



19 August 2013

European Banking Authority
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By email: EBA-CP-2013-14@eba.europa.eu

Re: Draft Regulatory Technical Standards dated 22 May 2013 on the retention of net economic interest and other requirements relating to exposures to transferred credit risk (Articles 394, 395, 397 and 398) of Regulation (EU) No [xx/2013] - EBA/CP/2013/14

Commercial Real Estate Finance Council Europe ("**CREFC Europe**") is part of the CRE Finance Council, an international trade association dedicated to promoting the ongoing strength, liquidity and viability of commercial real estate capital market finance worldwide. CREFC Europe and its members welcome the engagement of the European Banking Authority ("**EBA**") with market participants in respect of the consultation paper dated 22 May 2013 (EBA/CP/2013/14) published by the EBA on the draft regulatory technical standards (the "**RTS**") in connection with the securitisation retention rules under the Capital Requirements Regulation ("**CRR**"). The CRR includes risk retention and due diligence rules with respect to securitisations and is intended to replace the equivalent provisions of the capital requirements directive (Directive 2010/76/EU) (the "**CRD**").

Introduction

CREFC Europe members welcome the opportunity to participate in the consultation process regarding the RTS. Active and focused engagement with market participants is central to the successful implementation of the new regulatory requirements that market participants must face on a daily basis.

On that basis, this response letter has been drafted to focus on the issues that CREFC Europe members view as being highly important to the commercial real estate finance markets. In particular, this response letter focuses on A/B commercial real estate finance transactions and agency commercial real estate finance transactions. CREFC Europe members do not consider that such transactions should be considered as securitisations for the purposes of the CRR, and welcome the guidance offered by new recital 50 of the CRR.

In addition, this response letter seeks to endorse the positions expressed by the Association for Financial Markets in Europe ("AFME") in their response letter to the EBA. CREFC Europe agree with all of the positions and arguments that AFME have advanced in their response letter. This response letter makes such an endorsement by specifically endorsing some of the issues raised by AFME which are of particular relevance to commercial real estate finance.

Importance of commercial real estate securities transactions funding for CRE and the impact on the real economy

Commercial real estate is a fundamental source of employment and economic growth in Europe and plays a vital role in Europe's business, industry and social life. The value of the commercial real estate market in Europe is close to the value of each of the European stock markets and the European government bond markets. Commercial real estate securities transactions have been an essential source of funding to the commercial real estate markets in Europe and have historically accounted for approximately 10% of all lending in this sector. This contribution is expected to grow in the coming years primarily as a result of the significant retrenchment by the banking sector which has historically provided the vast majority of the funding to this asset class.

As well as traditional commercial real estate such as offices, retail and industrial, commercial real estate securities transactions have been utilised to fund operating businesses that offer significant employment opportunities as well as funding essential needs of individuals in the housing or healthcare sectors or the needs of small owner-occupied businesses. As a funding tool it has had real relevance not just to property owners but also operating businesses and the consumer/householder. Examples of the essential use of commercial real estate securities funding in the real economy include:

- The healthcare sector: In particular private hospitals and the largest care/nursing home operators;
- The housing sector: One of the largest asset classes in commercial real estate securities transactions is multi-family housing particularly in Germany and Scandinavia as well as areas such as student accommodation;
- The hospitality sector: In particular hotels, leisure/recreational parks and much of the pub industry in the UK;
- The retail sector: This includes supermarkets, DIY stores, department stores and shopping centres across Europe; and
- Small commercial loan programmes: These have provided essential funding for small family owner-occupied businesses in secondary locations.

The importance of an active and attractive commercial real estate securities market should therefore not be ignored especially in light of recent regulatory changes impacting the banking sector where increased capital requirements due to Basel III – CRD IV and increased risk weightings will significantly limit potential funding capacity from banks compared to historical levels. On broad estimates it is expected that assuming banks utilise the same level of capital against their commercial real estate debt exposures as they do today, under the new regulatory requirements they will only be able to lend approximately 50% of what they are currently able to lend. This is from a pure regulatory capital perspective but there are other reasons (such as sector concentrations and legacy issues) why banks will also look to decrease their exposure to commercial real estate

lending. Commercial real estate securities transactions are valuable alternate funding tools that must be available to fill this void.

