ALLEN & OVERY

Towards an EU STS framework for balance sheet synthetic securitisations – EBA final report published

June 2020

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1. Summary and Next Steps

The European Banking Authority (**EBA**) is mandated, under Article 45 of the EU Securitisation Regulation (the **Securitisation Regulation**)[1], to produce a report (the **Report**) on the feasibility of a regime for simple, transparent and standardised (**STS**) balance-sheet synthetic securitisations. On 24 September 2019, the EBA published a discussion paper (the **DP**)[2] in connection with the Report, which we analysed in our briefing of 16 October 2019 (linked here). On 6 May 2020, the EBA published its long awaited Report[3].

In line with the DP, the Report recommends the creation of a cross-sectoral STS framework for balance-sheet synthetic securitisations (excluding arbitrage synthetic securitisations) (the **Proposed Balance Sheet Synthetic STS Framework**). As in the DP, the EBA stops short of positively recommending a differentiated prudential regime to accompany the Proposed Balance Sheet Synthetic STS Framework. However, it indicates that such treatment could be justified based on the analysis undertaken, and the scope of a possible regime is newly outlined.

While the eligibility criteria for STS synthetics contained in the Report are broadly in line with the DP's proposals, certain improvements have been made and industry concerns addressed, including the addition of collateral in the form of cash deposits with the originator to the (limited) collateral types previously permitted for funded credit protection, and the sanctioning of synthetic excess spread (**SES**) in STS synthetics subject to specified conditions. (We provided input to the industry response to the DP via an AFME working group)[4].

This briefing provides an overview of the key points to note about the Report, setting out in Appendix 1 at the end of this briefing an overview table on the proposed balance sheet synthetic STS criteria, as set out in the Report (including a redline against the earlier proposals set out in the DP).

The Report and this briefing will be of interest to originators and investors currently active in the synthetic securitisation markets and to entities that may be interested in participating in those markets.

In terms of the next steps, the EBA final report will now form the basis for the European Commission's legislative proposals, but the timing for such proposals is unclear. The Securitisation Regulation provided for the European Commission to submit a report on STS for synthetics to the European Parliament and Council by 2 January 2020, which deadline has clearly passed and the new timeline is likely to be affected by the unfolding Covid-19 crisis. Maintaining momentum on this workstream and ensuring that the industry benefits from as much clarity as possible on the coming requirements in order to facilitate advance structuring for compliance will be key.

An electronic version of this briefing and the earlier briefing on the DP (as well as our briefing entitled "Navigating the EU Securitisation Regulation", which provides a general overview of the Securitisation Regulation regime) is available via our online services for clients through our online portal "AOHub", in particular, our ABS Regulatory Reform

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[1] Regulation (EU) 2017/2402: https://eur-lex.europa.eu/legal-content/en/TXT/?uri=celex:32017R2402.

[2] See https://eba.europa.eu/documents/10180/2963923/EBA+Discussion+Paper+on+STS+syntehtic+securitisation.pdf and note that the DP builds on the EBA Report on Synthetic Securitisation published in December 2015 (see https://eba.europa.eu/-/eba-issues-advice-on-synthetic-securitisation-for-smes).

[3] See https://eba.europa.eu/eba-proposes-framework-sts-synthetic-securitisation.

[4] AFME response paper is available at:
https://www.afme.eu/Portals/0/DispatchFeaturedImages/AFME%20response%20to%20EBA%20consultation%20on%20STS%20Framework%20for%20synthetic%20securitisation%20(Nov%202019).pdf

Roadmap website and the STS Spotlight website. Please visit http://www.allenovery.com/Online-Services/Pages/default.aspx for more information. Alternatively, please speak to your Allen & Overy contact or email capitalmarkets@allenovery.com.

2. Background

By way of background (and as defined in Article 2(10) of the Securitisation Regulation), a "*synthetic securitisation*" is a securitisation in which the transfer of risk is achieved through the use of credit derivatives or guarantees, and the securitised exposures remain exposures of the originator. By contrast (and as defined in Article 2(9) of the Securitisation Regulation), in a "*traditional securitisation*", the economic interest in the securitised exposures is transferred through the transfer of ownership of those securitised exposures from the originator to an SSPE or through sub-participation by an SSPE (ie so-called "*true sale*" securitisation). Synthetic securitisations are precluded from benefitting from the existing STS regime available to traditional securitisations.

In line with the DP, the term "*balance sheet synthetic securitisation*" is used in the Report to refer to a synthetic securitisation in which the protection buyer's primary objective is the transfer of credit risk relating to exposures held on its balance sheet and originated or purchased within a core lending/business activity. It is distinguished from the term "*arbitrage synthetic securitisation*", which refers to transactions where the protection buyer purchases exposures outside its core lending/business activity for the sole purpose of buying credit protection on them (ie securitising them) and thus creating an arbitrage on the yields resulting from the transaction. In line with the EBA's mandate, the Report (like the DP) excludes arbitrage synthetic securitisations from the potential new STS framework for synthetic deals, limiting it to balance sheet synthetic securitisations only.

Existing Article 270 of the Capital Requirements Regulation (**CRR**)[5] provides a limited, STS-like capital treatment for originators' retained senior positions in balance sheet synthetic securitisations of SME exposures where significant credit risk is transferred to either: (i) national or supranational entities (central banks, central governments, multilateral development banks or international organisations) that are 0% risk weighted through unfunded guarantees; or (ii) institutional investors through fully cash-collateralised guarantees (ie cash on deposit with the institution) and, in each case, the STS requirements for traditional securitisations are met (other than in respect of true sale and non-encumbrance) (the **Existing Art 270 Regime**).

[5] Regulation (EU) No 575/2013, as amended.

3. Key takeaways on the possibility of differentiated regulatory treatment

As indicated above, in line with the DP, the Report recommends the creation of a cross-sectoral STS framework for balance sheet synthetic securitisations (excluding arbitrage synthetic securitisations) (the **Proposed Balance Sheet Synthetic STS Framework**). As in the DP, the EBA stops short of positively recommending a differentiated prudential regime to accompany the Proposed Balance Sheet Synthetic STS Framework. However, it indicates that such treatment could be justified based on the analysis undertaken, and the scope of a possible regime is newly outlined.

The differentiated prudential regime would be limited to senior securitisation positions[6] retained by the originator (there would be no investor benefit), and would match the treatment for senior securitisation positions in STS traditional securitisations. The risk weight floor applicable to an originator's retained senior securitisation position would be reduced to 10% (from 15%) and each risk weighting approach in hierarchy would be re-calibrated to generate lower capital charges (for detail see footnote[7]). The exclusion of investors from the differentiated prudential regime would not represent a significant limitation at present, given the composition of the investor base for balance sheet synthetic securitisations (investors are typically not prudentially regulated), but could, potentially, have relevance in terms of future market development. The limitation of the benefit to senior securitisation positions could potentially prove relevant under the external ratings-based approach to securitisation position risk weighting (SEC-ERBA) to the extent that retained tranches are required to be split for ratings purposes. However, we note that the SEC-ERBA is subordinate in the risk weighting hierarchy to the SEC-IRBA and (save where CRR-specified exceptions apply) the SEC-SA, producing typically higher risk weights in any case.

The EBA indicates that all respondents to the DP requested the introduction of a differentiated regulatory treatment on the basis that the use made of the Proposed Balance Sheet Synthetic STS Framework would be likely to depend on the availability of such a regime. This is because the current investor base for balance sheet synthetic securitisations comprises a small number of highly specialised investors who, though supportive of the development of a synthetic STS framework, are well able to analyse transactions in all their complexity.

The EBA remains mindful that creation of a favourable prudential regime to accompany the Proposed Balance Sheet Synthetic STS Framework would entail non-compliance with Basel (which does not contain, and is not expected to develop, a 'simple transparent and comparable' (**STC**) framework for synthetic securitisations akin to its STC regime for traditional securitisations). The EU has, however (as the EBA repeats), diverged from Basel in certain other respects (for example, in extending a more favourable regime for covered bonds). Other negative factors articulated in the DP remain the limitations of the performance data on which the analysis in the DP is based and the market's limited experience to date with the traditional STS framework. The EBA now notes, however, that the available data have increased as a result of the consultation process, and will increase further through market compliance with the transparency requirements of the Securitisation Regulation[8]. The EBA articulates a new concern about potential large-scale replacement of regulatory capital by credit risk mitigation[9]. This would appear an unlikely consequence of the limited amendments envisaged by the Proposed Balance Sheet Synthetic STS Framework in the

[6] The Report does not contain an explicit cross referece, however, this term is defined in Article 242 CRR as a "position backed or secured by a first claim on the whole of the underlying exposures, disregarding for these purposes amounts due under interest rate or currency derivative contracts, fees or similar payments, and irrespective of any difference in maturity with one or more other senior tranches with which that position shares losses on a pro rata basis".

[7] P would be reduced by 50% (subject to p parameter floor of 0.3) on the SEC IRBA; P would be reduced to 0.5 (rather than 1 for other securitisations) [and the W delinquency parameter adjusted to reduce Ksa (Basel only, not in CRR?)] on the SEC-SA; and regulatory risk weights would be reduced on the ERBA.

[8] Which require loan level disclosures in relation to private as well as public securitisations.

[9] Presumably similar concerns are not raised by traditional STS securitisations in the sense that deals that achieve significant risk transfer typically also achieve accounting de-recognition, which is not the case for synthetic SRT deals, which remain on balance sheet for accounting purposes.

context of the existing synthetic securitisation, and broader credit risk mitigation frameworks. Mass expansion would also likely be constrained by the nature of the investor base. The concern is also, to some extent, in tension with the potential benefits of the Proposed Balance Sheet Synthetic STS Framework, cited by the EBA in terms of: funding the real economy (supporting lending to SMEs and large firms, in particular), the relevance of which might be expected to have increased significantly as a result of the Covid-19 crisis; and fostering financial stability (transferring credit risk from banks to markets). The EBA continues to note the potential for growth in the synthetic sector (overcoming constraints of the Existing Art 270 Regime) and the driver to this growth represented by on-going reforms to the prudential framework for banks. The EBA continues to articulate its belief in the technical feasibility of a prudentially sound STS synthetic securitisation product. Data cited by the EBA indicates that the historic performance of balance sheet synthetic securitisations has actually been better than that of traditional securitisations for all asset classes (with zero default and loss rates on senior tranches for a significant majority of transactions and asset classes, and very low default and loss rates overall), and that balance sheet synthetic securitisations have performed broadly consistent with the performance of comparable underlying exposures. The EBA notes the desirability of ensuring a prudentially level playing field with STS traditional securitisations and concludes that the Proposed Balance Sheet Synthetic STS designation would unlikely 'cannibalise' STS traditional securitisation, given the different portfolios associated with each of these securitisation types (the EBA notes, in particular, the advantages of synthetic, as opposed to true sale, techniques for portfolios of mixed jurisdiction assets) – it could also have noted the different investor bases for traditional and synthetics deals.

In order to benefit from the differentiated prudential regime indicated above, a securitisation would be required to comply with eligibility criteria relating to simplicity, transparency and standardisation specified in the Report and discussed below. The securitised assets would also, the Report newly confirms, be required to comply with prudential eligibility criteria identical to those applicable, under Article 243(2) CRR, to non-ABCP traditional securitisations seeking STS prudential treatment. Article 243(2) CRR imposes (broadly) a concentration limit in relation to the securitised exposures (a 2% maximum exposure to any obligor and its connected clients[10]). The concentration limit might be anticipated to be more restrictive, in practice, in the context of synthetic than traditional securitisations, given that synthetic securitisations are often less granular. Article 243(2) CRR also imposes (broadly) maximum risk weights for the underlying exposures, by asset class, at the point of contribution to the securitisation: 40% for residential real estate, 50% for commercial real estate, 75% for retail exposures (though retail exposures and residential real estate have, until recently, been relatively rare underlying asset classes for synthetic securitisations), and 100% for other exposures, (in each case assessed based on the Standardised Approach to credit risk) as well as a maximum loan to value ratio of 100% for residential real estate and charge seniority requirements for real estate in general[11].

The Report indicates that the differentiated prudential treatment would not extend beyond regulatory capital benefits to include, for example, liquidity benefits such as potential eligibility within the high quality liquid assets (**HQLA**) framework under the Liquidity Coverage Ratio regime.

[10] Excluding exposures relating to commitments to repurchase/re-finance securitised residual leasing values by third-party protection providers eligible under Article 201(1) CRR.
[11] It is a requirement in relation to real estate that assets secured by lower ranking exposures only be included where all loans secured by prior ranking exposures are also included.

