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Dear Sirs

The Basel Committee on Banking Supervision ("BCBS") and the International Organization of Securities Commissions ("IOSCO"): Criteria for identifying "simple, transparent and comparable" securitisation: consultative document issued by the BCBS and IOSCO (the "Consultation Paper").

Introduction

The Loan Market Association ("LMA") welcomes the opportunity to give feedback to the BCBS and IOSCO on the issues raised in the Consultation Paper, and thank both the BCBS and IOSCO for their continued engagement with the CLO market.

As discussed in more detail below, we are very concerned that the labelling of certain types of securitisations as "simple, standard and transparent" will create a "cliff" effect for securitisations which do not meet the criteria. In our view, as currently proposed very few securitisations will be able to meet the criteria. Securitisations which do not satisfy the criteria may be seen by the market as sub-standard thus discouraging investment in securitisations which do not obtain the label. In addition, favourable LCR and regulatory capital treatment for securitisations which meet the criteria is likely to discourage investment by regulated entities in securitisations which do not qualify.

We have previously provided responses to similar consultations initiated by the Bank of England, The European Central Bank and the European Banking Authority which we have included in our submission.

Our responses are limited to managed CLOs as opposed to other securitisations, in the hope that we can engage in productive dialogue with you around that asset class. The LMA would be pleased to provide additional information on the CLO market following the closure of this consultation, and would also be keen to meet in the coming months to assist you on a bilateral basis with any questions pertaining to the CLO market.

CLOs securitise the debt of sub-investment grade corporates. Corporates need capital in order to grow their businesses. A robust corporate debt market is an essential component to grow economies particularly in an environment where traditional lenders are capital constrained. CLOs offer this much needed capital to corporates. CLOs should not be disadvantaged because they are actively managed. As discussed in more detail below, the expertise of a CLO manager can add a great deal of value to a transaction through managing recoveries on credit impaired and defaulted credits. In fact CLO managers have consistently outperformed static loan indexes. For example, the median default rate for US sub-investment grade corporate debt is 3.61% but the median percentage of defaulted loans held in CLOs is at 0%[1]. Even through the credit crisis, default rates on European CLOs remained very low at just 0.1%[2].

Below is a brief description of a CLO:

CLOs differ from most static-pool securitisations in some fundamental ways most notably a CLO is not a balance sheet capital tool, it is a securitisation offering investors tranched exposure to a managed pool of corporate debt.

During the warehousing period, prior to issue of bonds by the CLO vehicle, the CLO vehicle accumulates assets from the open loan market, and these assets must meet the eligibility criteria.

Once these assets reach a critical mass, the CLO vehicle securitises them by issuing notes to investors in the market. A CLO portfolio will not usually be complete on closing of the securitisation. Instead, following note issuance the manager continues to purchase assets on behalf of the CLO vehicle, using the proceeds from the notes issuance, until the target value of the portfolio is reached. This "ramp-up" period may continue for up to six months after closing.

There follows a reinvestment period (typically four to five years after closing), during which the manager can i) trade assets up to a certain percentage (usually 20-30% annually), and any assets which are "credit improved", "credit impaired" or defaulted provided the new assets meet the eligibility criteria and certain tests are met, and ii) reinvest principal proceeds from the assets in buying new assets.

After the reinvestment period finishes, i) unscheduled principal payments received from the underlying assets, and ii) sale proceeds from "credit improved" and "credit impaired" assets may also be reinvested by the CLO manager (to the extent they are not required to pay items in the principal priority of payments such as any interest shortfalls on senior notes). Other principal receipts after the reinvestment period are used to redeem the notes sequentially, and many deals also have a clean-up call once the portfolio falls to 15-20% of its original target size.

Such "managed" CLOs provide banks, pension funds, insurance companies and other institutional investors with access to investment in the European corporate debt market but with robust portfolio quality requirements, structural protections and credit enhancement built in to the transaction to reduce risk. These features are outlined below. Typically, CLO notes are not designed to amortise earlier than 4-5 years after their issuance, hence are longer-term than some securitisations, which makes them attractive for investors who need to match their investment to their longer-term liabilities. CLOs do not rely on refinancing as the portfolio comprises assets in which there is an open market. Principal is paid to noteholders as assets amortise or are sold following the end of the reinvestment period (to the extent proceeds are not reinvested).

More detail as to the composition of the portfolio and the structural features of CLOs is given in our answers to the specific questions below.