Commercial real estate securities transactions can also assist many banks to fund commercial real estate in the future efficiently and to manage risk to certain sectors, industries and corporates by transferring their loan exposures on a more systematic basis to the capital markets. The capital markets primarily in the form of agency commercial real estate securities transactions have already stepped in to absorb some of the void left by the banking sector with issuance levels of €5.8bn in H1 2013. This is in excess of the aggregate issuance levels of the previous 3 years. The commercial real estate securities markets, however, remain highly fragile and are very sensitive to capital requirements that may disincentivise arrangers of and investors in commercial real estate securities transactions.

Therefore, CREFC Europe members consider commercial real estate securities transactions to have a direct impact on the real economies of Europe, and have prepared this response letter in that light.

A/B CRE whole loans and agency transactions

CREFC Europe members have long considered that certain commercial real estate finance transactions should not be considered as securitisations for the purposes of the risk retention rules. There are many examples of commercial real estate finance transactions that have completed since the inception of the risk retention rules where the parties involved have had to consider the possible application of the risk retention rules, in circumstances where the relevant transaction should not, in the view of CREFC Europe members, be considered a securitisation. Such transactions have incurred unnecessary costs in considering whether or not the risk retention rules apply, and in some cases have been conservatively structured in order to comply with the risk retention rules where such retention may not have been strictly necessary or desirable for commercial reasons.

In particular, CREFC Europe members and market participants of the wider commercial real estate finance industry have had to consider whether A/B whole loan transactions and agency commercial real estate securities transactions fall within the definition of securitisation for the purposes of the CRD.

A/B whole loan transactions

With respect to A/B whole loan transactions, market participants requested the EBA in the context of the Q&A published by the EBA on 29 September 2011 to confirm whether A/B structures in commercial real estate should be excluded from the definition of securitisation in the CRD. Market participants argued that it was beyond the intended scope of securitisation regulation for all tranching/subordination of indebtedness to result in such indebtedness being subject to the risk retention rules. Market participants further argued that if A/B loan transactions were to be treated as securitisations, then CMBS securitisations of such loans would be treated as "re-securitisations" for the purposes of the CRD. As a result, holdings of such CMBS securities by applicable institutions (e.g. credit institutions) would be subject to punitive capital treatment.

In response in the Q&A, the EBA indicated that as transactions can be structured in many different ways, a firm should look to the economic substance of a transaction to determine whether it is a securitisation as defined in the CRD.

In this context, CREFC Europe members welcome new Recital 50 in the CRR, which states in part: "An exposure that creates a direct payment obligation for a transaction or scheme used to finance or operate physical assets should not be considered an exposure to a securitisation, even if the transaction or scheme has payment obligations of different seniority."

CREFC Europe members are of the view that certain commercial real estate finance transactions will benefit from the increased certainty the above recital provides. In particular, CREFC Europe members consider that this new recital recognises that A/B whole loan commercial real estate structures should not be considered as securitisations. Applying the language of Recital 50, the A/B whole loan, as the exposure, creates a direct payment obligation of the relevant borrower to repay the loan advanced by the lender. Such A/B whole loan transactions are also used to finance physical assets, as the borrower will use the proceeds of the loan to finance or refinance the acquisition of real property assets. Real property assets are physical assets. On this basis, it seems reasonable to conclude that A/B whole loan commercial real estate finance transactions should not be considered securitisations for the purposes of the CRR.

Agency commercial real estate securities transactions

With respect to agency commercial real estate securities transactions, market participants have also previously requested the EBA to confirm that such transactions should not constitute a securitisation for the purposes of the CRD.

