Feedback on Council Working Group: 7/8 September on securitisation

1. Sole Purpose Test (SPT)

- The Sole Purpose Test should remain a Level 1 legislative matter to ensure legal certainty and consistent application across Member States.
- The objective should remain to enable and encourage the use of securitisation as a means to continue providing financing across all asset classes, in line with the existing objectives of enhancing, deepening and broadening the securitisation market to further the CMU and SIU. The framework should avoid unnecessary rigidity, complexity or diverging supervisory interpretations that could be unduly constraining. See annex for more detail.

2. Definition of Public vs Private Securitisation

- The current distinction between public and private securitisations remains appropriate and should be preserved.
- Additional reporting requirements should be targeted and proportionate, avoiding unnecessary burdens for transactions that are not intended for broad market distribution.
- Any potential compromise solutions should maintain the ability of private securitisation markets, including synthetic SRT transactions, to operate efficiently while ensuring regulatory transparency where needed.

3. Risk Weight Floor Calibrations

- The review provides an opportunity to address the overly conservative calibration of current securitisation capital requirements.
- The European Parliament position is preferable because it allows senior tranche risk weights to better reflect the level of credit enhancement and therefore the actual risk profile of the securitisation.
- **Specifically on the treatment of Delinquent Exposures (KA)**
    - The treatment of delinquent exposures within securitisations should remain consistent with the treatment of equivalent exposures outside securitisation structures.
    - Regulatory consistency across the prudential framework contributes to transparency, comparability and a level playing field.

4. P-Factor Framework

- The prudential treatment of senior securitisation tranches should be based on the underlying risk characteristics of the exposure rather than the institutional role of the holder (i.e. originator, sponsor, and investor).
- Maintaining different capital treatment for investors, sponsors and originators holding economically similar senior positions can create unjustified inconsistencies. In fact, a bank may decide to acquire a senior tranche through an ABCP conduit and be able to qualify as a sponsor, thus benefitting from lower capital requirements.
- A more harmonised approach would support market efficiency and align the EU framework more closely with international standards.
- In addition, calibrations under SEC-SA should avoid creating more punitive capital outcomes than those currently applicable through the Basel III transitional arrangements, particularly in the context of the output floor.

5. Significant Risk Transfer (SRT)

- On the topic of the performance-based amortisation test (PBA) for traditional securitisations, clarification and alignment with the EBA 2020 report is needed.
- The EBA 2020 report contemplates that for traditional securitisations for which the market test is passed, the excess spread is considered neither risk retained nor risk transferred to third parties, and its risk-absorbing effect should be recognised by reducing the amount of LTEL and regulatory Unexpected Loss of the securitised portfolio for the purpose of calculating the denominators of the PBA and CRT test.
- Furthermore, a specific clarification would be welcomed which allows transactions to pass the PBA and CRT test if the entire Unexpected Loss were to be allocated to the retained excess spread, for traditional securitisations for which the market test is passed.
- These clarifications are crucial for the viability of any PBA test for traditional securitisations on very established asset classes featuring high levels of excess spread, for instance Consumer Credits.

Annex A - Sole Purpose Test

1 Introduction

- The review of the Securitisation Regulation provides an opportunity to amend the Sole Purpose Test to clarify ambiguities certain ambiguities in the current text around the sole purpose test and to reflect more clearly the underlying legislative intent. Market practices should be an important consideration in this respect.

- This is an important topic for investors in the securitisation market and, importantly, for the mainstream economy that relies on securitisation as one of its funding tools. It is our view that clear and pragmatic regulation remains central to efforts to ensure securitisation can continue to play its key role in the attainment of the EU's financial stability and competitiveness goals.

- This note sets out legislative background, and views on the specific amendments that should be made. It also sets out why these changes are considered to be both necessary and consistent with the legislative intent.