4. Key takeaways on the proposed eligibility criteria

The EBA's Proposed Balance Sheet Synthetic STS Framework takes the STS criteria for traditional non-ABCP securitisations (the **Traditional STS Criteria)** as its starting point, adapting these, and introducing certain additional requirements to identify a set of STS criteria for balance sheet synthetic securitisation. The analysis below identifies: (i) the key differences between the Proposed Balance Sheet Synthetic STS Framework and the Existing Art 270 Regime; and (ii) the key novel aspects of these criteria compared with the Traditional STS Criteria[12] (please refer to Appendix 1 at the end of this briefing for an overview table on the proposed balance sheet synthetic STS criteria, as set out in the Report (including a redline against the earlier proposals set out in the DP)).

4.1 Requirement for an EU-regulated protection buyer and the UK withdrawal from the EU (Brexit)

In line with the DP, the Report indicates that, to qualify under the Proposed Balance Sheet Synthetic STS Framework, a transaction must be a synthetic securitisation within the meaning of Article 2(1) of the Securitisation Regulation and the protection buyer must be an originator in respect of the underlying exposures within the meaning of Article 2(3) of the Securitisation Regulation. The protection buyer must also be an EU-regulated undertaking[13] and established in the EU (the latter being a new requirement in the Report), meaning that balance sheet synthetic securitisations by UK originators would not qualify as STS from the perspective of the EU investors, once the UK withdraws from the EU (subject to any transitional provisions)[14]. The amended wording underscores that cross-border operation in the EU under third country/equivalence regimes in EU legislation would not bring UK originators within scope. However (unlike in a traditional securitisation context), the practical impact of this requirement is likely to be limited, given that investors in synthetic securitisations are outside the scope of the STS prudential benefit in any case (and typically not prudentially regulated). The prudential regulation of UK originators is a matter for the PRA/FCA and it remains to be seen whether and how any Balance Sheet Synthetic STS Framework will be implemented in the UK, which will in turn dictate the impact on the cross-border analysis from the perspective of an originator or investor that is prudentially regulated in the UK.

4.2 No restrictions on asset class

Helpfully, unlike the Existing Art 270 Regime, the Proposed Balance Sheet Synthetic STS Framework remains unlimited by asset class (subject to satisfaction of the Article 243(2) CRR risk weight restrictions discussed above).

4.3 Eligible credit protection types, providers and collateral

In big picture terms, the criterion, proposed in the DP, addressing the collateral used, in funded structures, to mitigate the originator's credit risk exposure to the protection provider has been amended to permit collateral in the form of cash deposits with the originator in addition to the (limited) collateral types previously envisaged. The criterion still precludes unfunded protection from private sector providers from benefitting from STS treatment, even if the provider is a regulated insurer.

[12] Note that this briefing does not focus on the issues associated with the Transitional STS Criteria, where such criteria are incorporated in similar/unchanged form into the Proposed Balance Sheet Synthetic STS Framework.

[13] References to specific EU legislation under which an originator must be regulated have been removed and substituted with a requirement to be an "EU regulated entity subject to [sic] authorisation/licensing regime that is established in the Union" (Criterion 1).

[14] And vice versa, for UK investors in balance sheet synthetics by EU originators, subject to any transitional arrangements.

Although the Proposed Balance Sheet Synthetic STS Framework is less restrictive in this respect than the Existing Art 270 Regime, market calls for the EBA to rely on the CRR's existing mechanics for credit risk mitigation (**CRM**) (which permit a wide range of unfunded credit protection providers and a wide range of collateral for funded transactions, adjusting the recognised protection/risk weight accordingly) remain unheeded. The EBA is, of course, attempting to make the framework available on a cross-sectoral basis so that, depending on the originator's regulatory status, the CRR CRM adjustment mechanics may (in theory) not apply. However, this is not the only basis for the proposed restrictions on eligible credit protection providers and collateral. The EBA indicates that its stakeholders remain concerned about the residual credit risk associated with the synthetic risk transfer format[15]. The EBA also remains of the view (notwithstanding industry responses to the contrary) that it is appropriate for the Proposed Balance Sheet Synthetic STS Framework to combine investor protection objectives with originator protection objectives, notwithstanding the existence of the significant risk transfer (**SRT**) regime under Article 245 of the CRR (and related guidance) designed to achieve the latter.

Unhelpfully, as in the Existing Art 270 Regime, unfunded credit protection remains required to take the form of a guarantee, or counter-guarantee (ie not a credit derivative) that is eligible under Chapter 4, Part Three, Title II of the CRR (ie the CRR CRM mechanics applicable on the standardised and foundation internal ratings-based approaches) (**Chapter 4 CRR**) and eligible guarantors/counter-guarantors are limited to national and supranational entities (central banks, central government, multilateral development banks and international organisations) that are 0% risk weighted. This would exclude, for example, the provision of unfunded credit protection by insurers.

Unlike the Existing Art 270 Regime, collateralised transactions can take the form of either guarantees or *credit derivatives*[16] (in each case, Chapter 4 CRR eligible), and, as in the DP, counterparty eligibility for collateralised transactions is not limited to institutional investors. Unfortunately, collateral types, though broader than cash on deposit with the protection purchaser (the only option under the Existing Art 270 Regime), remain more restricted than under the CRR CRM eligibility criteria. Collateral is permitted to take the form of 0% risk weighted debt securities with a residual maturity of three months or fewer[17] held by an independent custodian. The DP proposed requirement for "clearly determined and conservative" haircuts for "market and other risks" for such debt securities has, however, been dropped.

Alternatively, collateral is permitted to take the form of cash held with a third-party credit institution or on deposit with the protection purchaser. As indicated above, the latter is a new option in the Report; it is in line with market practice and preferable, from a risk weighting perspective, for the protection purchaser to exposure to a third-party credit institution.

In either case, unless the securitisation is a CLN directly-issued by the protection purchaser[18], cash collateral must be subject to ratings downgrade triggers providing for its transfer to an appropriately rated third-party bank, or investment in high quality securities held by a custodian/the protection buyer. It is not wholly clear that the two permitted collateral types can be combined (ie 0% risk weighted debt securities and cash), but hopefully this is the intention[19].

4.4 Balance sheet synthetic securitisation transactions only (exclusion of arbitrage synthetic securitisations)

In line with the DP, the Report includes a number of measures to define and limit the Proposed Balance Sheet Synthetic STS Framework to balance sheet synthetic securitisations, excluding arbitrage synthetic securitisations (as noted above, the latter refers to "*transactions where the protection buyer purchases exposures outside their core lending/business activity, for the sole purpose of writing credit*

[15] The residual credit risk of the originator of a synthetic securitsation to the protection provider in respect of protection payments, and the residual credit risk of the protection provider to the originator in respect of fees and (where relevant) collateral.

[16] Including credit linked notes.

[17] The maturity of which is required to match the securitisaion's payment dates facilitating redemption into cash in an amount equal to the outstanding balance of the protected tranche.

[18] In line with Article 218 CRR ratings downgrade triggers are not required in these circumstances, however, the purposive difference between directly and indirectly issued CLNs in this respect is not wholly clear.

[19] Given, for example, the need for collateral management in relation to 0% risk weighted debt securities.

protection on them (ie securitising them) and arbitraging on the yields resulting from the transaction"). In line with the DP, the Report requires that the underlying exposures of a balance sheet synthetic securitisation are part of the "*core lending or any other core business activity*" of the protection buyer, however this key term is undefined.

The EBA has responded to market concerns around insurance re-characterisation risk (and accommodated structures in which – to the extent compatible with the CRR requirement for direct credit protection[20] – protection to mitigate consolidated capital requirements is purchased by the topco of a group). The requirement therefore now permits underlying exposures to be held on the balance sheet of the protection buyer or a member of its corporate group (rather than on the balance sheet of the protection purchaser only) at or before the closing date. Amendments to the rationale description for this criterion, suggest that it is sufficient for an exposure to be included in a prudentially regulated protection purchaser's *regulatory* balance sheet. It is unclear whether this language intentionally facilitates synthetic securitisation of assets previously subject to non-SRT traditional securitisation. In line with the DP, the exposures must be identified via a reference register (however the register is no longer required to be updated "continuously") and, again, as in the DP, the protection buyer is required to undertake not to further hedge its exposure to the credit risk of the underlying exposures in a manner that results in double-hedging[21]. Where a protection buyer is a limb (b) originator (ie it purchases third-party exposures on its own account), the Report (in line with the DP) requires it to apply credit and collection, work-out and servicing policies to purchased exposures that are "*no less stringent*" than those applied to "*similar exposures*" that are not purchased (to avoid moral hazard)[22] and, for all originators, servicing procedures are required to be "*at least as stringent as the servicing procedures applied by the originator for similar exposures which are not securitised*".

4.5 Compliance with Article 249 of the CRR (and hence Chapter 4 CRR)

In the Report, in line with the DP, the credit protection agreement is required to comply with the CRM requirements for securitisations in Article 249 CRR (which requires compliance with, gold-plates, and clarifies the application of, Chapter 4 CRR, in certain respects, for securitisations) for CRR institutions, or with "*equivalently robust requirements*" for non-CRR institutions.

4.6 Early termination events

In line with the DP, the Report proposes to regulate permissible early termination events in the credit protection in a manner that is stricter than the requirements of Chapter 4 CRR, limiting these to:

- protection provider insolvency;
- originator failure to pay;
- protection provider breach of material contract obligation;
- eligible regulatory calls exercisable at the originator's option;
- time calls exercisable at the originator's option at or following the weighted average life (WAL) of portfolio as at closing and which are not structured to avoid allocating losses to credit enhancement positions or other positions held by investors, or otherwise structured to provide credit enhancement; and
- Article 245(4)(f) CRR compliant clean up calls exercisable at the originator's option.

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[20] Article 213 of the CRR in the Chapter 4 unfunded CRM requirements requires credit protection to be "direct". Credit protection written in favour of a topco whose subs hold the assets will not be direct from the perspective of the entity on whose balance sheet the asset sits. If the entities on whose balance sheets the assets sit are not themselves CRR institutions (so do not need to recognise the protection on a solo basis), however, it may be possible to argue that – in relation to consolidated capital requirements only – credit protection can be regarded as direct if it sits with the consolidating entity/anywhere in the prudential consolidation group ie, interpreting directness as covering the whole prudential consolidation group in relation to the consolidated position]

[21] As indicated above, it is no longer necessary for the underlying exposures to be held on the originator's own balance sheet, they can be on the balance sheets of other group companies, or sold in the ordinary course of business, however an originator's ability to double-hedge also has a bearing on insurance re-characterisation. Where a retained tranche constitutes the risk retention for a securitisation, the proposed prohibition on double-hedging overlaps with the risk retention requirements.

[22] Ensuring that the management of exposures purchased for the purposes of securitising them is consistent with that of similar exposures not securitised is important to avoid the occurrence of moral hazard behaviours by the protection buyer that could result in an overall lesser credit quality of the securitisation transaction, ultimately affecting both retained securitisation positions and securitisation positions placed with investors.

As in the DP, early termination events for originator bankruptcy are explicitly excluded (an approach mooted, but not confirmed, in the EBA's discussion paper on significant risk transfer (the **EBA SRT DP**))[23], with no discussion of a requirement for continued originator servicing (though, as indicated above, failure to pay is a permitted termination event). The EBA makes the point that (for originators subject to the BRRD) resolution would likely disapply originator bankruptcy termination in any event, and noted, in the Public Hearing, that this was a position that is often accepted by investors.

The proposed description of regulatory events permitted to trigger an originator call is revised relative to the DP. In line with proposals in the EBA SRT DP SRT calls (ie calls for failure to gain/loss of SRT) are now explicitly sanctioned. The amended text continues to refer to changes in tax or accounting treatment of a transaction as a permissible basis for a regulatory call. However, under the revised drafting, the changes are required to lead to a "*material adverse effect on the amount of capital that the protection buyer is required to hold in connection with the securitisation…*" (as opposed to a material impact on "*the allocation of benefits among the [transaction parties]*" as previously required). Although the permitted regulatory events included in the Report are not articulated as exclusive, the changed wording makes it harder to read a change in tax law as falling within the regulatory events expressly permitted in the Report (as a change in tax law could impact the withholding position of the protection purchaser/seller without impacting the protection purchaser's capital requirements for the securitisation). It is, hopefully, not the EBA's intention to exclude tax calls (we would expect not).

The proposed definition of permissible time calls is consistent with the DP and EBA SRT DP proposals (which go beyond the current SRT requirements at EU level), though no reference is made to replenishment periods. It is not clear whether this omission is intentional.

Certain (market standard) termination events are not addressed: force majeure; default by credit support provider (save to the extent that this involves material contract breach by the originator itself); illegality and tax events of default (save, in each case, to the extent covered by the originator's regulatory/as call option). At the Public Hearing in relation to the DP on 9 October 2019[24], the EBA, helpfully, indicated that the fact that these events were not discussed should be taken as an indication that the EBA was comfortable with them.

No reference is made in the Report to a protection purchaser being entitled to terminate the protection for material breach by the originator in general. However, as in the DP, the protection purchaser is required to make specified representations and warranties, and the Report now explicitly indicates that breach of those representations and warranties should lead to unenforceability of the credit protection.