Agency transactions are commercial real estate finance transactions where there is no transfer of risk from an originator to the SPV issuer. Such transactions are generally structured so that the SPV issuer issues classes of notes, the proceeds of which are advanced directly to the borrower. CREFC Europe members consider that the lack of risk transfer in such transactions demonstrate that such transactions should not be considered as securitisations. Support for this reasoning can be found in the draft RTS itself. Indeed, the title to the EBA consultation paper reads: "Draft Regulatory Technical Standards dated 22 May 2013 on the retention of net economic interest and other requirements relating to exposures to transferred [our own emphasis] credit risk (Articles 394, 395, 397 and 398) of Regulation (EU) No [xx/2013]." In addition, the first sentence of Recital 7 of the draft RTS reads: "The purpose of the requirement related to the retained interest is to achieve an alignment of interests between the parties respectively transferring [our own emphasis] and assuming the credit risk of the securitised exposures."

In this context, CREFC Europe members welcome new Recital 50 in the CRR which supports the conclusion that transactions which lack an element of risk transfer should not be considered as securitisations. Applying the wording of Recital 50, a loan made directly by a SPV issuer would be considered as an exposure for the purposes of the CRR and it creates a direct payment obligation of the borrower to repay the advance made by the SPV issuer. As is the case with an A/B whole loan transaction, the loan advanced to the borrower will be used to finance physical assets, as the borrower will use the proceeds of the loan to finance or refinance the acquisition of real property assets. Real property assets are physical assets. On this basis, Recital 50 is helpful to confirm that agency commercial real estate securities transactions should not be considered securitisations for the purposes of the CRR.

Option E

Article 405 of the CRR includes a new retention method that was not available under Article 122a of the CRD. Article 405(1)(e) provides that retention may be achieved by the holding of a first loss exposure not less than 5% of every securitised exposure in the securitisation.

Article 9(1) of the draft RTS provides that the retention of a first loss exposure at the level of every securitised exposure under option (e) shall be applied in so that the credit risk retained is always subordinated to the credit risk that has been securitised in relation to those same exposures. This is further confirmed by Paragraph 33 of the Impact Assessment of the RTS.

CREFC Europe members welcome the added flexibility option (e) may provide. However, it is noted that a literal construction of option (e) could lead to a conclusion that the provision can only apply in the context of a re-securitisation. Such a construction would focus on the wording of option (e), which requires retention of 5% of every securitised exposure in the securitisation. There is a concern that the exposures must have been the subject of a securitisation, i.e., having been previously securitised, in order to fit within option (e). While CREFC Europe members consider that this cannot be the intention of the primary text, such an interpretation could lead to a risk that a securitisation that relies on option (e) should be considered as a re-securitisation. This would attract punitive capital requirements for investor institutions, which would seem a perverse outcome.

It is noted that this anomaly is a primary text issue which cannot be amended but CREFC Europe members seek clarity as to the proper interpretation of option (e). It is also noted that the same drafting appears in draft Article 1(a) of the RTS, which states that option (a) can be achieved by retaining at least 5% of the credit risk of each of the securitised exposures, provided this credit risk ranks at least *pari passu* with the credit risk securitised for the same exposures. Guidance from the EBA on this matter of interpretation would add certainty to option (e) and should ensure that it is relied on in the proper manner by market participants.

CREFC Europe members further note the explanatory box provided after Article 9 to the draft RTS, which states: "the retention of B loans in the case of securitisations of the A parts of A/B loans would be considered to be an example of the application of retention option (e) of Regulation (EU) No xxxx/201y, as long as the retainer retains a first loss exposure in the form of B loans of not less than 5%." CREFC Europe members consider examples of this nature to be extremely helpful to market participants as a means to provide clarity to certain structures. It would be very helpful if this explanatory text could remain in the final version of the RTS as it is understood that the explanatory boxes will not feature in the final version.

Finally, CREFC Europe members note that it may be difficult to rely on option (e) where the commercial real estate securities financing relates to a pool of A/B loans, and the B loans are held by different junior lenders. In such a case, it may not be possible to have each junior lender undertake to retain the relevant B loan as would be required in order to comply with retention option (e).