2 Legislative Background

- In this note assumes a working knowledge of the Securitisation Regulation ("**Sec Reg**") and related material (Regulatory Technical Standards, Joint Committee report etc) and so does not set out regulatory provisions in full. However, brief recap of the core requirements and some of the legislative history most relevant to the amendments being considered is set out below.

- For a securitisation to be compliant with the Sec Reg, an entity qualifying as the originator, sponsor or original lender must retain a material net economic interest of 5% in the credit risk of the securitisation through one of a number of methods (including, most commonly, a first loss tranche or a "vertical slice" of 5% of each class of notes).

- However, in the case of an entity seeking to make a retention in its capacity as originator it must pass what has come to be known as the Sole Purpose Test in order to make a valid retention. The Sole Purpose Test says that an entity "shall not be considered to be an originator where the entity has been established or operates for the sole purpose of securitising exposures". This provision was included following a 2014 EBA report, which suggested that revisions to the definition of originator might be necessary in order to close potential loopholes and to prohibit structures that might meet the legal requirements without meeting the spirit, such as the use of Special Purpose Vehicles ("**SPVs**").

- The Sec Reg was later supplemented by a set of Regulatory Technical Standards relating to risk retention (the "**RTS**"). The RTS introduced a safe harbour relating to the Sole Purpose Test and said that an entity shall NOT be considered to have been established or to operate for the sole purpose of securitising exposures where two conditions are satisfied:

    - the first is that the entity has a strategy and the capacity to meet payment obligations consistent with a broader business model that involves material support from capital, assets, fees or other sources of income, by virtue of which the entity does not rely on the exposures to be securitised, on any interests retained or proposed to be retained in accordance with the risk retention article of the Securitisation Regulation or on any corresponding income from such exposures and interests (which we call "**Relevant Revenue**" in this note), as its sole or predominant source of revenue. This is what came to be known as the Predominant Revenue Test;

- the second condition is that the members of the management body have the necessary experience to enable the entity to pursue the established business strategy, as well as adequate corporate governance arrangements (the "**Governance Component**").

- In March 2025 the Joint Committee of European Supervisors published an Article 44 report (the "**JC Report**", written in the context of the CLO market), suggesting the term predominant should be understood to mean "greater than 50%". The market had up until that point been operating on the assumption that "sole or predominant" would be given the more natural meaning of "all or nearly all".

- It is worth noting that whilst the Level 1 text has required that an entity should not be established or operate for the sole purpose of securitising exposures, the Level 2 text and subsequent JC Report takes a more conservative approach (or gold plating of the Level 1 text) where the conditions require that predominant revenues should be unrelated to assets to be securitised or risk retention position to meet the minimum regulatory requirements.

- In addition, it is worth noting this conservative approach is exclusive to the EU Sec Reg and no similar approach on predominant revenue is apparent in the UK or US.

3 Predominant Revenue Test

- Certain provisions of the legislative provisions referred to above are written in a way that would permit more than one possible reading.

- One provision to highlight in particular that would benefit from clarification through an amendment, is the question of how to interpret the wording in the Predominant Revenue Test about which types of revenue constitute Relevant Revenue and which, therefore, count towards the maximum permitted proportion of an entity's total revenues (i.e. 50%, following the JC Report).

- The specific wording here is important. Revenue is Relevant Revenue if it comes from interests "retained in accordance with Article 6" of the Securitisation Regulation. That is the wording used in the RTS and repeated in the JC report. Article 6 is the risk retention article. Ther understanding, therefore, is that the only securitisation positions whose revenue is Relevant Revenue are those positions forming the minimum retention requirement (i.e. typically the 5% first loss tranche or vertical slice). Other positions in the securitisation that the originator voluntarily holds would not contribute to Relevant Revenue as they are not retained pursuant to Article 6. That is the plain and clear meaning of the wording that the legislative bodies chose to use; the references to the risk retention article are clear and presumably deliberate.