The subject matter of the required representations and warranties is unchanged relative to the DP text, however, their detailed drafting has been changed (see Criterion 2). Some knowledge qualifiers have helpfully been added, amendments have been made to clarify that the underlying exposures can be held within the protection purchaser group rather than by the protection purchaser directly, and it has been clarified that certain representations (such as compliance with the eligibility criteria) speak as of the date of inclusion of an underlying exposure in the portfolio only (the latter being essential in terms of compliance with the CRM eligibility requirements and the guidance on representations and warranties in the EBA SRT Guidelines). The warranty relating to the absence of default by underlying obligors now relates to the securitised exposures only and not to all debt of the relevant underlying obligor.

4.7 Credit Events

The Report proposes minimum requirements for credit events. These helpfully diverge from the DP in recognising a distinction between the requirements for credit protection in the form of credit derivatives and credit

[23] See https://eba.europa.eu/-/eba-launches-consultation-on-significant-risk-transfer-in-securitisation.

[24] The Public Hearing materials are available at: https://eba.europa.eu/calendar%3Fp_p_id%3D8%26_8_struts_action%3D%252Fcalendar%252Fview_event%26_8_eventId%3D2963958

protection in the form of guarantees. As the Report notes, it may be preferable, from an accounting perspective, for protection to take the form of a financial guarantee (typically accrual accounted) rather than a derivative (accounted for on a mark to market basis).

For credit derivatives, in the Report, as in the DP, restructuring (as well as failure to pay and bankruptcy of the underlying obligor) is a required credit event. This is in line with current market practice (not least because the omission of restructuring credit events under the current CRR framework for credit derivatives results in a 40% haircut to the recognised protection). However, we note that the omission of restructuring credit events will cease to result in prudential haircuts (in the presence of a unanimous lender consent requirement and robust insolvency law) once 'Basel IV' (ie the Basel III changes finalised in December 2017) is implemented in the EU[25]. The required credit event definitions (which track those in the EBA SRT DP) go beyond the required Chapter 4 CRR definitions for credit derivatives. It remains to be seen whether this gold-plating will also be applied by regulators to the non-securitisation CRM market, or will create divergence from that market.

For credit protection in the form of financial guarantees, the Report now indicates that restructuring is not a required credit event. This is helpful, however there remains a requirement to include a credit event relating to bankruptcy of the underlying obligor, as well as a credit event relating to failure to pay, whereas the CRR requirements for guarantees would mandate pay-out only on the occurrence of a failure to pay (such pay-outs would be required for as long as payments fall due under the underlying exposure, rather than leading to close-out as in the case of a credit default swap).

4.8 Credit protection payments

In line with the DP, the Report contains proposals relating to the calculation of credit protection payments. These are to be calculated based on the actual realised loss suffered by the originator in accordance with its standard recovery policies and procedures for the relevant exposure types as recorded in its financial statements at the time the payment is made[26].

In line with market practice, the Report, like the DP, proposals provide for interim credit protection payments to be made within six months of a credit event (where the work-out has not yet been completed), followed by a true up post work-out. This interim payment period requirement is shorter than the one-year interim payment period proposed in the EBA's synthetic STS report and endorsed in the EBA SRT DP. It would be helpful for the EBA to confirm that payment in accordance with the proposals constitutes 'timely' payment for the purposes of the CRR (and related EBA single rulebook Q&A), and to confirm whether the requirement overrides the Article 215(1)(a) CRR permitted two-year payment period in the context of residential real estate (hopefully not). The interim payment is calculated as the greater of: the impairment recorded in the originator's financial statements; and where applicable (meaning, presumably, where the originator applies the internal ratings based approach) the loss given default (**LGD**) that would be applied by the originator to the underlying exposures[27].

The calculation mechanics for interim and final credit protection payments must be set out in the credit protection agreement, the amounts payable must

[25] Assuming that this change is implemented in the EU in line with the Basel text.

[26] Where the protected amount is less than the outstanding notional amount of an underlying exposure, the Report proposes payment of such portion of the protected amount as the realised loss bears to outstanding notional amount, presumably this is subject to the attachment and detachment points for the transaction.

[27] Although calculating interim loss based on LGD is in line with market practice, the proposed mechanics for interim payments based on impairment/LGD are slightly hard to reconcile with the required basis of calculation under the CRR save, potentially, for interim payments made by public sector guarantors/counter-guarantors relying on the exception under Article 215(2) CRR where interim payments based on robust estimates of loss are permitted, and it would be helpful if the EBA could explicitly confirm that its proposals should be taken to be compatible. The CRR eligibility requirements for guarantees require payments (interim or otherwise) to be based on the amounts contractually due from the underlying obligor to the extent defaulted, rather than estimates of loss such as those represented by provisions (the protection buyer must be able to pursue the guarantor for the "monies due under the claim in respect of which the protection is provided", the guarantee must cover "all types of payments the obligor is expected to make in respect of a claim", save that "where certain types of payment are excluded from the guarantee, the [protection purchaser] has adjusted the value of the guarantee to reflect the limited coverage" – see Articles 215(1)(a) and (c) of the CRR). The CRR eligibility requirements for cash settled credit derivatives require payments to be based on "post credit event valuations of the underlying obligation" – see Article 216(1)(b) of the CRR. It would be helpful if the EBA could explicitly confirm that its proposals should be taken to be compatible.

be clearly defined, capable of calculation in all circumstances, and limited in amount, and the circumstances in which payments are required must be clearly defined and objective, or subject to determination by the verification agent (see below). The credit protection amount must be broken down to the level of individual underlying exposures (the CRR, which applies on an exposure-by-exposure basis, effectively requires this anyway for CRR institutions).

Where the work-out has not been completed before the scheduled legal maturity of, or early termination of, the credit protection, a final credit protection payment is required based on the actual realised loss suffered by the originator and recorded in its financial statements at the time it is calculated[28]. Whereas the DP required the final credit protection payment to be paid two years after legal maturity/early termination, the Report requires the parties to specify a maximum extension period of up to two years for this purpose in the transaction documentation.

4.9 Credit protection premiums[29]

In line with the DP, the Report contains proposals relating to credit protection premiums that are consistent with market practice in general. Premiums must be contingent (ie payments must be a function of the size and credit risk of the protected tranche) and must not be guaranteed, paid upfront, or subject to rebate, or other, mechanisms that may avoid or reduce actual allocation of losses to investors, or return part of paid premiums to the originator (there is no cross-reference to Basel or other guidance on highcost credit protection). Helpfully, the Report no longer requires the documentation to include "all relevant information …used to price the credit protection" including: market benchmarks/other market variables taken into account by the originator. It requires, more modestly, a clear description of the way in which the protection fee and any note coupons are calculated in respect of each payment date over the life of the securitisation. Diverging from the DP, the proposals now do permit premiums where the premium is a pass-through of the coupons on the underlying assets (however, it is worth noting that, for CRR institutions, such structures can be problematic in terms of the prohibition on clauses that "increase the effective cost of protection as a result of the deterioration in the credit quality of the protected exposure" eg where underlying asset interest increases with ratings downgrades).

4.10 Verification agent

In line with the DP, the Report proposes a requirement for a third-party verification agent (independent of the originator and, where applicable, the SSPE) and appointed by the originator at closing, to verify (as a minimum): the occurrence of credit events; that an underlying exposure was included in the securitisation at the time of the credit event; that an underlying exposure met the eligibility criteria at the time of its inclusion in the portfolio; that the underlying exposure complied with the replenishment conditions (where added in replenishment); the accuracy of the final loss amount by reference to the originator's P&L statement; and the allocation of losses between investors. Although use of verification agents is common in market practice, the requirement represents an additional mandatory expense and administrative hurdle. Helpfully, the EBA have clarified that the verification agent does not need to sign-off on the work-out procedure itself (which was previously ambiguous).

The required confidence level for verification, by sampling, of the underlying exposures' compliance with the eligibility criteria has been revised downwards from 99% to 95%.

4.11 Excess spread

Helpfully, as requested in industry feedback, the Report diverges from the DP by permitting the use of synthetic excess spread (**SES**) – a feature seen increasingly frequently in the market – subject to specified conditions. The

[28] Again, though consistent with market practice, this is somewhat hard to reconcile with the Chapter 4 CRR eligibility requirements for guarantees in the sense that (based on the CRR payment calculation requirements indicated above, and the Article 213(1)(c)(iii) CRR prohibition on clauses that prevent the protection seller from being required to pay), the protection buyer should arguably receive the maximum loss that could be suffered based on the contractual terms to the extent covered by the tranche, less recoveries to date. The DP indicates that the work-out process for credit events that occur prior to termination is required to continue post-termination of the credit protection.

[29] As per terminology used in the Report, in this briefing references are made to "premiums" rather than "premia".

changed position on SES is justified partly in terms of ensuring parity with traditional securitisations, and partly on the basis that it is essential for SRT securitisations of certain retail asset classes associated with high yield and losses. The restrictions are intended to ensure that SES is not excessive (excess spread represents credit protection for the investor, too much excess spread might therefore prevent the investor from, realistically, suffering losses and undermine credit risk transfer). SES could also be set at a level that is excessive in relation to the portfolio's ability to generate excess spread. The Report provides that SES must:

- be a fixed, contractually specified percentage, per payment period, of the outstanding portfolio balance (the use of 'actual' excess spread, or other calculation mechanics is not permitted);
- be provided on a 'use it or lose it' basis in that payment period (ie the SES must be available to cover losses arising in that payment period only, trapped SES is not permitted);
- represent, on an annual basis, no more than one year's regulatory expected losses on the underlying portfolio (it is presumably for reasons of standardisation that an originator is not permitted to commit actual excess spread up to the permitted amount as a maximum); and
- be clearly specified in the transaction documentation.

The Report notes that the sanction it provides for the use of SES in the context of synthetic STS transactions does not prejudice the ability of national competent authorities to scrutinise SES in assessing commensurate risk transfer for SRT transactions.

(At the Public Hearing on the SP, the EBA noted in passing that discussions in relation to excess spread are taking place at Basel level.)

4.12 Pro rata amortisation

Fortunately, in line with the DP, the Report indicates that pro rata amortisation to determine the outstanding size of tranches is considered compatible with STS[30], provided that specified triggers relating to the performance of the underlying exposures are included in the documentation to switch to sequential amortisation. In line with the equivalent Traditional STS Criterion, the triggers must include deterioration in the credit quality of the underlying exposures below a predetermined threshold. The Report helpfully clarifies (as the DP did not) that hybrid amortisation structures (involving a 'combination of pro rata and sequential' amortisation or in which pro rata amortisation applies to certain tranches only) are permitted.

4.13 Early amortisation provisions/triggers for termination of the revolving period

In line with the DP, the Traditional STS Criterion on early amortisation provisions/triggers for termination of the revolving period (of which the EBA SRT DP endorsed an early draft) is included but amended to mandate triggers for termination of the revolving period where the securitisation is a revolving securitisation, or amortisation of tranches. No trigger is included relating to the insolvency of the originator or servicer, and the trigger relating to decreases in the value of the underlying exposures is replaced with a trigger relating to losses rising above a predetermined period (absolute or over a specified time period), leaving the full list of triggers as follows:

- a deterioration in the credit quality of the underlying exposures to or below a predetermined threshold;
- losses rise above a predetermined threshold, or losses over a predefined period rise above a predetermined threshold; and
- a failure to generate sufficient new underlying exposures that meet the predetermined credit quality.

The drafting has been amended since the DP to clarify that references to early amortisation, in this context, mean that the notes are required to start to

[30] By contrast, the DP provides that the allocation of losses must always be sequential from the most junior to the most senior tranche, but this is already the effect – for CRR SRT transactions – of the EBA SRT Guidelines prohibition on "embedded mechanism[s] reducing the amount of credit risk transfer disproportionately over time".

amortise sequentially as the underlying exposures amortise, rather than being required to be redeemed in full, and are relevant to synthetic securitisations that do not involve an SSPE and note issuance (for example to determine the quantum of collateral return in a funded arrangement or tranche size for an unfunded deal). From a CRM and SRT eligibility perspective, the credit protection clearly has to remain available to the extent of the underlying exposures notwithstanding a decline in the creditworthiness of the underlying assets (see, for example, Articles 245(4)(c)(ii) and 213(1)(c) of the CRR).

4.14 Requirements after enforcement/acceleration notice

The confusing, traditional securitisation inspired, proposed requirements of the DP relating to enforcement/acceleration[31] have been replaced by a requirement that, following the occurrence of an enforcement event in relation to the protection buyer, the protection seller should be permitted to take enforcement action and terminate the credit protection, with collateral (where applicable) being returned to investors in order of seniority. Where an SSPE is used within a synthetic securitisation, the Report, in line with the DP, provides that, following a termination of the credit protection, no cash should be trapped in the SSPE beyond what is necessary to ensure the operational functioning of the SSPE or the orderly repayment of investors in accordance with the contractual terms of the securitisation. However, the Report clarifies that amounts required to fund protection payments in respect of assets that are still being worked out may also be retained.