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1 Morgan Stanley CLO Market Tracker Dec 14-2015 CLO Outlook, December 5, 2014

2 S&P European Structured Finance 12-months Rolling Default Line Drops to its lowest since March 2010, 28 April 2014

List of Questions

1 **DO RESPONDENTS AGREE THAT THE CRITERIA ACHIEVE THE GOALS THEY AIM TO ACHIEVE? IN PARTICULAR, DO RESPONDENTS BELIEVE THAT THE CRITERIA COULD HELP INVESTORS IDENTIFY "SIMPLE "TRANSPARENT" AND "COMPARABLE" SECURITISATIONS?**

We broadly agree with the criteria with some important exceptions as set out in Question 2 below.

2 **DO RESPONDENTS AGREE WITH THE STC CRITERIA SET OUT IN THE ANNEX OF THIS PAPER? IN PARTICULAR, ARE THEY CLEAR ENOUGH TO ALLOW FOR THE DEVELOPMENT BY THE FINANCIAL SECTOR OF SIMPLE, TRANSPARENT AND COMPARABLE SECURITISATIONS? OR DO RESPONDENTS THINK THEY ARE TOO DETAILED AS GLOBALLY APPLICABLE CRITERIA? THE ANNEX PROVIDES GUIDANCE ON EACH CRITERION. WHICH ADDITIONAL CRITERIA WOULD RESPONDENTS CONSIDER NECESSARY, IF ANY, AND WHAT ADDITIONAL PROVISIONS WOULD BE USEFUL OR NECESSARY TO SUPPORT THE USE OF THE CRITERIA? WHAT ARE RESPONDENTS' VIEWS ON THE "ADDITIONAL CONSIDERATIONS" SET OUT UNDER SOME CRITERIA IN THE ANNEX? SHOULD THEY BECOME PART OF THE CRITERIA? ARE THERE PARTICULAR CRITERIA THAT COULD HINDER THE DEVELOPMENT OF SUSTAINABLE SECURITISATION MARKETS DUE, FOR EXAMPLE, TO THE COSTLINESS OF THEIR IMPLEMENTATION?**

We broadly agree with the criteria with some very important exceptions:

Nature of the Assets: Homogenous in terms of asset type, currency and legal system: We do understand the need for a homogenous pool of assets however this requirement should be met by asset-type groupings, in the case of CLOs, corporate debt. We do not agree that there needs to be homogeneity in respect of jurisdiction, currency and legal system. Within the EEA itself there are different currencies and legal systems. The inclusion of diversity across legal systems, currencies and jurisdictions should not automatically exclude a securitisation from qualifying. For example, it should be possible to have a securitisation of a particular asset type (such as corporate loans) from jurisdictions across the EEA.

Asset Selection and Transfer: We do not share the view that a securitisation should be excluded on the basis that it is actively managed. A regulated CLO manager adds an expertise to the transaction and monitors each credit in the portfolio. A CLO manager performs in depth credit analysis on each asset. The CLO manager has knowledge and experience in corporate credit and represents the CLO on creditor committees and in work-out scenarios. These are regulated entities responsible for ensuring the CLO can repay its obligations to investors. We also disagree that active portfolio management adds a layer of complexity to a transaction. Investors investing in CLOs analyse both the Tests (as defined below) and the performance of the CLO managers in the same way and with the same rigour that they analyse a static portfolio of assets. There is a great deal of information available to investors on past performance of CLO managers as well as their approach to credit selection and work-outs. This information is widely available from a variety of public sources.

Management of a CLO portfolio is subject to collateral quality tests, overcollateralization tests and concentration limitation tests (the "**Tests**") – these are rigorous rating agency tests measuring over-collateralisation and various portfolio characteristics with which the manager is required to comply in order to continue to be able to reinvest in new assets. These portfolio-level tests are already industry-standard and are particular to managed CLOs as opposed to securitisations of static portfolios. The CLO manager has to meet the Tests on an on-going basis. The Tests and strict trading rules imposed on CLOs means that active management of the portfolio has a very limited effect (positive or negative) on the most senior tranches of a CLO.

The Tests also allow the CLO manager to provide detailed and transparent disclosure to investors on a monthly basis in respect of the portfolio. They cover data such as diversity of underlying obligors by industry and geography, weighted average spread on the assets, weighted average fixed rate coupon, weighted average rating and weighted average life of the underlying assets.

Unlike traditional asset-backed securities, the underlying portfolios of CLOs are typically not purchased from one originator or seller but are typically sourced in the primary or secondary market by regulated investment managers who are independent of any originator or seller of the loans. The CLO manager is able to independently assess the quality of the portfolio and is free of the negative incentives which can arise in an originate-to-distribute securitisation model. This adds an additional level of credit analysis which is not a feature of other types of securitisation.

