capital Document can be found [here](#). 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.

On July 6, 2017, the BCBS issued two consultative documents entitled “Criteria for Identifying Simple, Transparent and Comparable Short-Term Securitisations” and “Capital Treatment for Simple, Transparent and Comparable Short-Term Securitisations” (together, the “Consultative Documents”). The DTC framework proposed by BCBS in the Consultative Documents raised several issues for industry participants. These issues made the proposed framework practically unusable for the industry.

Among other issues, the Consultative Documents took an “all or nothing” approach to qualifying for STC status and capital treatment. All of the conduit level and transaction level criteria would have been required to 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. This requirement and the extensive nature of the criteria would have made it practically impossible for exposures to ABCP conduits to qualify for STC status. As discussed further below, this all or nothing approach has been eliminated in the Standards Documents and transaction level securitization exposures of banks through ABCP conduits will now be eligible for STC status regardless of whether conduit-wide exposures would so qualify. For conduit-wide exposures, including ABCP, to qualify for STC status, it is still necessary for all of the conduit level and transaction level criteria to be met for *all* transactions in an ABCP conduit.

As was proposed in the Consultative Documents, for notes issued by ABCP conduits that meet the short-term STC capital criteria, capital will 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 will 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% for senior positions and 15% for other positions. Investors using the external ratings-based (“ERB”) approach to determining capital will 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%

Again, consistent with the Consultative Documents, 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 will 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 will 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% for senior positions and 15% 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 will 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.

Set forth below are the categories of major concerns raised by the industry with the Consultative Documents and an analysis of whether and how these concerns were addressed in the Standards Documents.

1. *The treatment of ABCP issued by an ABCP conduit and the treatment of transaction-level exposures should be separated.*

As discussed above, the “all or nothing” approach has been eliminated in the Standards Documents and transaction level securitization exposures of banks through ABCP conduits will now be eligible for STC status regardless of whether conduit-wide exposures would so qualify. This means that STC capital treatment will be available for transaction exposures that meet the specific STC criteria, making the framework potentially practically useful for existing ABCP conduit sponsors.

For conduit-wide exposures to qualify for STC status, however, it is still necessary for all of the conduit level and transaction level criteria to be met for all transactions in an ABCP conduit. As a practical matter, given the specificity of the requirements and the impossibility that all existing transactions will meet the transaction level criteria, ABCP and other conduit-wide securitization exposures of banks to existing ABCP conduits will not be eligible for STC status or capital treatment.

2. *Qualifying transaction exposures funded directly by banks should be eligible for short-term STC treatment.*

Since the financial crisis, several banks have funded securitization transactions that would have otherwise been financed (or, in the case of certain multi-lender transactions continue to be financed) by ABCP conduits. These transactions would not otherwise be eligible for treatment as STC term securitizations due to their privately negotiated nature and the resulting lack of formal disclosure documents, among other issues. Permitting banks that fund transactions outside of sponsored ABCP conduits to receive short-term STC treatment would promote the stated goal of encouraging more STC-compliant securitization transactions. In many cases, securitization exposures funded directly by banks are also funded by ABCP conduits. While it seems illogical that the same exposure could qualify for STC treatment if funded via an ABCP conduit and not if funded directly by a bank, the Standards Documents are consistent with the Consultative Documents on this point and do not allow STC treatment for directly funded exposures.

3. *The description of credit claims and receivables and the requirement that deal cash flows be homogeneous seemed to unnecessarily exclude certain standard asset classes that warrant STC treatment.*

Specific concerns were raised with respect to mixed auto loan and auto lease securitizations and equipment loan and equipment lease securitizations. BCBS clarifies in the

Standards Documents that these mixed pool deals would be eligible for STC treatment if they otherwise meet the applicable criteria.

4. *The requirements that the performance history of the financed assets and the experience of the sponsor/servicer be not shorter than seven years for non-retail assets and no shorter than five years for retail exposures should be adjusted.*

BCBS accepted industry comments on this issue and shortened the performance history and experience requirements to five years for non-retail assets and to three years for retail assets.

5. *The short-term STC criteria with respect to payment status should be revised to properly accommodate appropriate revolving asset pool securitizations.*

The Consultative Documents contained specific credit criteria that must be met with respect to each credit claim or receivable being transferred into the securitization. This requirement would be problematic for many revolving asset transactions, where the transactions require an asset originator to sell all credit claims or receivables of a specific type into a transaction structure regardless of their credit quality. In these transactions, the ABCP conduit or bank providing funding protects itself from the credit risk of any sub-standard receivables by excluding such receivables from the advance rate calculation for such transaction. Thus, while these receivables are technically a part of the collateral pool for these transactions and are available as excess enhancement, they are assumed to have zero value. Allowing these receivables to be a part of the collateral pool is irrelevant as a practical matter to the credit quality of the bank’s securitization exposure to the transaction.

Trade receivables securitizations are a prominent example of this type of transaction. In these transactions one or more asset originators transfer all of their trade receivables as generated to a sponsored special purpose entity, which in turn obtains financing for the receivables from one or more ABCP conduits or banks. The financing documents set forth eligibility requirements for the financed trade receivables that exclude low credit quality receivables. Excluding ineligible receivables from these transactions would be administratively burdensome, increase the risk of cash commingling, and potentially create an inability to properly mark the records identifying the collateral and would not benefit the credit quality of these transactions. The advance rate calculations in such transactions include only eligible receivables.

Unfortunately, BCBS did not change the proposed criteria in the Standards Documents. This means as a practical matter that trade receivables securitizations and other similar securitizations, as currently structured, would not be eligible for STC treatment.

6. *The additional requirement for capital purposes that credit claims and receivables meet certain credit criteria is too specific.*

The Consultative Documents set forth certain specific asset quality requirements that would not be met in securitizations of certain standard asset types. In a standard securitization of non-retail assets such as trade receivables, for example, asset obligors that are currently the subject of bankruptcy or other insolvency proceedings are treated as ineligible receivables rather than being excluded from asset pools as required under the Consultative Documents. There is also no requirement in these transactions that the originating entity ensure, as required under the Consultative Documents, that any obligor of a securitized receivable not have an “adverse credit history” that is reflected in a public registry and not have a credit score indicating a significant risk of default. It appeared that these specific requirements were written in contemplation of

securitizations of retail receivables where such information is tracked and available. The industry suggested instead that a more principled approach be taken to address this issue, which allows a bank to use well established credit criteria relevant to the specific asset class to address concerns with financing sub-standard receivables. Unfortunately, BCBS did not address these issues in the Standards Documents, which would again cause trade receivables securitizations and certain other similar securitizations of non-retail assets to be ineligible for STC treatment as currently structured.

The Consultative Documents also required that at least one payment be made with respect to all credit claims and receivables. BCBS excepted replenishing asset trust structures such as credit card receivables, trade receivables, and other exposures payable in a single installment, at maturity from this requirement in the Standards Documents.

For More Information

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