4.15 Appropriate mitigation of interest rate and currency risks and maturity transformation

Helpfully, the EBA has responded to market feedback, moderating the previous DP proposals around mitigation of interest rate and currency risks. The DP proposals required the protection *buyer* to bear *no* currency or interest rate risk in relation to the credit protection (and the measures taken to mitigate currency and interest rate risks to be disclosed). This appeared a high threshold to meet, and went beyond the usual risk management mechanisms included in transactions, causing concern, especially, in relation to mixed currency portfolios. The Report's proposed requirements now indicate, in relation to currency risk, that the transaction documentation should "clearly describe how any currency risk arising in the synthetic securitisation will affect payments to the protection buyer" (though the rationale section continues to refer to currency risks being "appropriately mitigated" through denomination of the protection in the same currency as the underlying exposures (and, if relevant, collateral) or use of hedges and guarantees). In relation to interest rate risk, the Report's proposed requirements now indicate that the transaction documentation should "clearly describe how any interest rate risk associated with synthetic securitisation will be mitigated and what impact it will have on the payments to the protection provider and the investor".

As proposed in the DP, where a securitisation involves an SSPE, the SSPE's interest liabilities to investors on any payment date must be less than or equal to its income from the protection buyer and the collateral arrangements.

Reflecting an equivalent provision for STS traditional securitisations, the DP had proposed to prohibit maturity transformation[32] (repayment of the SSPE's liabilities to investors not being predominantly reliant on the sale or refinancing of the underlying exposures), however, this prohibition has been deleted as less relevant in a synthetic context.

4.16 Eligibility criteria and absence of active portfolio management

In line with the DP, the Traditional STS Criterion on eligibility criteria and absence of active portfolio management is adapted, in line with market practice, to incorporate restrictions on the circumstances in which exposures can be removed from a pool. As under the DP, removals are permitted where the exposures: are repaid or otherwise matured; are subject to refinancing,

[31] The DP required that following the occurrence of an enforcement or acceleration event, enforcement or acceleration should be initiated immediately and sequential amortisation should continue to apply to all tranches so that, as the underlying exposures amortise, the outstanding amount of all tranches is reduced in the order of their seniority.

[32] The DP indicated that where a securitisation involved an SSPE, the SSPE's interest liabilities to investors on any payment date must be less than or equal to its income from the protection buyer and the collateral arrangements.

restructuring or similar amendment that is not credit driven, and which occurs in the ordinary course of servicing such exposure (such as maturity extension); or did not meet the eligibility criteria at the time of inclusion. The Report, however, also clarifies (in response to concerns relating to insurance re-characterisation) that sale of the exposures in the ordinary course of the protection buyer's business is permitted provided that this would not constitute implicit support for purposes of Article 250 of the CRR[33]. Again, this provision relates to originator (rather than investor) protection.

4.17 Transparency requirements

In line with the DP, the requirement in the Traditional STS Criteria for compliance with the Securitisation Regulation transparency requirements is replicated in the Proposed Balance Sheet Synthetic STS Framework[34]. Although this is not a novel aspect of the Proposed Balance Sheet Synthetic STS Framework compared with the Traditional STS Criteria, it is worth pointing out that – given the greater severity of transparency compliance issues for private deals – the significance of this criterion is increased in a synthetic context. In line with the DP, the proposed eligibility criteria include specified additional transparency requirements (ie over and above the requirements of Article 7 for synthetic securitisations in scope of the Securitisation Regulation) relating to liability cashflow models, the provision of historical default and loss performance data before pricing, and external verification and disclosure of environmental performance for deals involving residential loans or auto loans or leases.

4.18 Homogeneity

In line with the DP, the he proposed homogeneity requirement in the Report is akin to that found in the Traditional STS Criteria and also requires the development of separate technical standards with regard to the homogeneity criteria for synthetic securitisations for particular asset types. While this is not a novel aspect of the Proposed Balance Sheet Synthetic STS Framework compared with the Traditional STS Criteria, it is worth pointing out that the homogeneity criterion has proved to be a hotly debated topic in the context of the Traditional STS Criteria and that synthetic portfolios are often more mixed than those in a traditional securitisation context (it is an advantage of the synthetic structure, for example, that it is easier to deal with multi-jurisdictional assets under different laws). It therefore remains to be seen how workable the synthetic homogeneity criterion will be.

The drafting in the Report newly envisages that the underlying exposures may include commitment fees on the basis that some synthetic securitisations include unused credit lines or undisbursed loans as underlying exposures.

[33] Article 250 CRR regulates transactions by originators (and sponsors) supporting their securitisations post recognition of SRT.

[34] Save that the originator alone is responsible for compliance.

Appendix 1 – Overview table on the proposed balance sheet synthetic STS criteria, as set out in the Report

Click here to see a redline of the synthetic STS criteria table set out in the Report against the proposals set out in the DP.

In the table below, the colour coding indicates the following[35]:

GREEN – similar to traditional (non-ABCP) STS securitisation criteria

ORANGE – adaptation of corresponding traditional (non-ABCP) STS securitisation criteria

BLUE – replacement of the traditional (non-ABCP) STS securitisation criteria and new requirements specific to synthetic securitisations

STS synthetic securitisation criterion	Comparison with criterion for traditional (non-ABCP) STS securitisation	Rationale for the STS synthetic securitisation criterion
SIMPLICITY CRITERIA		
Criterion 1: Balance sheet synthetic securitisation, credit risk mitigation **General requirements for balance sheet securitisation:** In order to be considered STS synthetic balance sheet securitisation, the following requirements should be met: 1. The securitisation should be a **synthetic securitisation**, as defined in Article 2(10)[36] of the Securitisation Regulation. 2. The protection buyer under the credit protection arrangements establishing synthetic securitisation is **an EU-regulated entity subject to authorisation/licensing regime that is established in the Union** and is an **originator** with respect to the underlying exposures, as defined in Article 2(3)[37] of the Securitisation Regulation. 3. When the protection buyer is an originator with respect to the underlying exposures, as defined in point (b) of Article 2(3) of the Securitisation Regulation, i.e. the exposures underlying the	Replacement of the criteria in Article 20(1)-(5) with definition of balance-sheet synthetics and requirement to ensure robustness of credit protection contract (credit risk mitigation criteria)	The objective of the criterion is to set out requirements for balance-sheet synthetic transactions, i.e. those transactions in which the regulated institution's primary objective is the transfer of credit risk of exposures that the regulated institution itself holds on its balance sheet. The ultimate object of credit risk transfer should be exposures originated or purchased by an institution within a core lending/business activity of such regulated institutions and held on its balance sheet (or regulatory balance sheet, in the case of prudentially regulated institutions) at the closing date. In order to ensure alignment with the traditional STS framework, the protection buyer needs to be an EU established entity. This criterion should exclude arbitrage securitisations, i.e. transactions in which the protection buyer purchases exposures outside their core lending/business activity, for the sole purpose of writing credit protection on them (i.e. securitising them) and arbitraging on the yields resulting from the transaction.

[35] The table sets out the relevant extracts from the Report and the colour-coding corresponds to how it is presented in the Report.
[36] Article 2(10) – "**synthetic securitisation**" means a securitisation where the transfer of risk is achieved by the use of credit derivatives or guarantees, and the exposures being securitised remain exposures of the originator.
[37] Article 2(3) – "**originator**" means an entity which: (a) itself or through related entities, directly or indirectly, was involved in the original agreement which created the obligations or potential obligations of the debtor or potential debtor giving rise to the exposures being securitised; or (b) purchases a third party's exposures on its own account and then securitises them;

STS synthetic securitisation criterion	Comparison with criterion for traditional (non-ABCP) STS securitisation	Rationale for the STS synthetic securitisation criterion
synthetic securitisation have been purchased from a third party before they are securitised, the originator should apply to the purchased exposures credit and collection policies workout policies and servicing policies that are no less stringent than those that the originator applies to similar exposures that have not been purchased. 4. The underlying exposures are part of the **core lending or any other core business activity of the protection buyer**. 5. The underlying exposures should be **held on the balance sheet of the protection buyer** (or a member of the same corporate group as the protection buyer), at or before the closing date. 6. The protection buyer should undertake in the securitisation documentation not to **further hedge** its exposure to the credit risk of the underlying exposures beyond the credit protection obtained through the synthetic securitisation in a manner that results in the double hedging of the same credit risk. **Credit risk mitigation rules:** The credit protection agreement establishing the synthetic securitisation should comply with the credit risk mitigation rules laid down in Article 249 of the amended CRR (including the requirements on SSPE) or with equivalently robust applicable requirements in case the protection buyer is not an institution regulated under the CRR.		Ensuring that the management of exposures purchased for the purpose of securitising them is consistent with that of similar exposures not securitised is important to avoid the occurrence of moral hazard behaviours by the protection buyer that could result in an overall lesser credit quality of the securitisation transaction, ultimately affecting both retained securitisation positions and securitisation positions placed with investors. This criterion should also exclude arbitrage transactions in which the risk is subject to a double hedge (for example, when more than one credit default swap is used to hedge the same credit risk). In order to ensure legal certainty in terms of the payment obligations, the protection buyer should make sure that it does not hedge the same credit risk more than once by obtaining credit protection in addition to the credit protection provided by the synthetic securitisation for such a credit risk. In order to ensure the robustness of the credit protection agreement, this agreement should fulfil the credit risk mitigation requirements in accordance with Article 249 of the amended CRR that have to be met by institutions seeking significant risk transfer through a synthetic securitisation.
Criterion 2: Representations and warranties The securitisation documentation should contain the representations and warranties provided by the protection buyer that the following requirements, in respect of the underlying	Adapted criterion (Article 20(6)): extension of required representations and warranties and adaptation of their objective and content to synthetic securitisation	To enhance the legal certainty with respect to the underlying exposures and enforceability with respect to credit protection agreement, the securitisation documentation should contain specific representations and warranties provided by the protection buyer in respect of the characteristics of those underlying exposures and the correctness of the information

STS synthetic securitisation criterion	Comparison with criterion for traditional (non-ABCP) STS securitisation	Rationale for the STS synthetic securitisation criterion
exposures, are met, as a condition of enforceability of the credit protection: • **Title to and accounting of the exposures**: If the protection buyer is a credit institution or an insurance company, either the protection buyer or a member of the same corporate group as the protection buyer has full right, good and valid title to the underlying exposures and their associated ancillary rights and accounts for the credit risk of the underlying exposures in the regulatory balance sheet. If the protection buyer is not a credit institution or an insurance company, the protection buyer or a member of the same corporate group as the protection buyer has full right, good and valid title to the underlying exposures and their associated ancillary rights. • **Compliance of the exposures with all eligibility criteria set out in the securitisation documentation**: On the date it is included in the securitised portfolio, each underlying exposure complies with all eligibility criteria and any other conditions, other than a credit event, for a protection payment in accordance with the credit protection agreement within the securitisation documentation. • **Financing agreements' validity and enforceability**: To the best of the protection buyer's knowledge, the contractual agreement for each underlying exposure contains a legal, valid, binding and enforceable obligation of the obligor to pay the sums of money specified in it. • **Underwriting standards**: The underlying exposures meet the standard underwriting criteria and these are no less stringent		included in the securitisation documentation. Non-compliance of the underlying exposures with the representations and warranties should lead to non-enforceability of the credit protection, following a credit event.

STS synthetic securitisation criterion	Comparison with criterion for traditional (non-ABCP) STS securitisation	Rationale for the STS synthetic securitisation criterion
than the underwriting criteria that the originator applies to similar exposures that are not securitised. • **No obligor default or other material breach**: To the best of the protection buyer's knowledge, on the date it is included in the securitised portfolio, none of the obligors with respect to each underlying exposure are in material breach or default of any of their obligations in respect of that underlying exposure. • **No untrue information**: To the best of the protection buyer's knowledge, there is no untrue information on the particulars of the underlying exposures contained in the securitisation documentation. As at the closing date, in relation to each underlying exposure, no contractual agreement between the obligor and the original lender has been subject to any variation, amendment, modification, waiver or exclusion of time of any kind that in any material way adversely affects the enforceability or collectability of the underlying exposure.		
Criterion 3: Eligibility criteria, no active portfolio management The underlying exposures should, at all times, be subject to predetermined, clear and well-documented **criteria determining their eligibility** for protection under the credit protection agreement establishing the synthetic securitisation. After the closing date, the securitisation should not be characterised by an active portfolio management on a discretionary basis. The following should, in principle, not be considered an active portfolio management:	Adapted criterion (Article 20(7)): adaptation of allowed portfolio management techniques, inclusion of additional conditions for the removal of the underlying exposures in securitisation	Eligibility criteria are essential safeguards in synthetic securitisation transactions, as they determine the validity of the credit protection purchased by the protection buyer. Protection buyers and protection sellers should be in a position to identify, in a clear and consistent fashion, under which criteria exposures are selected to be securitised. The selection should not be an opaque process. Legal clarity over the eligibility for credit protection reduces legal risk. To enhance legal certainty, additional criteria have been added to limit the conditions under which an underlying exposure may be removed from the securitisation, once it has entered the securitisation under the clearly defined eligibility criteria.