Risk-reducing characteristics of managed CLOs

We cannot stress too heavily the fact that the assets in a CLO portfolio are only a part of the performance of the CLO itself. As we state above, CLOs give investors the ability to invest in the loan market with the benefit of structural enhancements and active management which significantly reduce risk to the senior noteholders when compared with a direct investment, or with a static loan portfolio. The exclusion of managed portfolios fails to recognise the weight that should be given, uniquely in this asset class within the securitisation space, to structural deleveraging and active management.

Structural deleveraging

In summary, structural deleveraging in a CLO interrupts the normal priority of payments in the event that the quality of the portfolio falls below a certain level. The debt coverage tests measure the amount of over-collateralisation in the CLO. In a managed CLO transaction, there is typically a maximum of 7.5% CCC (or below) rated assets in the portfolio. If these low-rated assets rise above that percentage, those assets will be treated as valued at market value rather than at the usual par value in meeting the debt coverage tests. If the debt coverage tests fail as a result, no interest can be paid out on the junior notes and the majority of the CLO management fees and all receipts from the assets will go to pay principal on the senior notes sequentially until the pool complies again with the coverage tests. The same applies to failure of the coverage tests as a result of defaulted assets. Thus the senior notes benefit both from the credit enhancement provided by the junior tranches and the protection of senior income and principal prior to any default. In a static-pool securitisation, whilst mechanisms may be built in to ensure excess income supports deficiencies on the senior notes, this is not done on a managed basis. This structural deleveraging was partly responsible for the subsequent upgrades on many of the AAA CLO tranches which were downgraded by S&P in 2009.

Further, post the expiry of a CLO reinvestment period, to the extent that portfolio collateral is repaying and the manager is unable to reinvest these proceeds (the circumstances are usually related to note ratings or certain test compliance), these proceeds are ultimately repaid to noteholders in order of seniority. This is another mechanism by which structural deleveraging can occur and is an inherent characteristic across European CLO 1.0 and 2.0 structures.

In addition to those protections, we would suggest that a CLO which complies with the following criteria should be included in any "high-quality" class of ABS which receives preferential regulatory treatment:

(a) the securitised exposures must be managed on a continuing, discretionary basis by:

(i) an EEA investment firm which is required to be regulated in its home member State and which is subject to the Markets in Financial Instruments Directive ("**MiFID**") or an affiliate thereof; or

(ii) a firm authorised under the Alternative Investment Fund Managers' Directive ("**AIFMD**") or an affiliate thereof; or

(iii) a firm or an affiliate thereof which would fall within (i) or (ii) above if its head office was situated in the EEA and which is subject to equivalent regulation in relation to the conduct of its business and its management of conflicts as a firm established in the EEA (for instance investment advisors registered under the US Investment Advisers Act of 1940, as amended);

(b) the CLO manager of the securitised exposures must undertake to the investors in the securitisation to comply with the regulatory requirements applying to it in relation to the management of conflicts of interest, in connection with its management of the securitised exposures (i.e. compliance with MiFID and/or AIFMD or equivalent regulations outside the EU);

(c) the securitisation must contain provisions whereby the interests of the CLO asset manager are appropriately aligned with the interests of the investors during the whole life of the securitisation. It is recognised that this may be achieved by a material part of the manager's compensation for carrying out its duties being structured as an incentive fee, which will only become payable upon appropriate performance thresholds of the securitised exposures having been met; and

(d) investor reports should be provided monthly.

In addition, the following portfolio characteristics could be provided for in a definition of CLOs to ensure that only certain types of structures would actually constitute a CLO:

(i) it contains a high percentage of senior secured loans and bond loans to corporates;

(ii) it does not contain any asset-backed securities or synthetic securities; and

(iii) it is managed by an independent investment firm or an affiliate thereof which satisfies paragraph (a) above and who independently reviews, and individually selects, each asset to purchase in the primary or secondary market (with no obligation to purchase from any individual bank or originator).

The assets in a CLO portfolio are purchased according to the eligibility criteria, which specify the conditions for individual loans, such as jurisdiction, rating, non-convertibility, tax and regulatory conditions etc., and as at the effective date the portfolio profile and collateral quality tests must be satisfied. CLO managers may also only invest in assets during the reinvestment period if following investment, the portfolio profile and collateral quality tests remain satisfied or if not satisfied, they must be improved following such reinvestment. These tests ensure diversification of assets by industry, limit maximum concentration in a single borrower or borrower type, and ensure quality of loan covenants etc. The active management of the portfolio ensures the continued compliance with these tests. Thus CLOs have built-in protection for the quality of the assets in the portfolio.