- In a significant number of cases, the way this wording is interpreted is the difference between an entity passing the Predominant Revenue Test and not. For example, let's assume that all of an originator's financial assets are financed through a securitisation that has the following three tranches:
    - a senior tranche of 60% thickness (i.e. representing the 40-100% least risky portion of the securitisation);
    - a mezzanine tranche of 35% thickness (representing the 5-40% risk position); and
    - a first loss tranche of 5% thickness (representing the 0-5% risk position).

  Let's then assume that the first loss tranche is held by the originator as the risk retention position and the mezzanine tranche is, in addition, voluntarily held by the originator. In this situation, pretty much ALL of the originator's revenues will be coming from the junior and mezzanine tranches. If it is

necessary to count the voluntarily held mezzanine tranche as Relevant Revenue, then the originator will fail the test.

If, alternatively, the originator did not retain the mezzanine tranche and instead used the additional proceeds from selling the mezzanine tranche to invest in unrelated assets, it would pass the test. It is not a logical outcome that by voluntarily creating *additional* alignment of interest with investors, an originator can cease to qualify as an eligible retaining entity.

4 An Originator's Real Purpose

- To further illustrate the point made in section 3 a real-world example is described. To note in passing that the Predominant Revenue Test was originally intended to be a component of the Sole Purpose Test, which itself is something of an anti-avoidance provision against the use of SPVs created solely to play regulatory roles in a securitisation. The Predominant Revenue Test should not, be thought of as an abstract, purely numerical thing.

- For this example, please imagine that someone establishes a platform for making consumer loans in France. It is initially funded by equity from the founder. It is clear that the platform has been established for the purpose of making consumer loans. It is hard to see any argument against that conclusion.

- As the platform grows a little bigger, it starts to incur full recourse debt from a bank, in order to fund part of its consumer loan origination activity. The platform's purpose remains the making of consumer loans. It now uses bank debt *to help it to fulfil* this purpose, but its purpose has not become the incurrence of bank debt; that is nonsensical.

- Then the platform gets even bigger and decides to replace its full recourse bank debt with financing in securitisation format. It does this by selling all of its loan book to a SPV, which funds itself through the issuance of the following three tranches:
    - a senior tranche of 60% thickness (i.e. representing the 40-100% least risky portion of the securitisation), sold to third party investors;
    - a mezzanine tranche of 35% thickness (representing the 5-40% risk position) voluntarily retained by the platform; and
    - a first loss tranche of 5% thickness (representing the 0-5% risk position), retained by the platform in compliance with its Article 6 risk retention obligation.

- At this point, effectively <u>all</u> of the platform's revenues come from the mezzanine and junior notes. If one is required to treat the revenue from the mezzanine notes as Relevant Revenue (i.e. apply a more conservative interpretation than we consider correct), then the platform would fail the Predominant Revenue Test and therefore the Sole Purpose Test. The implication of this is a conclusion that somehow the platform "was established or operates for the purposes of securitisation". We find this conclusion illogical. The platform's purpose remains the making of consumer loans; securitisation is simply the funding tool it uses to implement that purpose (and the structure of a securitisation is such that the platform's revenues now come via its interest in the securitisation).
- The above is one example of the type of entities that could be affected by narrowly defining the Sole Purpose Test. Such interpretation would also wrongfully result in an adverse impact for directly lending funds that use securitisation to finance their loan origination activity. In particular, where such activity clearly far removed from the originate to distribute model which the risk retention and Sole Purpose Test were designed to prevent.

- There are numerous real versions of this example in sectors of importance to the EU economy (autos, consumer, corporate lending (including SME lending)) and depriving originators of access to the securitisation market by promulgating this conservative interpretation (which, as noted, does not reflect the plain meaning of the Level 1 text) would, in our respectful submission, seem inconsistent with key policy goals.

5 Other Considerations

- Even though the Sole Purpose Test / Predominant Revenue Test is the main focus some additional points that, would also benefit from clarificatory amendments through the current legislative process the Sec Reg is undergoing are set out below.