STS synthetic securitisation criterion	Comparison with criterion for traditional (non-ABCP) STS securitisation	Rationale for the STS synthetic securitisation criterion
• substitution of exposures that are in breach of representations and warranties; • if the securitisation includes a replenishment period and the addition of exposures that meet clearly defined replenishment conditions. any case, any exposure added to the securitisation after the closing date should meet eligibility criteria that are **no less strict** than those applied in the initial selection of underlying exposures at the closing date. An underlying exposure may be **removed** from the securitisation if it: • has been repaid or otherwise matured; • has been disposed of during the ordinary course of the protection buyer business, provided such a removal would not constitute implicit support for the purposes of Article 250 of the CRR; • is subject to a refinancing, restructuring or similar amendment that is not credit driven and that occurs during the ordinary course of servicing such an exposure (for example, maturity extension); • did not meet the eligibility criteria at the time it was included in the securitisation because of an error in the underlying exposures.		Active portfolio management adds a layer of complexity and increases the likelihood of cherry-picking practices occurring, which may undermine the effectiveness of credit protection and hence increase the risk of the securitisation positions retained by the protection buyer. Active management is deemed to arise whenever the manager of the portfolio sells one or more exposures that were initially included in the securitisation. Replenishment practices and practices of substitution for non-compliant exposures in the transaction due to previous errors in the selection of exposures should not be considered active management of a transaction's portfolio, provided that they do not result in any form of cherry-picking. Replenishment periods and other structural mechanisms resulting in the inclusion of exposures in the securitisation after the closing date of the transaction may introduce the risk that exposures of lesser quality could be added to the pool of exposures protected under the credit protection agreement. For this reason, it is important to ensure that any exposure added to the securitisation after the closing date meets eligibility criteria that are similar to, and not weaker than, those used to structure the initial pool of the securitisation.
Criterion 4: Homogeneity, enforceable obligations, full recourse to obligors, period payment streams	Similar to criterion on homogeneity, enforceable obligations, full recourse to	See the overarching rationale for consistency with the traditional qualifying framework.

STS synthetic securitisation criterion	Comparison with criterion for traditional (non-ABCP) STS securitisation	Rationale for the STS synthetic securitisation criterion
The underlying exposures should meet the following criteria: • The synthetic securitisation should be backed by a pool of underlying exposures that are homogeneous in terms of asset type, subject to conditions clearly defined and specified in the transaction documentation. • The underlying exposures should comprise obligations of the debtors and, when applicable, guarantors to pay the sums of money specified in the terms that are contractually binding and enforceable, with full recourse to debtors and, when applicable, guarantors. • The underlying exposures should have defined periodic payment streams, the instalments of which may differ in their amounts, relating to rental, principal and interest payments or commitment fees, or to any other right to receive income from assets supporting such payments. • - The underlying exposures may also generate proceeds from the sale of any financed or leased assets.	obligor, periodic payment streams, (Art. 20(8))	Commitment fees have been included, as some synthetic securitisations include unused credit lines or undisbursed loans as underlying exposure. As regards the homogeneity, additional homogeneity criteria should be developed to specify the homogeneity in terms of asset type, as has been similarly done for traditional securitisation in the regulatory technical standards on homogeneity, which should take into account specificities of synthetic securitisation.
Criterion 5: No transferable securities The underlying exposures should not include transferable securities, as defined in point (44) of Article 4(1) of Directive 2014/65/EU, other than corporate bonds that are not listed on a trading venue.	Similar to criterion on transferable securities (Art. 20(8))	See overarching rationale for consistency with traditional qualifying framework. Excluding transferable securities other than corporate bonds that are not listed on trading venue is particularly important in the case of synthetic transactions, as it ensures that the proposed STS framework targets only 'balance-sheet' transactions, as opposed to 'arbitrage' transactions that were structured in the past to include different types of securities as underlying exposures.
Criterion 6: No resecuritisation The underlying exposures should not include any securitisation position.	Similar to criterion on no resecuritisation (Art. 20(9))	See the overarching rationale for consistency with the traditional qualifying framework.

STS synthetic securitisation criterion	Comparison with criterion for traditional (non-ABCP) STS securitisation	Rationale for the STS synthetic securitisation criterion
		The definition of balance-sheet synthetic securitisations for STS purposes should exclude resecuritisations. In the past, resecuritisations have been structured into highly leveraged structures in which lower credit quality notes could be re-packaged and credit could be enhanced, resulting in transactions in which small changes in the credit performance of the underlying assets severely affected the credit quality of the resecuritisation tranches. The modelling of the credit risk arising in these bonds proved very difficult because of high correlations arising in the resulting structures. Synthetic resecuritisations were often structured with arbitrage purposes and did not serve the credit risk transfer as a primary objective. In addition, unlike synthetic securitisations that are not structured for arbitrage purposes and are not using securitisation positions as underlying exposures, synthetic resecuritisations performed materially worse than traditional securitisations that were structured largely in line with the STS criteria for traditional securitisation.
Criterion 7: Underwriting standards and material changes thereto The underwriting standards pursuant to which the underlying exposures are originated and any material changes from prior underwriting standards should be fully disclosed to potential investors without undue delay. The underlying exposures are underwritten with full recourse to an obligor that is an individual, an SME or a corporate body and that is not a special-purpose entity. No broker intermediary or similar party was involved in the credit or underwriting decisions relating to the underlying exposures.	Adapted criterion on underwriting standards and material changes thereto (Art. 20(10): additional clarification with respect to the types of eligible obligors and with respect to underwriting of the underlying exposures	See the overarching rationale for consistency with the traditional qualifying framework. Some arbitrage synthetic securitisations have been structured in the past with SSPEs as underlying obligors or by involving third parties, such as broker intermediaries, in the credit or underwriting decisions with respect to the underlying exposures. To ensure that only genuine balance-sheet securitisations of underlying exposures that are part of the core/business activity of the originator can be eligible under the STS framework, no SSPEs should be allowed as obligors, and no broker intermediaries and similar parties should be involved in underwriting decisions.

STS synthetic securitisation criterion	Comparison with criterion for traditional (non-ABCP) STS securitisation	Rationale for the STS synthetic securitisation criterion
Criterion 8: Self-certified loans In the case of securitisations in which the underlying exposures are residential loans, the pool of loans should not include any loan that was marketed and underwritten on the premise that the loan applicant was made aware of the fact that the information provided might not be verified by the lender.	Similar to criterion on self-certified loans (Art. 20(10))	See overarching rationale for consistency with the traditional qualifying framework.
Criterion 9: Borrower's creditworthiness The assessment of the borrower's creditworthiness should meet the requirements set out in Article 8 of Directive 2008/48/EC or paragraphs 1 to 4 point (a) of paragraph 5, and paragraph 6 of Article 18 of Directive 2014/17/EU or, if applicable, equivalent requirements in third countries, to the extent that such standards would, according to their terms, apply to the individual underlying exposures.	Similar to criterion on borrower's creditworthiness (Art. 20(10))	See overarching rationale for consistency with traditional qualifying framework.
Criterion 10: Originator's expertise The originator or original lender should have expertise in originating exposures that are of a similar nature to those securitised.	Similar to criterion on originator's expertise (Art. 20(10))	See also the overarching rationale for consistency with the traditional qualifying framework. In light of the criterion that requires that the underlying exposures should refer to a core lending/business activity of the originator/purchaser of the credit protection, this criterion appears less relevant in the case of synthetic securitisations than in the case of traditional securitisations. It has, however, still been kept, as, owing to strategic decisions, institutions may define new core/business activity in respect of which the required expertise has yet to be developed.
Criterion 11: No defaulted exposures or exposures subject to outstanding disputes	Similar to criterion on no defaulted exposures (Art. 20(11))	See overarching rationale for consistency with traditional qualifying framework.

STS synthetic securitisation criterion	Comparison with criterion for traditional (non-ABCP) STS securitisation	Rationale for the STS synthetic securitisation criterion

At the time of selection, the underlying exposures should not include:
• exposures in default within the meaning of Article 178(1) of Regulation (EU) No 575/2013;
• exposures to a credit-impaired debtor or guarantor that:
  ○ to the best of the originator's or original lender's knowledge, has been declared insolvent or whose creditors have been granted by a court a final non-appealable right of enforcement or material damages as a result of a missed payment within three years prior to the date of origination of the underlying exposure or which has undergone a debt-restructuring process with regard to its non-performing exposures within three years prior to the date of selection of the underlying exposures, unless:
    ▪ a restructured underlying exposure has not presented new arrears since the date of the restructuring, which must have taken place at least one year prior to the date of selection of the underlying exposures;
    ▪ the information provided by the originator in accordance with points (a) and (e)(i) of the first subparagraph of Article 7(1) of the Securitisation Regulation explicitly sets out the proportion of restructured underlying exposures, the time and details of the restructuring and their performance since the date of the restructuring;
  ○ was, at the time of origination of the underlying exposure, if applicable, on a public credit registry of		

STS synthetic securitisation criterion	Comparison with criterion for traditional (non-ABCP) STS securitisation	Rationale for the STS synthetic securitisation criterion
persons with adverse credit history or, if there is no such public credit registry, another credit registry that is available to the originator or the original lender; o has a credit assessment or a credit score indicating that the risk of contractually agreed payments not being made is significantly higher than for comparable exposures held by the originator that are not securitised.		
Criterion 12: At least one payment made The debtors should, at the time of inclusion of the relevant exposures in the securitisation, have made at least one payment. This does not include revolving securitisations, in which exposures are payable in a single instalment or have a maturity of less than one year, including without the limitation of monthly payments on revolving credits. This criterion does not apply to an exposure that represents the refinancing of a pre-existing exposure already included in the securitisation.	Similar to criterion on at least one payment made (Art. 20(12))	See the overarching rationale for consistency with the traditional qualifying framework. STS synthetic securitisation should minimise the extent to which investors are required to analyse and assess fraud and operational risk. At least one payment should therefore be made by each underlying borrower at the time of inclusion of the exposure in the securitisation, since this reduces the likelihood of the exposure being subject to fraud or operational issues; this does not include revolving securitisations, in which the distribution of underlying exposures is subject to constant changes because the securitisation relates to exposures payable in single instalment or with an initial legal maturity of less than one year. Examples of exposures to which the requirement of at least one payment being made at the time of inclusion of the exposures in the securitisation does not apply should include personal overdraft facilities, credit card receivables, trade receivables, trade finance obligations and dealer floorplan finance loans.