In addition, it may be that a pool of loans contains both A/B loans and senior loans. In the case of the senior loans in the pool, it would not be possible to rely on option (e) as there would not be a related junior loan to retain. In respect of those loans, the retention obligation would need to be met by complying with an option other than option (e). However, as it is not possible to comply with the retention obligations by using more than

one retention option, it would not be possible to use option (e) for the A/B loans in the pool.

Therefore, option (e) may be of limited use for certain types of commercial real estate securities transactions that include A/B loans with different junior lenders, or that include both A/B loans and senior loans.

Endorsement of AFME responses

CREFC Europe has worked closely with the AFME in considering the draft RTS and in preparing responses. Members of AFME have kindly agreed to share their response letter in draft form with members of CREFC Europe in order to increase the quality of the responses that market participants are able to provide the EBA. CREFC Europe agree with all of the positions and arguments that AFME have advanced in their response letter. Although some of the aspects discussed in the AFME response letter are not relevant to the types of transactions undertaken by CREFC Europe members, CREFC Europe members fully endorse the AFME response letter. In addition, CREFC Europe members wish to specifically endorse the following issues raised by AFME in their response letter which are of particular relevance to CREFC Europe members.

Position of existing transactions

CREFC Europe members consider that a high degree of market uncertainty may arise if the draft RTS does not include grandfathering provisions with respect to existing transactions. Indeed, many transactions have been structured in reliance on the existing guidelines. As the previous text of Article 122a of the CRD was not clear in all cases market participants have been forced to rely on the helpful guidance previously provided by CEBS/EBA. Market participants who structured transactions or invested in transactions in good faith in reliance on such guidance should not be penalised if the new guidance does not have a similar position to that which was relied upon. While this may not directly impact every commercial real estate finance transaction, CREFC Europe members are very concerned that if certain securitisation transactions are subsequently found to be non-compliant, this could cause significant disruption to the securitisation market as a whole. The recovery of the European securitisation market, and therefore the European CMBS market, could be significantly set back if this were to transpire. CREFC Europe members request the EBA to consider including adequate grandfathering provisions in the RTS to protect otherwise compliant transactions.

Activities deemed to trigger the application of the requirements; liquidity facilities

Article 3(1) in the draft RTS provides that where an institution acts as a liquidity facility provider to a securitisation, it shall be deemed to become exposed to the credit risk of a securitisation position where the conditions to Article 255 of the CRR are not met. Liquidity facilities have historically been important structural features of commercial real estate securities transactions and CREFC Europe members are concerned that this provision will unnecessarily deem liquidity facilities which are not intended to be exposed to credit risk as being exposed to a securitisation position.

Article 3(1) in the draft RTS is in contrast to the position with respect to derivative or hedge counterparties which is set out in Article 3(2) of the draft RTS which provides that a derivative or hedge counterparty shall be deemed to become exposed to the credit risk of a securitisation position when the hedge assumes the credit risk of the securitised exposures or the securitisation position. The rule applicable to derivative or hedge counterparties is consistent with the rule that applied to both liquidity facility providers

and derivative or hedge counterparties in the current guidance with respect to Article 122a of the CRD.

The new guidance in the draft RTS treats liquidity facility providers on a different basis than derivative and hedge counterparties. In particular, only liquidity facility providers that meet the conditions of Article 255(1) of the CRR will not be considered to be exposed to the credit risk of a securitisation. These conditions are very narrow and do not cover all types of liquidity facilities that would normally be considered as super senior in a securitisation and therefore not subject to the credit risk of the securitisation. In particular, paragraph (b) of Article 255(1) of the CRR requires that the liquidity facility may not provide liquidity in respect of exposures in default. Many securitisation liquidity facilities are structured so that they remain capable of being drawn upon by the issuer in circumstances where the underlying loan is in default even though the liquidity facility is over-collateralised and will be repaid on a super senior basis from loan recoveries. This is a requirement of the rating agencies to provide rating of the notes as in many European jurisdictions a period of time is required to enforce security on the underlying commercial mortgage loan.