- **Seasoning Period**. An entity can qualify as an originator in two different ways. Under limb (a) of the definition of originator, an entity can qualify by being involved in the original agreement which created the securitised exposures. Alternatively, under limb (b) of that definition, an originator qualifies if it "purchases a third party's exposures on its own account and then securitises them". The definition does not contain any minimum period between the originator purchasing the assets and securitising them. The only regulatory data point that we are aware of is a single sentence in the 2014 EBA report which suggests that an originator SSPE that "is established solely for buying a third party's exposures and securitises the exposures within one day" might not meet the spirit of the definition. Market practice (which we believe is compliant with the requirement) is typically to accept a period of around 10 calendar days and we think some codification of this would be useful. Confirmation of the market view that a "purchase [...] on its own account" (i.e. the entity becoming exposed to the risks associated with the relevant assets) can occur in a number of different legal forms would also be welcome. We suggest appropriate wording in section 6 of this note.

- **Funds with External Managers**. Many investment fund groups are structured in a way that the assets are owned by a fund, which then appoints a different entity as its investment manager or investment advisor (i.e. a typical AIF/AIFM set up under AIFMD). Where the fund is acting as the originator of a securitisation, our understanding is that in assessing its compliance with the Governance Component of the Sole Purpose Test it is appropriate to also take account of the expertise of the investment manager / investment advisor that are acting on behalf of the fund under a documented contract. An alternative approach (of ignoring the effectively outsourced activity to the manger / advisor) would appear to disqualify externally managed investment funds from qualifying as originators, which is not consistent with our understanding of the EU policy position on that matter.

6 Support for Proposed Amendments

- This section of the note outlines the amendments that we support.

- **Sole Purpose Test**. It should be made clear that entities or funds that operate a real-world lending business pass the Sole Purpose Test, without the need to perform any revenue calculation. The European Parliament draft from earlier in the year contained wording along these lines but was limited to entities that provide SME loans, consumer credit or residential mortgages. Broader wording that would also cover, for example, originators of large corporate loans should be included. The wording that is most appropriate is that which was included in Amendment 152, which says "An entity shall not be deemed established or operating for the sole purpose of securitising exposures where its purpose is to generate revenues from the exposures to be securitised and it enters into the securitisation transaction solely to finance or refinance those exposures." That seems to us to address most directly the *purpose* question that was at the heart of the original legislative intent.

- **Predominant Revenue Test**. Any uncertainty about the correct operation of this test should be settled through a clarificatory amendment. It should be made absolutely clear that revenues from securitisation positions held voluntarily in excess of the 5% minimum requirement and management fees are not considered to be securitisation-related revenue for the purpose of the test (i.e. are not Relevant Revenue, using the terminology we adopt in this note).

  As a related matter, there does not seem to be any particular benefit in any regime that would involve a case-by-case examination of an originator by a competent authority; don't see how that would work in practice to provide market-wide consistent outcomes unless specific criteria were used, at which point it makes more sense to include those criteria in the regulatory text itself.

- **Originator Definition**. As noted above, limb (b) of the definition of originator would benefit from clarification regarding the minimum period that an originator has to hold or otherwise be exposed to the assets prior to securitisation. The right wording would be to say that an entity must hold or otherwise be exposed to the assets for at least 10 calendar days prior to securitisation.

- **Investment Funds**. It is important that it be confirmed (to settle any doubt), that investment funds that use an external management entity are capable of qualifying as originators and meeting the governance componence of the Sole Purpose Test. This could be done by the inclusion in limb (b) of the definition of originator wording making clear that the activity of purchasing and securitising assets can be done directly or "through related entities". That wording already appears in limb (a) and so propose also including it in limb (b); no policy basis for it to be included in one place and not the other can be seen. The wording of the Sole Purpose Test should also be refined so that it is confirmed that the Governance Component can be met through reliance, in whole or in part, on expertise housed in an investment advisor or manager.