STS synthetic securitisation criterion	Comparison with criterion for traditional (non-ABCP) STS securitisation	Rationale for the STS synthetic securitisation criterion
STANDARDISATION CRITERIA		
Criterion 13: Risk retention requirements The originator or original lender should satisfy the risk-retention requirement in accordance with Article 6 of the Securitisation Regulation.	Similar to criterion on risk retention requirements (Art. 21(1))	See overarching consistency with the framework for traditional securitisation. Although it is not necessary strictly to include this requirement in the STS criteria, given it is applicable to all securitisations as per Article 6 of the Securitisation Regulation, it is included here for consistency purposes.
Criterion 14: Appropriate mitigation of interest rate and currency risks **Currency risk**: The transaction documentation should clearly describe how any currency risk arising in synthetic securitisation will affect payments to the protection buyer and the investors. • If applicable, any collateral securing the credit protection obligation must be denominated in the same currency as that used for the credit protection (i.e. the transaction currency). **Interest rate risk**: The transaction documentation should clearly describe how any interest rate risk associated with synthetic securitisation will be mitigated and what impact it will have on the payments to the protection buyer and the investor. In the case of a synthetic securitisation involving an SSPE, the amount of the SSPE's liabilities in terms of interest payments to investors at any payment date should be equal to or less than the amount of its income from the protection buyer and any collateral arrangements at such payment date. The underlying exposures should not include derivatives, other than derivatives entered into for currency or interest-rate hedging purposes in connection with the underlying exposures. Those derivatives should be underwritten and documented in accordance with common standards in international finance.	Adapted criterion on appropriate mitigation of interest rate and currency risks (Art. 21(2)): to further specify measures for appropriate mitigation of interest rate and currency risks	Unlike in the case of traditional securitisation, the interest and principal cash flows generated by the underlying exposures in synthetic securitisation are not used to repay investors. Payments towards synthetic securitisation investors are limited to the credit risk protection premium and, as applicable, the yield from the re-investment of the collateral used in funded transactions and the redemption of such collateral, which will be used to repay noteholders at maturity or at early termination of the contract. However, the originator (protection buyer) of synthetic transactions may (i) face instances of under-protection due to exchange rate fluctuations in transactions involving more than one currency; (ii) be exposed to interest rate mismatches, itself or through the SSPE set up to issue notes to investors, in which it guarantees, to investors, a return on the collateral received as credit risk protection beyond the payment of the due credit protection premium. Currency risk: In synthetic securitisation transactions in which the underlying exposures are denominated in a currency that is different to the currency used for the credit protection (i.e. the transaction currency), there arises the risk that, because of exchange rate fluctuations and depending on the reference exchange rate used to convert loss amounts into protection

STS synthetic securitisation criterion	Comparison with criterion for traditional (non-ABCP) STS securitisation	Rationale for the STS synthetic securitisation criterion
		payment amounts, the outstanding amount of the notes/available collateral/committed guarantee amount after conversion into the currency in which the underlying exposures are denominated may be reduced, resulting in diminished protection in respect of the underlying exposures. Even though the CRR provides for additional capital requirements on the originator for transactions characterised by currency mismatches, it is important that the currency risk to which STS securitisation positions are exposed is appropriately mitigated. This can be done by ensuring that the credit protection is denominated in the same currency as the underlying exposures and, if relevant, collateral, or through other measures, such as using hedges and guarantees that can fix the currency rate for the protection buyer, or by other arrangements such as for example adapting the notional amount of the portfolio to manage exchange rate fluctuations through replenishment. Interest rate risk: Interest rate risk should be appropriately mitigated. Additional criterion 35 provides for eligible credit risk protection arrangements. The exclusion of more complex collateral and re-investment arrangements in synthetic STS securitisations further reduces the extent to which interest rate mismatches may occur in such securitisations. Derivatives should be allowed as underlying exposures of a synthetic STS securitisation only when those derivatives are used for the single purpose of hedging the currency and interest rate risk arising from the underlying exposures that are not derivatives. For the sake of clarity, it should be highlighted that any derivative contract used to effect the credit risk transfer that gives rise to synthetic securitisation is not to be considered an ‘underlying’ exposure of synthetic securitisation.

STS synthetic securitisation criterion	Comparison with criterion for traditional (non-ABCP) STS securitisation	Rationale for the STS synthetic securitisation criterion
		The appropriate mitigation of interest rate and currency risks should be clearly specified in the transaction documentation.
Criterion 15: Referenced interest payments Any referenced interest payments in relation to securitisation should be based on either (i) generally used market interest rates or generally used sectoral rates that are reflective of the cost of funds and do not reference complex formulae or derivatives, and/or (ii) income generated by the collateral securing the protection seller's obligations under the credit protection agreement. Any referenced interest payments in relation to the underlying exposure should be based on either (i) generally used market interest rates, or generally used sectoral rates reflective of the cost of funds, and should not reference complex formulae or derivatives.	Similar to criterion on referenced interest payments (Art. 21(3))	This criterion is less relevant for synthetics, as the repayment of the securitisation positions is not dependent on the cash flows from the underlying exposures on a pass-through basis, and consequently there is less need for investors to understand the calculation of the interest payments on the underlying exposures. However, this information might still be useful, particularly with regard to public synthetic securitisations making use of an SSPE with various investors, and the requirement should therefore be kept for consistency purposes.
Criterion 16: Requirements after enforcement notice Following the occurrence of an enforcement event in respect of the protection buyer, the protection seller should be permitted to take enforcement action and/or terminate the credit protection agreement. In the case of funded credit protection, upon such termination, collateral should be returned to investors in order of their seniority. When an SSPE is used within a synthetic securitisation, following an enforcement or termination of the credit protection agreement, no amount of cash should be trapped in the SSPE beyond that which is necessary to ensure the operational functioning of the SSPE, the payment of protection payments in respect of defaulted underlying exposures that are still being worked out at the time of such a termination or the orderly repayment of investors, in accordance with the contractual terms of the securitisation.	Adapted criterion on requirements after enforcement notice (Art. 21(4)): adapted to reflect that not all synthetic securitisations use SSPE	It is appropriate that arrangements are in place for the protection of protection buyers in case adverse circumstances affect the SSPEs or, where applicable, the collateral (such as insolvency of SSPE or inaccessibility of collateral), which has a consequence of immediately initiating enforcement and applying sequential amortisation to all tranches of the synthetic securitisation. The requirements applicable when enforcement has been delivered have been adapted, compared with the STS requirements applicable to traditional securitisation, to reflect the fact that not all synthetic securitisations include the use of an SSPE and that, even if an SSPE is used in balance-sheet synthetic securitisations, there is no legal transfer of title to the underlying exposures to the SSPE. As a result of the latter, a requirement that does not allow the automatic liquidation of the

STS synthetic securitisation criterion	Comparison with criterion for traditional (non-ABCP) STS securitisation	Rationale for the STS synthetic securitisation criterion
		underlying exposures at market value is not needed for synthetic securitisations.
Criterion 17: Allocation of losses and amortisation of tranches **Allocation of losses:** The allocation of losses to holders of a securitisation position in a synthetic STS securitisation should always proceed in order of seniority of tranches, from the most junior tranche to the most senior tranche in the transaction. **Amortisation of size of tranches**: Pro rata or hybrid (i.e. comprising a combination of pro rata and sequential, or pro rata applying to only some tranches) amortisation may only be applied to determine the outstanding amount of all tranches if clearly specified triggers relating to the performance of the underlying exposures ensure the switch of the amortisation scheme to sequential amortisation. Such performance-related triggers should at least include deterioration in the credit quality of the underlying exposures below a predetermined threshold. When this is not the case, sequential amortisation should apply to all tranches in order to determine the outstanding amount of the tranches at the each payment date, i.e., as the underlying exposures amortise, such amortisation should be applied first to reduce the most senior tranches and, only once these most senior tranches have fully amortised, should they be used to reduce more junior tranches according to the order of seniority, as agreed in the transaction documentation. As tranches amortise, when investors have provided collateral for those tranches, an amount of that collateral equal to the amount of amortisation on such tranches should be returned to investors. In the case of underlying exposures in relation to which a credit event has occurred and the workout process has not been completed, the amortisation provisions should ensure that the remaining amount	Adapted criterion on allocation of losses and amortisation of tranches (Art. 21(5)): adapted with additional requirements for pro rata amortisation and allocation of losses requirements	See the overarching rationale for consistency with the traditional qualifying framework. From a prudential perspective, pro rata amortisation schemes in the presence of back-loaded losses, i.e. losses that crystallise towards the end of the underlying exposures' tenor, may undermine the simplicity and standardisation of the transaction. Other things being equal, in the presence of pro rata amortisation the originator is able to rely only on a level of credit protection that, towards the end of the tenor of the transaction, is materially lower than the one it could rely on when a sequential amortisation scheme is adopted. Therefore, pro rata amortisation should be allowed only under limited circumstances, i.e. if it is subject to specific contractual triggers that require a switch to sequential amortisation. In order to ensure that all parties involved in the synthetic securitisation have at all times a thorough understanding of applicable amortisation schemes under a securitisation, such amortisation schemes should be clearly specified in the transaction documentation.

STS synthetic securitisation criterion	Comparison with criterion for traditional (non-ABCP) STS securitisation	Rationale for the STS synthetic securitisation criterion
of credit protection at any payment date is at least equivalent to the notional outstanding amount of these underlying exposures after consideration of the amount of any interim payments that have already been effected on these underlying exposures in relation to the relevant credit events. All amortisation agreements should be clearly documented.		
Criterion 18: Early amortisation provisions/triggers for termination of the revolving period The transaction documentation should include appropriate triggers for the termination of the revolving period in which the securitisation is a revolving securitisation and a switch to the amortisation of tranches, including at least the following: • a deterioration in the credit quality of the underlying exposures to or below a predetermined threshold; • losses that rise above a predetermined threshold or losses over a predefined period that rise above a predetermined threshold; • a failure to generate sufficient new underlying exposures that meet the predetermined credit quality over a specified period of time.	Adapted criterion on early amortisation provisions/triggers for termination of the revolving period (Art. 21(6)): adapted with requirements for early amortisation only in the case of the use of an SSPE	It is important to include safeguards for investors when the securitisation is a revolving securitisation, as they ensure that, subject to specific triggers, the replenishment period truncates and the tranches start to amortise. This criterion is generally relevant to synthetic securitisation, as the use of replenishment periods is very common in synthetic securitisation. The triggers have been adapted to synthetic securitisation. By contrast, early amortisation is about the earlier repayment of principal and therefore is relevant only to synthetic securitisations that use an SSPE to place notes with investors. This criterion is linked to the requirement for the credit protection payments (which should be contingent upon the outstanding balance of the protected tranche).
Criterion 19: Transaction documentation The transaction documentation should clearly specify: • the contractual obligations, duties and responsibilities of, as applicable, the verification agent, the servicer of the underlying exposures, the trustee and other ancillary service providers;	Adapted criterion on transaction documentation (Art. 21(7)): adapted with additional requirements for servicing standards and procedures	See the overarching rationale for consistency with the traditional qualifying framework. Particularly when the credit risk of the securitised portfolio is transferred to more than one investor (e.g. when CLNs of different seniority are issued by an SSPE), the appointment of an identified person with fiduciary responsibilities acting in the best interest of investors is necessary, in order to minimise the impact of potential conflicts in terms of the interpretation of

STS synthetic securitisation criterion	Comparison with criterion for traditional (non-ABCP) STS securitisation	Rationale for the STS synthetic securitisation criterion
• upon default, insolvency and other specified events, where applicable, provisions to ensure the replacement of relevant counterparties (other than the protection buyer and the investors) for in cases where the respective services for the benefit of the securitisation are not provided by the originator itself; • the processes and responsibilities necessary to ensure that, when servicing is not provided by the originator itself, the default or insolvency of the current servicer does not result in termination of servicing, such as contractual provisions that enable the replacement of the servicer in such cases; • the servicing procedures that apply to the underlying exposures at the closing date and thereafter and the circumstances under which these procedures may be modified; • the servicing standards that the servicer will have to adhere to in servicing the underlying exposures within the entire maturity of the synthetic securitisation.		certain provisions of the securitisation documentation and their applicability at payment dates. From the perspective of an investor in synthetic securitisation, it is also important that, irrespective of whether the underlying exposures are serviced by the originator or by another party, at closing date and thereafter, the servicer adheres to high servicing standards, in order to ensure that credit events covered by the credit protection agreement and corresponding losses are determined correctly at each payment date.
Criterion 20: Servicer's expertise The servicer should have expertise in servicing exposures that are of a similar nature to those that are securitised and be supported by a management team with extensive industry experience. The servicer should have well-documented and adequate policies, procedures and risk management controls relating to the servicing of exposures. The servicer should apply servicing procedures to the underlying exposures that are at least as stringent as the servicing procedures	Similar to criterion on servicer's expertise (Art. 21(8))	See the overarching rationale for consistency with the traditional qualifying framework. Effective servicing standards are crucial in any synthetic securitisation, as the validity of the credit protection obtained greatly depends on the timely identification of relevant credit events protected under the credit protection agreement. Losses that are not identified at the time of their occurrence, because of servicing disruptions, may not be eligible for credit protection. Such risk increases the overall riskiness of the originator's

STS synthetic securitisation criterion	Comparison with criterion for traditional (non-ABCP) STS securitisation	Rationale for the STS synthetic securitisation criterion
applied by the originator to similar exposures that are not securitised.		retained senior position. This appears to be particularly relevant in those cases in which servicing is not carried out by the originator of the transaction. Consistency and clarity of servicing standards, and sufficient experience of applying such standards, significantly reduce the extent of risks arising in relation to the servicing. In addition, STS synthetic securitisations should not be used to put in place any 'originate to distribute' behaviour through moral hazard practices arising in the servicing of exposures subject to protection.
Criterion 21: Reference register The underlying exposures should be identified at all times via a **reference register**. The reference register should clearly identify, at all times, the reference obligors, the reference obligations from which the underlying exposures arise, and the protected notional amount and the outstanding protected notional amount for each underlying exposure.	Replacement of the criterion (requirements for the transaction documentation to specify payment conditions is covered in separate criteria) (Art 21(9))	To avoid conflicts between the protection buyer and the protection sellers and to ensure legal certainty in terms of the scope of the credit protection purchased for underlying exposures, such credit protection should reference clearly identified reference obligations, giving rise to the underlying exposures, of clearly identified entities or obligors. Therefore, the reference obligations on which protection is purchased should be clearly identified at all times, via a reference register, and kept up to date. This requirement is also indirectly part of the criterion defining the balance-sheet securitisation and excluding arbitrage securitisation from the STS framework.
Criterion 22: Timely resolution of conflicts between investors The transaction documentation should include clear provisions that facilitate the timely resolution of conflicts between different classes of investors. If an SSPE is used within a synthetic securitisation to issue notes placed with investors, voting rights should be clearly defined and allocated to noteholders and the responsibilities of the trustee and other entities with fiduciary duties to investors should be clearly identified.	Similar to criterion on timely resolution of conflicts between investors (Art. 21(10))	See the overarching rationale for consistency with the traditional qualifying framework. This requirement aims to quickly resolve any potential conflicts between investors, as an additional safeguard to the appointment of a verification agent, particularly when the credit risk of the securitised portfolio is transferred to more than one investor (e.g. where CLNs of different seniority are issued by an SSPE), the appointment of a trustee or other entity with fiduciary duties to investors appears necessary.

