

Criteria for identifying STC short-term securitisations

06/06/2018

Banking and Finance analysis: David Quirolo and Jeremiah M Wagner (partners) and Neil Macleod (special counsel) in Cadwalader, Wickersham & Taft LLP's Capital Markets Group, point out that new criteria aimed at assisting the financial industry in its development of simple, transparent and comparable (STC) short-term securitisations may be too restrictive, and the regulatory benefits may not be sufficiently significant, for the criteria to be widely adopted.

Original news

BCBS and IOSCO issue criteria for identifying STC short-term securitisations, [LNB News 14/05/2018 59](#)

The Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) have issued criteria for identifying STC short-term securitisations. The criteria maintain and build on the principles in the criteria for identifying simple, transparent and comparable securitisations issued by BCBS–IOSCO in July 2015.

Why have the Basel Committee and IOSCO issued the criteria?

On 14 May 2018, the Basel Committee on Banking Supervision and the Board of IOSCO issued criteria for identifying STC short-term securitisations (Short-Term STC Criteria).

The criteria build upon the principles in the [Criteria for identifying simple, transparent and comparable securitisations](#) issued by the Basel Committee and IOSCO in July 2015 (July 2015 STC Criteria). Given that the structures of short-term securitisations, notably those using an asset-backed commercial paper (ABCP) conduit to issue commercial paper, differ from those of term securitisations, the July 2015 STC Criteria have been amended so as to make them applicable to short-term securitisations.

On the same day, the Basel Committee issued a [Standard on the capital treatment of STC short-term securitisations](#). The Standard sets out additional guidance and requirements regarding applying preferential regulatory capital treatment for banks acting as investors in, or as sponsors of, STC short-term securitisations (Short-Term STC Capital Criteria).

The July 2015 STC Criteria were intended to identify and assist in the development of simple and transparent securitisation structures. However, these criteria apply only to term securitisations. Given that short-term securitisations, which typically use an ABCP conduit to issue commercial paper, differ in structure from term securitisations, the July 2015 STC Criteria cannot be applied to them without amendment. Therefore, in July 2017, the Basel Committee and IOSCO published consultation papers on the criteria for identifying STC short-term securitisations and on the capital treatment for STC short-term securitisations. The May 2018 publications took account of feedback received to these consultations and finalised the Short-Term STC Criteria and the Short-Term STC Capital Criteria.

What do the criteria aim to do?

The purpose of the various Basel STC criteria is to identify those securitisations that are simple, transparent and comparable, there being lower regulatory capital requirements relating to banks' exposures to securitisations that are STC-compliant.

The Short-Term STC Criteria indicate that a securitisation possesses a level of simplicity, transparency and comparability that could assist market participants in evaluating the risks of a short-term securitisation transaction.

'Simplicity' refers to the homogeneity of underlying assets with simple characteristics and to a transaction structure that is not overly complex. 'Transparent' refers to providing investors with sufficient information on the underlying assets, the structure of, and the parties in, the transaction. This is with the aim of ensuring that investors have a comprehensive understanding of the risks involved in the transaction. The 'comparable' requirement is intended to enable a more straightforward comparison across securitisations within an asset class, taking into account differences between jurisdictions.

The Basel Committee Standard published on 14 May 2018 sets out additional guidance and requirements in relation to applying alternative regulatory capital treatment for STC short-term securitisations. The Standard explained that, while the Short-Term STC Criteria are sufficiently detailed to serve as guidance for good practice, the use of the criteria for the setting regulatory capital requirements requires greater prescriptiveness. The Basel Committee therefore supplemented

the Short-Term STC Criteria with additional criteria for the specific purpose of applying preferential capital treatment for banks acting as investors and sponsors.

The background to this is that, in 2014, the Basel Committee published its Revisions to the Securitisation Framework Basel III document, which set out revised methodologies for the calculation of regulatory capital requirements for securitisation exposures held by banks in their banking book. A revised version of this document was published in July 2016 and included an alternative regulatory capital treatment for securitisation transactions which meet the criteria for identifying STC securitisations ([July 2016 Framework](#)). The May 2018 Standard provides that exposures to ABCP conduits and/or transactions financed by ABCP conduits, where the conduit and/or transactions financed by it meet the Short-Term STC Capital Criteria, are STC-compliant for the purposes of alternative capital treatment for STC securitisations in the July 2016 Framework.

What are the main amendments made to the criteria in comparison to the criteria published in July 2015?

The July 2015 STC Criteria only apply to term securitisations and are not appropriate to ABCP conduits. The Short-Term STC Criteria cover ABCP conduits that mainly finance themselves by the issue of commercial paper, normally involving one or more sellers of assets (such as short-term trade receivables) to the ABCP conduit, and so focus on the characteristics of the ABCP conduit and the underlying transactions.

The principles underlying the July 2015 STC Criteria are relevant for short-term securitisations, but some criteria have been amended to reflect specific aspects of ABCP conduits, notably:

- the short maturity of the commercial paper issued by ABCP conduits
- the different forms of programme structures (multi-seller, single seller) and
- the existence of multiple forms of liquidity and credit support facilities on different levels of the ABCP structure (ie conduit level or transaction level)

The Short-Term STC Criteria also differ from the July 2015 STC Criteria so as to reflect the roles played by the sellers and the sponsor in ABCP Conduits. The sponsor is key in:

- establishing and managing the ABCP conduit
- providing credit and liquidity support for the ABCP conduit and
- assuming a fiduciary responsibility as regards the investors (eg holders of the commercial paper or the lenders to the ABCP conduit) in ensuring that the transactions financed by the ABCP conduit and their underlying assets meet the transaction-level standards, and in reporting to investors on how these criteria are met

As well as taking account of the roles played by the sellers and the sponsor in ABCP conduits, the Short-Term STC Criteria distinguish between criteria relevant at the transaction level (which must be separately met by each transaction in the conduit) and at the conduit level (which must be met by the ABCP conduit as a whole). Most criteria are relevant at both levels, but have a slightly different focus to reflect the differences in risk, parties and structure at each level. The obligations of the sponsor at the conduit level in large part relate to the information, representation and warranties to be provided to investors regarding its compliance with its various obligations.

