

**MEMORANDUM**

**TO:** File No. S7-08-10  
File No. S7-14-11

**FROM:** Jay Knight  
Special Counsel  
Office of Structured Finance  
Division of Corporation Finance  
U.S. Securities and Exchange Commission

**RE:** Meeting with Representatives of the Association for Financial  
Markets in Europe

**DATE:** November 4, 2011

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On November 2, 2011, Paula Dubberly, Katherine Hsu, Rolaine Bancroft, and Jay Knight of the Division of Corporation Finance, and Eric Emre Carr and Stanislava Nikolova of the Division of Risk, Strategy, and Financial Innovation met with the following representatives of the Association for Financial Markets in Europe (“AFME”):

- Richard Hopkin (AFME staff)
- Nicole Rhodes (Allen & Overy)
- Rob Collins, Nationwide Building Society (AFME member)
- Lainie Kaye, Deutsche Bank (AFME member)
- Richard Dorfman (SIFMA staff)
- Chris Killian (SIFMA staff)

The meeting participants discussed topics relating to the Commission’s March 30, 2011 proposals regarding credit risk retention and the Commission’s April 7, 2010 proposals regarding loan-level disclosures in asset-backed securities transactions. A handout is attached to this memorandum.

Attachment



# **European perspective on risk retention and asset-backed securities**

**Presentation to  
US Securities & Exchange Commission**

**Washington, D.C., 2<sup>nd</sup> November 2011**

**Richard Hopkin  
Managing Director, AFME**

- Introduction to AFME
- Key aspects of the European risk retention regime
- European experience since implementation
- Key AFME concerns regarding the Commission's proposals

## **The Voice of Wholesale Capital Markets in Europe**

- Represents some 170 global and European market participants
- Focus on wide range of wholesale markets, business and prudential issues, including topics previously covered by former European affiliates of the Securities Industry Financial Markets Association
- Main office in London with representation in Brussels
- An independent regional organisation with global integration through membership of the Global Financial Markets Association (GFMA), together with SIFMA in the US and ASIFMA in Hong Kong
- Our response to the risk retention NPR involved input from a range of EU market participants, including those who may seek to fund securitisations of EU assets by issuing ABS to US persons and others

## **Fair, orderly, and efficient European wholesale capital markets, and leadership in advancing the interests of all market participants**

- Build public trust and confidence in financial markets through a focus on transparency and systemic stability
- Co-operate with stakeholders and policymakers toward developing a harmonised and open pan-European market
- Play a prominent and constructive role in the development of a globally coherent regulatory framework
- Lead the industry in the formulation and adoption of market solutions, standards, and practices that contribute to the efficient and reliable functioning of financial markets
- Serve as the provider of authoritative expertise and industry views to governments, market participants, media, and the general public

## **The bridge between the wholesale financial services industry, legislators, regulators and the wider public**

- Advocacy – engagement with legislators and regulators to ensure that the industry’s perspective is communicated
- Policy – applying our expertise, and that of our members, to contribute constructively to the development of EU and country legislation
- Education – providing information and explanation for legislators, the media and the public
- Communication – hosting conferences and events at which views may be aired and the key elements of financial reform debated
- Co-ordination – bringing together a broad array of market participants and industry bodies to work as one on the most important issues facing the sector

## Article 122a of the Capital Requirements Directive

- Key differences in approach and scope
- Principles-based approach
- Significant differences in key terms
- 'Securitisation' defined by reference to tranching of risk
- Mandates both risk retention and due diligence by investors
- Onus and sanction on investors, not originators or sponsors
- Effective January 1<sup>st</sup> 2011 for new deals
- Detailed guidance from CEBS (now European Banking Authority) issued 31<sup>st</sup> December 2010; discussions ongoing
- Applies to the consolidated group, so extra-territorial in application