Members of CREFC Europe suggest that the principles based approach adopted by the guidelines in respect of Article 122a of the CRD are more reflective of the true risks undertaken by a liquidity facility provider.

Consolidated group entities

Paragraphs 8 and 9 of the existing CEBS guidance provide very helpful flexibility to credit institutions that become exposed to credit risk of a securitisation position by virtue of the activities of any related entity, which falls within the same scope of a group where consolidated supervision is applied. In particular, paragraphs 8 and 9 of the existing CEBS guidance (and the related guidance on paragraphs 4 and 5 of Article 122a of the CRD) provide that when the exposure occurs within the trading book of another group entity, and such exposures are not overly material, nor form a disproportionate share of trading activities, no additional risk weights for infringements would apply, provided that there is a thorough understanding of the exposure and that formal policies and procedures have been implemented which are appropriate and commensurate with that entity's and the group's overall risk profile. CREFC Europe members fully endorse the request of AFME for the EBA to include guidance in the RTS consistent with the current regime. The existing guidance is indeed regarded as essential to EU banking groups which undertake market-making activities and that otherwise become subject to securitisation exposures in non EU jurisdictions.

Responses to specific questions raised by the EBA

CREFC Europe members note that the EBA has requested responses to specific questions throughout the draft RTS. CREFC Europe members have sought to address the questions which relate to areas of specific concern to CREFC Europe members. With respect to the other questions which are not specifically addressed below, CREFC Europe members fully endorse the responses provided by AFME.

Question 1 - The EBA would like to know to what extent securitisations rely on paragraphs 25-26 of the CEBS Guidelines in order to achieve the retention commitment and would also like to understand if these transactions could also meet the requirements set out in Article 394(1) of the CRR without applying the criteria provided in Paragraphs 25 and 26 of the CEBS Guidelines on Articles 122a of Directive 2006/48/EC taking into account the definition

of securitisation according to Article 4(37) of the CRR and the respective definitions of originator, sponsor or original lender.

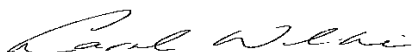
Paragraphs 25 and 26 of the existing CEBS guidance have provided flexibility in the context of several commercial real estate securities transactions. In particular, market participants have relied on paragraph 26 in transactions where the commercial real estate borrower has undertaken to act as the retainer by holding not less than 5% of the subordinated notes. However, CREFC Europe members consider that this will no longer be relevant if agency commercial real estate securities transactions are not considered securitisations, in keeping with the clarification provided by recital 50 of the CRR (as discussed above).

Question 15 - Do you consider that the information in existing templates (e.g. ECB ABS loan-level data template or Bank of England ABS transparency requirements) meet the relevant due diligence and disclosure requirements under Article 395 and Article 398 of the Regulation (EU) No xxxx/201y, respectively? Please differentiate in your response in terms of the types of underlying assets, if applicable.

Article 23 of the draft RTS provides helpful guidance on Article 409 of the CRR. In particular, it is helpful to have guidance that materially relevant data must be disclosed at the time of the securitisation and at least annually, and that generally, data must be provided on a loan-by-loan basis. CREFC Europe members consider that the CMBS market has historically provided a high level of disclosure on a loan by loan basis, both at the time of the securitisation (by including information in the prospectus) and on an ongoing basis. In response to question 15, CREFC Europe members note that there are existing templates other than the ECB ABS loan-level data template and the Bank of England ABS transparency template which meet the due diligence and disclosure requirements under Articles 405 and 409 of the CRR. In particular, CMBS market participants have used the European Investor Reporting Package, commonly known as the **CREFC European Investor Reporting Package® ("E-IRP")** and CREFC Europe members consider that both meet the due diligence and disclosure requirements under Articles 405 and 409 of the CRR. To the extent the EBA intends to endorse any existing template in the final version of the RTS, it is requested that the E-IRP is included in such endorsement.

We greatly appreciate the opportunity to comment on the consultation paper. Please do not hesitate to contact us should you have further questions.

Your Sincerely,



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