The additional criteria for capital purposes in the Short-Term STC Capital Criteria (being either guidance or a requirement depending on the criteria) include two additional Short-Term STC Capital Criteria.

Do you think that the criteria will assist the financial industry to develop STC securitisations, or do you foresee any problems with using the criteria?

For banks' exposures at the conduit level (eg exposures arising from investing in the commercial paper issued by the ABCP programme, or sponsoring at the conduit/programme level), the Short-Term STC Capital Criteria have to be complied with fully at *both* the conduit level and the transaction level. The requirement for compliance with the Short-Term STC Capital Criteria for both the conduit and for all the transactions in the ABCP conduit, will make compliance at this level difficult to achieve in practice (particularly as regards the compliance of any existing transactions).

For banks' exposures at the transaction level to qualify for STC capital treatment, compliance with the transaction-level Short-Term STC Capital Criteria *alone* would suffice (ie independently of whether the overall conduit/other transactions underlying the conduit qualified) (Transaction Level Approach). This contrasts with the preferred approach set out in the July 2017 consultative paper in which the Basel Committee proposed that the Short-Term STC Capital Criteria would have to be fully complied with at both the conduit level and the transaction level (with an exception regarding the full support criterion for sponsors' exposures) (termed by the Basel Committee as the Baseline Approach).

One of two alternatives to the Baseline Approach set out in the July 2017 consultative paper was the Transaction Level Approach subsequently adopted in the May 2018 Standard. Advantages of such a Transaction Level Approach, as set out in the July 2017 consultation, are:

- that assessing STC capital treatment on a transaction-by-transaction basis provides an incentive to structure STC-compliant transactions (ie there continues to be an incentive to be STC-compliant even when other transactions under the ABCP structure are not)
- any increase in risk exposure resulting from non-STC transactions under the ABCP structure has no impact on the transaction sponsored by the sponsor bank and
- it provides an incentive to transaction-level participants to reinforce the sponsor's STC attestation by carrying out their own due diligence regarding the transactions to which they are exposed

The adoption of the Transaction Level Approach over the Baseline Approach is to be welcomed, as the former would have made it difficult in practice for banks' exposures at transaction level to have been eligible for STC capital treatment.

In a separate process, the EU has developed its own regime in the Securitisation Regulation ([Regulation \(EU\) 2017/2402](#)) for what are termed simple, transparent and standardised (STS) securitisations. The Securitisation Regulation and a parallel CRR Amendment Regulation ([Regulation \(EU\) 2017/2401](#)) entered into force in January 2018 and will apply to securitisations the securities of which are issued on or after 1 January 2019.

The Securitisation Regulation sets out the criteria for identifying STS securitisations, while the CRR Amendment Regulation sets out a framework for a more risk-sensitive regulatory treatment of exposures to securitisations complying with such criteria. As with the Basel STC criteria, the Securitisation Regulation provides for different STS criteria for term (ie non-ABCP) securitisations, as distinguished from short-term (ie ABCP) securitisations. Although the criteria are similar, those for ABCP securitisations focus on the distinction between transaction, sponsor and programme level criteria. The Securitisation Regulation provides that by 18 October 2018, the European Banking Authority (EBA) shall adopt guidelines and recommendations on the harmonised interpretation and application of the STS requirements for both ABCP and non-ABCP securitisations.

On 20 April 2018, the EBA published consultation papers on its draft guidelines for ABCP and non-ABCP securitisations. The EBA noted that where possible and appropriate, the existing recommendations in the Basel July 2016 Framework had been taken into account, when developing their interpretation.

As regards whether the criteria will assist the financial industry to develop STC securitisations, we would first note that the Basel STC framework has to a large extent been superseded in the EU by the STS criteria in the EU's new Securitisation Regulation. These STS criteria are already set out in EU law and are similar to, but not identical to, the STC criteria. There is some scope for the EBA's new guidelines to reflect aspects of the STC criteria, but the Basel Short-Term STC Criteria were published after the EU primary legislation on this subject had already been finalised.

Furthermore, the STC criteria may be too restrictive, and the regulatory benefits may not be sufficiently significant, for the criteria to be widely adopted. The adoption of the Transaction Level Approach over the Baseline Approach for banks' exposures at the transaction level is to be welcomed, but there remain practical difficulties in complying with all the applicable Short-Term STC Capital Criteria.

We await to see whether the regulatory capital benefits justify banks' compliance costs in complying with the short term STC framework. In addition, although the short-term STC framework takes effect immediately, its implementation is not mandatory and jurisdictions which consider that the implementation costs outweigh the potential benefits retain the option not to implement the STC framework.

David Quirolo's practice focuses primarily on collateralised loan obligations (CLOs), securitisation and repackaging transactions involving various asset types in the US and Europe, and he represents banks, arrangers and asset managers in a variety of structured finance transactions. David has extensive experience using 'cash flow,' 'market value' and hybrid structures, and is recognised as a leading practitioner in the CLO 2.0 market. David also represents the Loan Markets Association in relation to regulation affecting the CLO market. He regularly meets with regulators and policy makers in relation to securitisation regulation.

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