# Cross-border comparison basics

	US proposals	EU requirements, Article 122a
Who must comply?	Sponsor Entities within jurisdiction of relevant US agencies	Relevant entity assuming exposure to credit risk, e.g. investor EU regulated banks and consolidated entities
Jurisdictional scope	Unclear, non-US sponsors may be within jurisdiction in certain circumstances But proposed safe harbour	Potential global application; requirements triggered by relevant involvement of EU regulated bank or consolidated entity
Which deals?	Transactions involving issue and sale of ABS Widely defined, required to involve security Exemptions for deals backed by QRMs, qualified assets, GSE-guaranteed MBS, government claims Previous issues grandfathered, but new issues under existing programmes caught	CRD defined securitisations Widely defined, definition turns on credit risk tranching Exemption for certain correlation trading activities, deals backed by government claims, retained deals Limited grandfathering, pre-2011 deals (including issues under existing programmes) caught from end 2014 if new assets/substitutions
Who is required to retain?	Sponsor in general, but can allocate portion to originator; one sponsor only Third-party B-piece buyer acceptable for certain CMBS deals, originator-sellers in ABCP conduit	One of originator, sponsor or original lender; split in proportion between multiple originators/sponsors Limited flexibility for other entity to hold (including via originator SPV) under EBA/CEBS guidelines
Interest level and how it can be held	5% in general, but exemptions Base case holding options include vertical slice, first loss, L-shaped, representative sample Specific holding options for certain deals/assets – CMBS, ABCP, certain master trusts Specific forms required to be used	5%, but possible member state gold-plating – although CRD4 will reduce issues in this regard Four holding options for all deals – vertical slice, first loss, representative sample, seller share Relative flexibility provided via guidelines re forms that may be used to hold retained interest
Penalty	Wide penalties may apply under general provisions in D-F Act	Proportionate additional risk weight re relevant securitisation position held by e.g. investor

# Scope uncertainty and mismatch

	US Sec Exchange Act def'n of ABS	EU CRD def'n of securitisation
Warehouse arrangements, no security issue	[?]	✓* <small>*(if tranching funding arrangements)</small>
Tranching real estate lending arrangements	[x]	[✓]* <small>*(if subordination determines losses during ongoing life of deal)</small>
Synthetic securitisations	x	✓
CLOs	✓*	✓
	<small>*(no retention if loans are "qualified assets")</small>	
Untranching bond funds	[?]	x
Covered bonds	[?]	x
GSE-guaranteed MBS	✓*	[x]
	<small>*(but proposed exemption)</small>	
Repacks, untranching	✓	x
ABCP conduits	[✓]	✓

- Both regimes apply
  - E.g. relevant US deal involving EU bank or consolidated entity as investor or assuming credit risk exposure via other activities OR relevant EU deal involving US offering
  - **Why does it matter?** Ability to comply with both regimes unclear in various scenarios (e.g. UK mortgage master trust deals); cross-border market liquidity constraint
  - UK FSA proposals may be helpful but patchwork relief undesirable in general
- Exempt under US requirements but possibly caught by EU requirements (if EU bank or consolidated entity assumes credit risk exposure)
  - E.g. QRM and qualified asset backed deals, synthetic securitisations
  - **Why does it matter?** May restrict access by US participants to EU market; may limit practical effect of flexibility intended to be provided under US regime; may restrict business activities of EU banks and consolidated entities in respect of US deals
- Exempt under EU requirements but possibly caught by US requirements (if US offering)
  - E.g. deals which may be caught by US definitions but not EU (such as untranchéd repacks, covered bonds etc.), deals exempt under EU requirements but not by US (such as deals backed by EU government guaranteed claims)
  - **Why does it matter?** May restrict access by EU institutions to US market; uncertainty with respect to whether retention requirements apply

- Industry has largely adjusted to the new requirements, although there have been considerable difficulties in some specific asset classes
- CLOs, CMBS, secured corporate borrowings with tranching risk
- Impact on market practices
- Costs of implementation
- Compliance burden
- Effect on investors
- Real benefit to be gained through sensible alignment; over-hasty implementation should be avoided
- Cross-border perspective is key

- Securitisation is a critical global source of funding for EU and US issuers, both in term ABS and ABCP
- Co-ordination between US and EU authorities to maintain access to pools of liquidity in both trading blocs
- Clarity of scope of application
- Flexibility to accommodate non-US transactions and structures needed

- Our preferred approach is formal co-ordination and mutual recognition between the US and the EU
- The safe harbour provides a useful secondary approach, if properly calibrated, albeit with limitations
- Limited options for compliance with both regimes

- Covered bonds
- Repackaging transactions

- Mortgage master trust issuers
- ABCP conduits
- Managed CLOs
- Challenges for European compliance with US concepts

AFME and its members thank the Commission for the opportunity to discuss these important issues in person. Our contact details are set out below:

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The Association for Financial Markets in Europe advocates stable, competitive and sustainable European financial markets, which support economic growth and benefit society.

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