Documentation disclosure and legal review: Offering documents which comply with the Prospectus Directive are required to describe all material terms. While we do not object with the premise of making the transaction documents available (CLO transactions documents are made available to the market following the closing of the transaction), the practicalities of distributing these prior to issuance would be problematic. As is the case with most transaction timelines, documents are being negotiated and agreed up to the issue date of the securities. Investors are required to make their investment decision based on the offering document. Issuer, arrangers and collateral managers are required to include full, accurate and complete disclosure in the offering document. This is the case in Europe and the United States. Securitisations have multiple documents comprising many pages. Providing investors with the documents prior to issuance could distract investors from a full and complete review of the offering document which not only describes the material terms of the transaction in great detail but also highlights material risks of which investors should be aware. It should also be noted that under the European Credit Rating Agency Regulation, it has been proposed that transaction documents be posted to a public website set-up by ESMA. Again any such disclosure should be required after the transaction has closed.

3 **WHAT ARE RESPONDENTS' VIEWS ON THE STATE OF SHORT-TERM SECURITISATION MARKETS AND THE NEED FOR INITIATIVES WITH INVOLVEMENT FROM PUBLIC AUTHORITIES? DO RESPONDENTS CONSIDER USEFUL THE DEVELOPMENT OF DIFFERENTIATING CRITERIA FOR ABCP, IN A MANNER SIMILAR TO THAT OF TERM SECURITISATIONS? THE BCBS AND IOSCO WOULD PARTICULARLY WELCOME ANY DATA AND DESCRIPTIONS ILLUSTRATING THE STATE OF SHORT-TERM SECURITISATION MARKETS BY JURISDICTION AND THE VIEWS OF RESPONDENTS ON CONCRETE COMPARABLE CRITERIA THAT COULD BE APPLIED TO SHORT-TERM SECURITISATIONS.**

As stated above our responses are limited to the CLO market. We would support an initiative to create an alternative regulatory framework for CLOs. CLOs have been in many instances harshly affected by regulatory changes that were originally intended for the more mainstream securitisation market. Many of these regulatory initiatives have made CLO issuance very difficult. As discussed above CLOs provide much needed capital to corporates and have performed very well throughout the credit cycle. As noted in your paper comparing risk retention initiatives, "*Global Developments in Securitisation Regulation*" dated 16 November 2012, exceptions and exemptions should be considered where alignment of interests is achieved in a different way as is the case for CLOs where managers have always had an alignment of interest with investors through the subordination of management fees which are tied to the performance of the CLO manager. Excluding CLOs from the "simple, transparent and comparable" initiative would have a further adverse effect on the CLO market, making it less attractive to investors when compared with securitisations that do receive this label.

4 **WHAT ARE RESPONDENTS' VIEWS ON THE LEVEL OF STANDARDISATION OF SECURITISATION TRANSACTIONS' DOCUMENTATION? WOULD SOME MINIMUM LEVEL OF STANDARDISATION OF PROSPECTUSES, INVESTOR REPORTS AND KEY TRANSACTION TERMS BE BENEFICIAL? DO RESPONDENTS THINK THERE ARE OTHER AREAS THAT COULD BENEFIT FROM MORE STANDARDISATION? WOULD A STANDARDISED TEMPLATE INCLUDING WHERE TO FIND THE RELEVANT INFORMATION IN THE PROSPECTUS BE HELPFUL? THE BCBS AND IOSCO WOULD PARTICULARLY WELCOME A DESCRIPTION, BY JURISDICTION, OF THE EXTENT TO WHICH DIFFERENT ELEMENTS OF INITIAL DOCUMENTATION ARE STANDARDISED.**

We generally support the standardisation of the securitisation documents, however there are instances where such standardisation is not possible. In the CLO market, offering documents do broadly follow the same organisational structure however terms can differ for many reasons. In particular, individual investors may require certain provisions and stipulations in a transaction. In addition, the terms may differ depending on the rating agencies rating the deal.

CLO reporting is already standardised. CLOs typically provide detailed monthly reports to investors. These reports contain details on the composition of the portfolio, cash flows and various statistics of the portfolio.