STS synthetic securitisation criterion	Comparison with criterion for traditional (non-ABCP) STS securitisation	Rationale for the STS synthetic securitisation criterion
TRANSPARENCY CRITERIA		
Criterion 23: Data on historical default and loss performance The originator should, before pricing, make available to potential investors data on static and dynamic historical default and loss performance, such as delinquency and default data, for exposures that are substantially similar to those being securitised, as well as the sources of those data and the basis for claiming similarity. Those data should cover a period of at least five years.	Similar to criterion on data on historical default and loss performance (Art. 22(1))	See the overarching rationale for consistency with the traditional qualifying framework. As the first criterion on simplicity requires that the protection buyer under the credit protection arrangements is an originator with respect to the securitised exposures, and according to the definition of sponsor pursuant to Article 2(5) of the Securitisation Regulation only credit institutions or investment firms other than the originator can qualify as a sponsor, the obligation in terms of making data available has been limited to the originator for synthetic securitisation.
Criterion 24: External verification of the sample A sample of the underlying exposures should be subject to external verification, prior to the closing date, by an appropriate and independent party, including verification that the underlying exposures meet the criteria determining eligibility for credit protection under the credit protection agreement.	Similar to criterion on external verification of the sample (Art. 22(2))	In synthetic securitisation, compliance with contractual eligibility criteria determines the validity and therefore the effectiveness of the credit protection. From a transparency perspective, it is crucial to ensure that any potential for disputes over the validity of the credit protection is minimised during the life of the transaction. For this reason, in the case of synthetic securitisation, the audit prior to issuance should specifically cover eligibility conditions and should be carried out with a confidence level of at least 95%.
Criterion 25: Liability cash flow model The originator should, before the pricing of the securitisation, make available to potential investors a liability cash flow model that precisely represents the relationship between the underlying exposures and the payments flowing between the originator, investors, other third parties and, when applicable, the SSPE, and should, after pricing, make that model available to investors on an ongoing basis and to potential investors upon request.	Similar to criterion on liability cash flow model (Art. 22(3))	To ensure consistency with the traditional framework and enhance transparency, the requirement to make available a liability cash flow model to investors is being maintained for synthetic STS securitisation.

STS synthetic securitisation criterion	Comparison with criterion for traditional (non-ABCP) STS securitisation	Rationale for the STS synthetic securitisation criterion
Criterion 26: Environmental performance of assets In the case of a securitisation whose underlying exposures are residential loans or auto loans or leases, the originator should publish the available information related to the environmental performance of the assets financed by these residential loans or auto loans or leases, as part of the information disclosed pursuant to point (a) of the first subparagraph of Article 7(1) of the Securitisation Regulation.	Similar to criterion on environmental performance of assets (Art. 22(4))	See overarching rationale for consistency with traditional qualifying framework.
Criterion 27: Compliance with transparency requirements The originator should be responsible for compliance with Article 7 of the Securitisation Regulation. The information required by point (a) of the first subparagraph of Article 7(1) should be made available to potential investors, upon request, before pricing. The information required by points (b) to (d) of the first subparagraph of Article 7(1) should be made available before pricing at least in draft or initial form. The final documentation should be made available to investors at the latest 15 days after the closing of the transaction.	Similar to criterion on compliance with transparency requirements (Art. 22(5))	See overarching rationale for consistency with traditional qualifying framework.
CRITERIA SPECIFIC TO SYNTHETIC SECURITISATION		
Criterion 28: Credit events The credit protection agreement establishing the synthetic securitisation should cover, **at least, the following credit events**: • failure to pay the underlying obligor, defined to encompass at a minimum the circumstances defined in Article 178 (1)(b) of the CRR; • bankruptcy of the underlying obligor, defined to encompass at a minimum the circumstances defined in Article 178 (3)(e) and (f) of the CRR;	n/a	The definitions of credit events provided in the CRR shape the way prudential regulation quantifies the credit risk to be covered by regulatory capital, and these well-established definitions should also be applied as a basis for standardising the minimum credit events to be considered in synthetic STS securitisations. A reference to the CRR definitions also strikes the right balance between the interest of the protection buyer and the interest of investors. The parties under the credit protection agreement may agree on additional events or stricter definitions of the events mentioned

STS synthetic securitisation criterion	Comparison with criterion for traditional (non-ABCP) STS securitisation	Rationale for the STS synthetic securitisation criterion
• in the case of credit protection other than financial guarantee, restructuring of the underlying exposure, defined to encompass at a minimum the circumstances defined in Article 178(3) (d) of the CRR. The requirement to include at least these three events should not prevent the parties from agreeing on additional and/or stricter credit events. All credit events that are to apply and their precise definitions should be **clearly documented**. **Forbearance measures**, as defined in Annex V, Section 30, paragraphs 163 to 183, of Commission Implementing Regulation (EU) No 2015/227 amending Implementing Regulation (EU) No 680/2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013, applied to underlying exposures must not preclude the trigger of eligible credit events.		in the criterion (e.g. failure to pay with a grace period of less than 90 days or the introduction of minimum payment thresholds for defaulted claims to qualify as 'failure to pay'), in line with the general framework provided for in the standard industry master agreements, as long as the credit protection agreement complies with the requirements provided in Article 249 of the amended CRR, and, at a minimum, the events taken into account for prudential purposes for institutions regulated under the CRR are included in the credit protection agreements. Forbearance measures, which consist of concessions towards a debtor that is experiencing or about to experience difficulties in meeting its financial commitments, should not preclude the triggering of the credit protection event. In this regard, the term 'concessions' refers to either a modification of the previous terms and conditions of a contract that the debtor is considered unable to comply with because of its financial difficulties ('troubled debt'), resulting in insufficient debt service ability, and that would not have been granted had the debtor not been experiencing financial difficulties, or a total or partial refinancing of a troubled debt contract that would not have been granted had the debtor not been experiencing financial difficulties. A concession may entail a loss for the lender, which should be considered within the credit protection agreement. Restructuring has been excluded as a credit event in the case of financial guarantees, in order to avoid them being treated as a derivative in accordance with the relevant accounting standards. The underlying reference portfolio is often held in the banking book and is therefore subject to accrual accounting, while derivatives are subject to mark-to-market. Financial guarantees, however, are typically accrual accounted;

STS synthetic securitisation criterion	Comparison with criterion for traditional (non-ABCP) STS securitisation	Rationale for the STS synthetic securitisation criterion
		nevertheless, if a financial guarantee also references restructuring, then it may have to be treated as a derivative in accordance with the relevant accounting standards. Therefore, buying protection for portfolios held on the banking book in the form of a financial guarantee rather than a derivative avoids mark-to-market volatility.
Criterion 29: Credit protection payments The credit protection payment following the occurrence of a credit event should be calculated based on the **actual realised loss** suffered by the originator or the relevant lender, as worked out in accordance with its standard recovery policies and procedures for the relevant exposure types[38] and recorded in its financial statements at the time the payment is made. The final credit protection payment should be payable within a specified period following the end of the workout process for the relevant underlying exposure if the end of the workout process occurs before the scheduled legal maturity or early termination of the credit protection agreement. Transactions should provide that an **interim credit protection payment** is to be made, at the latest, six months after the credit event has occurred in cases in which the workout of the losses for the relevant underlying exposure has not been finalised by that time. The interim credit protection payment should be, at least, the higher of the impairment considered by the originator in its financial statements, in accordance with the applicable accounting framework, at the time the interim payment is made or, if applicable, the LGD determined in accordance with Part Three, Title II, Chapter 3, of the CRR, which, according to the CRR, has	n/a	From the originator's perspective, in order to ensure that credit protection eventually covers the losses incurred by the originator, it is important that loss settlements do not fall short of the loss amounts, as worked out by the originator. In addition, aligning credit protection payments with the loss amounts worked out by the originator ensures that the protection buyer's and the protection seller's interests in the transaction are more aligned, leading to better incentives on both sides of the transaction. As the full workout of losses can be a lengthy process, depending on the type of asset class/collateral under consideration as well as the characteristics of national judicial and insolvency regimes, it is important from the originator's perspective to ensure a minimum degree of timeliness in credit protection payments in all circumstances. For this reason, and also to ensure that the originator does not keep paying for credit protection on the protected notional amount of a given underlying exposure when a credit event has occurred in relation to that exposure, an interim payment should be made, at the latest, six months after such a credit event has occurred. By means of a final adjustment payment, the payment to cover losses under the credit protection agreement in relation to a particular underlying exposure should then be adjusted to the

[38] The term 'exposure type' is used here, to avoid confusion with the term 'type of exposure', as defined for IRB purposes according to Art. 142(1)(2) of the CRR.

STS synthetic securitisation criterion	Comparison with criterion for traditional (non-ABCP) STS securitisation	Rationale for the STS synthetic securitisation criterion
to be applied to the corresponding underlying exposures in order to determine the IRB capital requirements on the originator for such underlying exposures. If an interim credit protection payment is made, a final credit protection payment should be made in order to adjust the interim settlement of losses to the actual realised loss, in accordance with the first paragraph of this criterion. If the protected amount is less than the outstanding notional amount of the corresponding underlying exposure, the credit protection payment should be in the same proportion to the protected amount, as the protection buyer's realised loss bears the outstanding notional amount of the underling exposure, subject only to the rule on interim payments. The method by which interim and final credit protection payments are calculated should be clearly specified in the credit protection agreement. The rights of the protection buyer to receive protection payments under the synthetic securitisation should be enforceable. The amounts payable by investors under the securitisation are clearly defined, capable of calculation in all circumstances and limited in amount. The circumstances in which investors are required to make payments under the credit protection agreement should be clearly and objectively defined, or subject to a determination by the verification agent, and limited in number. The credit protection amount should be broken down to the level of individual underlying exposures.		loss amounts that have been fully worked out, in order to ensure the coverage of actual losses through the credit protection. If an originator uses the IRB approach for the purposes of determining its capital requirements for an underlying exposure, the interim payment should reflect, at least, the originator's LGD assigned to the underlying exposure (regulatory LGD or own estimate). If the institution decides to recognise, in its financial statements, a higher figure than that used by the LGD for capital requirements purposes, it is important that the interim payment reflects such a decision. In order to facilitate the loss allocation during the occurrence of credit events, the credit protection coverage should be broken down to the level of individual underlying exposures, irrespective of whether the credit protection amount is specified with reference to the individual underlying exposures or the obligors in respect of those exposures.