7 Proposed Amendment Text

- Specific wording to implement the changes is set out below. This will ensure that the intended meaning of the Level 1 text is clear to all EU investors (i.e. banks, insurers and asset managers). The wording is comprised of two amendments.
- **Amendment 1 – Solving the issue of the predominant revenue test**

EU Securitisation Regulation, Article 6, paragraph 1, second subparagraph

"For the purposes of this Article, an entity shall not be considered to be an originator where the entity has been established or operates for the sole purpose of securitizing exposures. ***An entity shall not be deemed established or operating for the sole purpose of securitising exposures where its purpose is to generate revenues from the exposures to be securitised and it enters into the securitisation transaction to finance or refinance these exposures. In case the assessment linked to a predominant source of revenue test is performed in accordance with the delegated act adopted under paragraph 7, first subparagraph, point (b), revenue from the tranches held in excess of the 5 % material net economic interest requirement referred to in the first subparagraph, and management fees, shall not be deemed as income that relies on the exposures to be securitised on any interests retained or proposed to be retained in accordance with Article 6 or on any corresponding income from such exposures and interests."***

- **Amendment 2 – Solving the issues of seasoning period and the separate advisory entity**

EU Securitisation Regulation, Article 2, paragraph 3

(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) ***itself or through related entities*** purchases a third party's exposures on its own account and then securitises them;

In order to purchase exposures on its own account it is required that the entity has exposure to such assets for at least 10 calendar days prior to the securitisation.

8 Market Context

Set out below is some market context. This illustrates how certain types of originator would be precluded from qualifying as retaining entities, if the more conservative reading of the relevant provisions is allowed.

1) CLO Market

Anecdotal evidence suggests that a large part if not substantially all CLOs rely on the revenue from holdings in excess of the minimum risk retention requirements being "good revenue" and therefore not see to be "from assets to be securitised, or from risks retained or proposed to be retained under Article 6 of the Securitisation Regulation".

At stake is the European CLO market c. €280bn in size and internationally, the global CLO market at c. €1.3tn from which EU institutions would be carved out if a different interpretation is applied.

2) Public Securitisation Markets

Primary or secondary investors in public securitisations, typically rely on representations provided within the prospectuses and are not provided with the granular information to undertake the aforementioned predominant revenue test. In particular, the European non-bank originator market will likely suffer significant disruption (this is estimated at more than c. €250bn);

3) Non-bank originated private securitisations will also be subject to material disruption, including:

a) Fintecs/lending platforms that provide loans to SME, consumer loans or residential mortgages in Europe where securitisation is used as a primary financing tool for their loan origination activity. It is clear that these entities are not set up for the sole purpose of securitisation but the response to this question could in effect challenge their funding source and hence their business; and

b) Fund originators, for example, direct lending funds (current estimates of non-bank European private credit assets under management (AUM) is c. €470bn and globally private debt fund AUM was c. $2tn in 2023) whose primary objective is to invest in a broad array of corporate loans and that use securitisation as a financing tool to support its primary objective of acquiring or underwriting corporate exposures directly or indirectly.

Taken together the impact from the read across of the predominant revenue test for European institutions investing in securitisations and the European securitisation market itself would be significant should the revenue from holdings in excess of the minimum risk retention position not be excluded from the numerator of the formula described above.

Industries that would be dramatically affected by this interpretation would include the following: auto lending and leasing companies, SME lending businesses, consumer lenders, fintech companies, digital infrastructure and other commercial real estate investors, regulated direct lending funds and many others

(a number of these industries are strategic priorities for Europe identified through the Letta, Noyer and Draghi reports on the Savings & Investment Union and Capital Market's Union).

4) Market Players

In relation to the competitive landscape such level of prescription and strict conditions does not exist in the UK or US securitisation rules and hence a further risk EU institutional investors including EU banks face not only in their home market but international markets is that whilst provision of financing secured against assets in securitisation format can be an effective financing tool for the array of entities described above, it could be dominated by foreign institutions including foreign bank investors that will most likely be able to operate rather than EU investors (including EU banks) both in the EU economy and broader international economy