We remain very concerned that the labelling of certain securitisations as simple, standard and transparent could materially and adversely affect the wider securitisation market. CLOs are an important source of capital for corporate borrowers. The availability of capital to the corporate section is essential to promote sustained growth in Europe. Excluding CLOs from meeting the criteria set out in the Consultation Paper, particularly because they are actively managed, is not necessary given i) the way the transactions are structured, ii) the limited effect management has on the most senior tranches of a CLO, and iii) the information available to investors to evaluate CLO manager performance. As noted in your paper "*Global Developments in Securitisation Regulation*" 16 November 2012, CLOs already achieve an alignment of interest with investors. CLOs have performed exceptionally well throughout the credit crisis and to exclude CLOs from meeting the criteria would create even more hurdles to a well-functioning CLO market.

We would like to thank the BCBS and IOSCO for their continued engagement on these issues. We are also grateful for the opportunity to comment on the consultation paper. We would be very happy to answer any questions you may have. If you would like to do so, please contact Nicholas Voisey of the Loan Market Association (nicholas.voisey@lma.eu.com) or David Quirolo of Cadwalader, Wickersham & Taft LLP (david.quirolo@cwt.com).

Yours faithfully

N A Voisey

Nicholas Voisey
Director
The Loan Market Association

Annex 1

Previous consultation responses

1. ECB/Bank of England Discussion Paper – the case for a better functioning securitisation market in the European Union, May 2014

2. EBA Discussion Paper on Simple Standard and Transparent Securitisations 14 October 2014

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4th July 2014

Dear Sirs

ECB/Bank of England Discussion Paper– The case for a better functioning securitisation market in the European Union, May 2014 (the "DP").

Introduction

The Loan Market Association ("**LMA**").welcomes the opportunity to give feedback to the European Central Bank and the Bank of England (the "Central Banks") on the issues raised in the DP, and thank both Central Banks for their continued engagement with the CLO market.

Whilst the discussion below attempts to answer many of the questions raised in the DP, it has not been possible to give a complete response to some questions in the time available. We have however aimed to highlight the main issues for managed CLOs as opposed to other securitisations, in the hope that we can engage in productive dialogue with the Central Banks around that asset class.

The LMA would be pleased to provide additional information on the CLO market following the closure of this consultation, and would also be keen to meet in the coming months to assist the Central Banks on a bilateral basis with any questions pertaining to the CLO market.

Whilst CLOs returned to Europe during 2013, with new issuance totalling €7.4 billion by the end of the year, some challenging obstacles remain for the market in the medium term. Risk retention rules continue to restrict the ability of managers, who are typically thinly capitalised, to issue significant numbers of transactions. On the asset side, leveraged loan supply has been significantly down on pre-crisis volume, reaching €67.6 billion across leveraged buy-out and non-leveraged buy-out volumes by the end of 2013 compared to €165.5 billion by the end of 2007[1]. Furthermore, an increasing proportion of pre-crisis CLOs have reached the end of their re-investment period. At the end of 2013 there were approximately €78-€79 billion of CLOs currently outstanding in Europe of which there were €52.7 billion of CLO transactions in their amortisation period at the beginning of 2014, with another €15.5 billion (33 deals) of CLO 1.0s expected to enter amortisation by the end of 2014[2]. The vast majority of present European CLO investment capacity is rolling off and is not being replaced in sufficient volume by the new issue market owing in part to regulatory constraints arising from risk retention requirements.

Furthermore, the figure of €7.4 billion for European CLOs is merely a fraction of U.S. issuance over the equivalent time – which totalled $81.8 billion[3]. In our view, the speed of recovery in the U.S.

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1 Source - S&P LCD

2 Source – S&P LCD referencing Deutsche Bank.

3 Source – S&P LCD

CLO market versus that in Europe is at least in part due to the impact of risk retention on EU CLO managers.

We think it is helpful in reading this paper to remember that "open market" managed CLO portfolios have an uneasy fit into the definition of securitisation used in CRR and other regulations and have encountered significant problems in complying as a result. One result of this is to restrict the number of CLO managers who can bring deals to market, thereby reducing investor choice. Additionally, even larger managers are restricted as to the number of deals they can complete, due to the size of the retention requirement they have to hold as sponsor.

CLOs differ from most static-pool securitisations in some fundamental ways. Below is a brief description of the timeline of a CLO:

A CLO portfolio will not usually be complete on closing of the securitisation. During the warehousing period, prior to issue of bonds by the CLO vehicle, the CLO vehicle accumulates assets from the open loan market, and these assets must meet the eligibility criteria.