STS synthetic securitisation criterion	Comparison with criterion for traditional (non-ABCP) STS securitisation	Rationale for the STS synthetic securitisation criterion
Criterion 30: Credit protection payments following the close out/final settlement at the final legal maturity of the credit protection agreement With regard to underlying exposures for which a credit event has occurred and the workout process has not been completed upon the scheduled legal maturity or early termination of the credit protection agreement, the credit protection agreement should clearly specify the maximum extension period that should apply to the workout process for those exposures. Such an extension period should not be longer than two years. A final credit protection payment within this extension period should be made on the basis of the final estimated loss expected to be suffered by the originator and recorded by the originator in its financial statements at that time. Following any termination of the credit protection by investors, the workout process should continue, in respect of any outstanding credit events that occurred prior to the termination, in the same way as that described in the first paragraph above.	n/a	As the full workout of losses can be a lengthy process, depending on the type of asset class/collateral under consideration as well as the characteristics of national judicial and insolvency regimes, it is important from the originator's perspective to ensure a minimum degree of timeliness in credit protection payments. This not only increases certainty in the effectiveness of the credit protection arrangement from the originator's perspective but also increases legal certainty in terms of the final date of payments under the credit protection agreement from an investor's perspective, contributing to a well-functioning market.
Criterion 31: Credit protection premiums The credit protection premiums paid under the credit protection agreement establishing the synthetic securitisation should be structured as contingent premiums: no guaranteed premiums, upfront premium payments, rebate mechanisms or other mechanisms that may avoid or reduce the actual allocation of losses to the investors or return part of the paid premiums to the originator after the maturity of the transaction should be stipulated in the credit protection agreement.	n/a	For the sake of simplicity of the transaction and effectiveness of the risk transfer, the credit protection premiums should be contingent, i.e. the actual amount of premium paid should be a function of the size and the credit risk of the protected tranche. Contingent premiums may be structured as a fixed percentage of the residual outstanding balance of the protected tranche at each payment date, hence reflecting tranche amortisation and tranche write-downs due to incurred losses. Non-contingent premiums should not be allowed in synthetic STS securitisations, i.e. when the actual amount of premium paid is not a function of the outstanding size and credit risk of

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The transaction documentation should clearly describe how the protection fee and any note coupons are calculated in respect of each payment date over the life of the securitisation. The rights of the protection seller to receive credit protection premiums under synthetic securitisation should be enforceable.		the protected tranche. Non-contingent premiums may take the form of guaranteed premiums. The timing of the premium payments may also vary across transactions. In some transactions, protection premiums are paid up front, in contrast to the most widespread market practice, according to which protection premiums are paid in accordance with a regular schedule. Transactions may also be structured to include protection premium rebate mechanisms, through which, if at the maturity of the protection period the aggregate premium paid by the protection buyer exceeds losses suffered on the reference portfolio, the excess would be returned to the originator. In order to ensure that synthetic STS securitisations are simple and that the risk assessment of these securitisations is not overly complex, these premium structures should not be allowed.
Criterion 32: Verification agent A third-party verification agent should be appointed by the originator at the outset of the transaction, in order to verify, at a minimum, for each of the underlying exposures in relation to which credit event notice was given: • that the credit event in the credit event notice occurred in accordance with the terms of the credit protection agreement; • that the underlying exposure was included in the securitised portfolio at the time of the occurrence of the relevant credit event; • that the underlying exposure met the eligibility criteria at the time of its inclusion in the reference portfolio;	n/a	The appointment of a verification agent is a widespread market practice that enhances legal certainty in the transaction for all parties involved, thus decreasing the likelihood of disputes and litigations that could arise in relation to the loss allocation process. This contributes to decreasing the overall riskiness of both retained securitisation positions and securitisation positions placed with investors and is instrumental to a well-functioning transaction.

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• that, if an underlying exposure has been added as result of a replenishment, such a replenishment complied with the replenishment conditions; • that the final loss amount is in line with the losses registered in the profit and loss statement by the originator; • that, at the time when the final protection payment is made, the allocation of losses to investors in relation to the underlying exposures has been conducted correctly. The verification agent should be independent of the originator and investor, and the SSPE when it is used within a synthetic securitisation, and should have been appointed, and its appointment accepted, on or before the closing date. Such verification by the verification agent may be performed on a sample basis, rather than for each individual underlying exposure for which a protection payment is sought, but in all cases, any investor must have the right that the eligibility of a particular underling exposures is subject to verification including in case if it is not satisfied with the sample verification. The originator should undertake to provide to the verification agent, in the securitisation documentation, all the information necessary to verify the requirements set out in the first paragraph above.		
Criterion 33: Early termination events Other than as a result of insolvency of the protection provider, a failure to pay (in respect of any premium or other amounts payable by the originator to investors under the synthetic securitisation) or a breach of a material contractual obligation by the protection provider, the originator should be permitted to terminate a	n/a	Synthetic STS securitisations should not feature complex call clauses for the originator. Although the merit of time calls is acknowledged from the originator's perspective, particularly to ensure that the economic sustainability of a transaction is accounted for, originators should not use synthetic securitisation transactions with very short-dated time calls with the aim of temporarily changing the representation of their capital position on an ad hoc basis.

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transaction prior to its scheduled maturity only when any of the following occurs:
• Relevant regulatory events, which should:
   o include relevant changes in any law and/or regulation (or official interpretation of that law and/or regulation by competent authorities) or the tax or accounting treatment of a transaction that have a material adverse effect on the amount of capital that the protection buyer is required to hold in connection with the securitisation or the underlying exposures, in each case compared with that anticipated at the time of entering into the transaction, which was reasonable unforeseeable at that time.
   o include a determination by a competent authority that the protection buyer (or any affiliate of the protection buyer) is not or is no longer permitted to recognise significant risk transfer in respect of the securitisation, in accordance with Article 245 of the CRR;
   o exclude other factors affecting the economic efficiency of the transaction that are not enshrined in law or regulation, such as credit rating agencies' methodologies and a central bank's collateral framework.
• A time call is exercised, at a point in time when the time period measured from the securitisation's closing date is equal to or higher than the weighted average life of the initial reference portfolio at closing. The time call should not be structured to avoid allocating losses to credit enhancement
		The originator's bankruptcy as an additional clause of early termination in synthetic transactions is reported as widespread market practice of the synthetic securitisation market. It should be seen from two perspectives:
		• Investor (protection provider) perspective: The originator's bankruptcy exposes the investor to the following risks: (i) subordination vis-à-vis other creditors of the insolvent originator and (ii) deterioration of the originator's servicing standards/incentives during the bankruptcy phase. The early termination clause allows investors to mitigate these risks as the originator's bankruptcy occurs and thus maintain an incentive for the protection provider to participate in this market.
		• Originator (protection buyer) perspective: With respect to the originator's bankruptcy, in the case of termination of the credit protection agreement because of the originator's bankruptcy, the originator's insolvency estate may not rely on credit protection on the securitised portfolio and is faced with reduced regulatory capital resources against the portfolio under consideration as a result of the previous achievement of SRT and consequent capital relief since origination. In this respect, the recovery prospects of the originator's other insolvency creditors are at stake, as the credit protection contract is terminated upon the event of bankruptcy. The originator's bankruptcy should therefore not be permitted as an early termination event.
		Taking into consideration the above, the bankruptcy of the originator should not be allowed as an early termination event for the STS synthetic securitisation.
		It is, however, also to be noted that, with the introduction of the BRRD, as an alternative to liquidation, originators may be

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positions or other positions held by investors and should not be otherwise structured to provide credit enhancement. • A call as per Article 245(4)(f) of the amended CRR is exercised (clean-up call). If any of these call rights are included in a transaction, they should be clearly specified in the documentation. Any other originator calls should not be allowed under the terms of the synthetic transaction.		subject to resolution measures. The BRRD foresees that, as originators enter resolution, structured finance transactions and other specific classes of arrangements are subject to specific provisions safeguarding the transactions' counterparties, in the context of partial property transfers and other resolution measures. In these cases, contractual clauses such as termination upon originator's bankruptcy may be dis-applied and the rights and interests of the counterparties in the transaction would be dealt with by BRRD-specific measures and tools. (It should be noted that a number of (small) firms are likely to be excluded from such BRRD provisions.)
Criterion 34: Synthetic excess spread The originator (protection buyer) can commit to the SES, which is available as credit enhancement for the investors under the following conditions: • The amount of the SES that the originator commits to using as credit enhancement at each payment period is predetermined in the contract and expressed as a fixed percentage of the total outstanding portfolio balance (fixed SES). • The SES may be used to cover credit losses that materialise during each payment period. The SES that is not used for that purpose during the payment period is returned to the originator (use-it-or-lose-it mechanism). • The total committed amount every year may never be higher than the one-year regulatory expected loss on the underlying portfolio (in order to ensure that originators do not commit amounts of excess spread that are excessive/can hardly be generated by the portfolio). If any SES is included in a transaction, these conditions should be clearly specified in the transaction documentation.	n/a	The SES is widely present in synthetic securitisation transactions, it is a helpful mechanism for both investors and originators, and it is also available in traditional STS securitisation transactions. Furthermore, the SES is essential for some specific retail asset classes (e.g. SME and consumer lending) that benefit from the higher yield for investors and for which the underlying exposures generate higher losses and excess spread to cover for those losses. Not allowing the inclusion of SES among the STS criteria would substantially limit the use of STS balance-sheet synthetics for many asset classes. However, if the amount of SES subordinated to the investor (protection seller) position is too high, it is possible that under no realistic scenario will the investor (protection seller) in the securitisation positions be eroded by losses, resulting in no effective risk transfer. This could be the result of an inappropriate specification of SES amounts within transactions that use actual excess spread, or could occur in transactions that contractually commit a

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		predetermined amount of excess spread that is not proportionate to the level of risk that characterises the portfolio, e.g. as measured by the portfolio's expected and unexpected loss amount, or cannot be generated by the portfolio (e.g. in the case of yield-impaired portfolios). The use of SES in balance-sheet synthetics can pose material concerns in relation to SRT; given this, it is important to specify strict criteria, to mitigate supervisory concerns and further standardise this structural feature, and to ensure full disclosure on the use of excess spread. For the avoidance of doubt, the SES criterion for balance-sheet synthetics does not impede or prevent any consideration of competent authorities when assessing if SRT and commensurate risk transfer has been achieved by an originator. The final EBA report on SRT, which is expected to be published before January 2021, will provide considerations on SES for the purpose of SRT and commensurate risk transfer.
Criterion 35: Eligible credit protection agreement, counterparties and collateral Only the following credit protection arrangements establishing the synthetic securitisation should be allowed: A. a guarantee meeting the requirements set out in Chapter 4 of Part Three, Title II, of the CRR, by which the credit risk is transferred to any of the entities listed under Article 214 (2)(a)-(d) of the CRR, provided that the exposures to the protection provider qualify for a 0% risk weight under Chapter 2 of Part Three, Title II, of the CRR; B. a guarantee meeting the requirements set out in Chapter 4 of Part Three, Title II, of the CRR, which	n/a	Unlike in the case of traditional (true sale) securitisation, the actual extent of credit risk transfer in synthetic securitisation transactions also depends on: • the risk of default of the protection provider, in the case of unfunded credit risk mitigation arrangements; • the risk that the protection buyer may not have access to the collateral in a timely fashion and/or without incurring losses on the value of that collateral, in the case of funded protection. In the case of unfunded credit risk protection arrangements, this is ensured by restricting the scope of eligible protection providers to those entities that are eligible providers in accordance with the CRR and that the CRR recognises as

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benefits from a counter-guarantee of any of the entities referred to in point (A); C. other credit protection in the form of guarantees, credit derivatives or credit link notes not referred to under the previous two points, that is meeting the requirements set out in Sub-Section 2 of Section 3, Chapter 4, of Part Three, Title II, of the CRR, as amended by Article 249 of the CRR, provided that the obligations of the protection seller are subject to the following collateral requirements. When the collateral is provided in accordance with point (C), both the originator and the protection seller need to have recourse to high-quality collateral, in either of the following forms: • Collateral in the form of 0% risk-weighted debt securities that have a short remaining maturity of maximum three months, matching the payment dates, which are redeemed into cash in an amount equal to the outstanding balance of the protected tranche and which are held by a custodian independent of the protection buyer and the protection seller. • Collateral in the form of cash held with a third-party credit institution or in the form of cash on deposit with the protection buyer, subject to a minimum credit quality standing requirement, meaning that, if the third-party credit institution or the protection buyer ceases to satisfy that minimum credit quality standing, it is required either to transfer the collateral to a third-party bank that does have the minimum credit quality standing or to invest the cash collateral in high-quality securities held by a custodian or the protection buyer. The requirements set out in this paragraph would be deemed to be satisfied in the case of the investments of the collateral		counterparties to be risk weighted at 0% in accordance with the standardised approach for credit risk. If the counterparty is not recognised by the CRR as being eligible for a 0% risk weight, the resulting counterparty credit risk can be mitigated by requiring the counterparty to fund the credit protection by providing high-quality collateral (which in the case of synthetic securitisation may include the issuance of credit linked notes when making use of an SSPE). In order to mitigate the counterparty credit risk for both the originator and the protection seller, such high-quality collateral in the form of 0% risk-weighted debt securities should be held with a third party (such as EU government securities or securities of supranational entities held in a trust or a similar entity), and, when it is in the form of cash, it should be held either with a third-party credit institution or on deposit with the protection buyer, subject in both cases to a minimum credit quality standing. In addition, a legal opinion should be provided to the originator to confirm that the credit protection is enforceable in all relevant jurisdictions. This requirement already exists under the CRR (Article 245(4)(g)), and to ensure regulatory alignment it should be applicable to all eligible originators under the STS synthetic framework.

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coming from credit linked notes issued by the originator, in accordance with Article 218 of the CRR. In addition, the following requirements should apply to the collateral: • The right of the protection buyer to use the collateral to meet protection payment obligations of the protection seller should be enforceable. Security arrangements should be provided to ensure this right of the protection buyer. • The right of the investors, when the synthetic securitisation is unwound or as the tranches amortise, to return any collateral that has not been used to meet protection payments should be enforceable. • If collateral is invested in securities, the securitisation documentation should set out the eligibility criteria and custody arrangement for such securities. If the investors remain exposed to the credit risk of the originator, this must be clearly disclosed in the securitisation documentation. The originator should obtain an opinion from a qualified legal counsel confirming the enforceability of the credit protection in all relevant jurisdictions.		

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