Once these assets reach a critical mass, the CLO vehicle securitises them by issuing notes to investors in the market. Following note issuance, the manager continues to purchase assets on behalf of the CLO vehicle, using the proceeds from the notes issuance, until the target value of the portfolio is reached. This "ramp-up" period may continue for up to six months after closing.

There follows a reinvestment period (typically four to five years after closing), during which the manager i) can trade assets up to a certain percentage (usually 20-30% annually), and any assets which are "credit improved" "credit impaired" or defaulted provided the new assets meet the eligibility criteria and certain tests (described in our response to Question 7 below) are met, and ii) reinvest principal proceeds from the assets in buying new assets.

After the reinvestment period finishes, i) unscheduled principal payments received from the underlying assets and ii) sale proceeds from "credit improved" and "credit impaired" assets may also be reinvested by the manager (to the extent they are not required to pay items in the principal priority of payments such as any interest shortfalls on senior notes). Other principal receipts after the reinvestment period are used to redeem the notes sequentially, and many deals also have a clean-up call once the portfolio falls to 15-20% of its original target size.

Such "managed" CLOs provide banks, pension funds, insurance companies and other institutional investors with access to investment in the leveraged loan market but with robust portfolio quality requirements, structural protections and credit enhancement built in to the transaction to reduce risk. These features are outlined in Questions 6 and 7 below. Typically, CLO notes are not designed to amortise earlier than 4-5 years, hence are longer-term than some securitisations, which makes them attractive for investors who need to match their investment to their longer-term liabilities. CLOs do not rely on refinancing as the portfolio is comprised of assets in which there is an open market. Principal is paid to noteholders as assets amortise or are sold (to the extent not reinvested) following the end of the reinvestment period.

More detail as to the composition of the portfolio and the structural features of CLOs is given in our answers to the specific questions below.

List of Questions

1. **DO RESPONDENTS AGREE WITH THE BENEFITS OF A WELL-FUNCTIONING SECURITISATION MARKET AS OUTLINED IN SECTION 2?**

   We largely agree with the benefits outlines in Section 2 of the DP. With respect to managed CLOs, we would add some further comments.

   As CRD IV comes into effect, non-bank institutional lending will be necessary in order to inject much needed credit into the loan markets. The continuing development of the CLO market is, in the view of the LMA and the Working Group, a key component of this initiative.

As the well-publicised €122 billion "refinancing wall" approaches, there is a significant risk that many European corporate borrowers will be unable to refinance their existing debt via traditional methods, such as through relationship banks and the syndicated loan market. At the same time as there is a peak in refinancing, the European loan market faces reduced lending capacity. Primarily, banks, which provided over 60% of pre-crisis credit, are less able to lend under revised regulatory capital regimes - a trend likely to continue as the leverage ratio is introduced. CLO vehicles provide a crucial means of bank de-leveraging. The pre-crisis CLO universe is reaching the end of its permitted reinvestment capability, whilst new CLO issuance has been low due to European-specific regulatory change. The lower lending capacity will be further impacted by the regulatory capital treatment of European credit institutions following the implementation of CRD IV, which is likely to make lending to the sub-investment grade sector less attractive for European credit institutions.

Whilst the high yield bond market or the IPO market can fill a portion of this refinancing gap, many borrowers will be unable to access these markets for a number of reasons, such as their enterprise value, size or credit profile. Therefore, as European corporate refinancing requirements substantially increase, there is a concurrent risk of refinancing options and investment capacity substantially diminishing. The U.S. CLO market has experienced a significant revival over the past two years whilst in Europe the risk retention rules in particular have created a number of difficulties for the CLO market.

CLOs do not re-securitise assets. The underlying loans in a CLO portfolio support private and public companies across Europe, which in turn create employment for millions of people throughout Europe.

2. **DO RESPONDENTS AGREE WITH THE IMPEDIMENTS TO AND ECONOMIC CONCERNS OF INVESTORS THAT HAVE BEEN IDENTIFIED? DO RESPONDENTS THINK THAT THERE ARE ANY ADDITIONAL IMPEDIMENTS TO INVESTORS, AND IF SO, WHAT ARE THEY? DO RESPONDENTS AGREE THAT THE INFRASTRUCTURE CONCERNS RAISED ABOVE AFFECT THE ECONOMICS OF SECURITISATION?**

2.1 *Solvency II and the EIOPA technical report*

The proposed capital treatment of CLOs in the Solvency II regime give us significant cause for concern. In September 2012, the European Commission requested EIOPA to review the calibration of capital requirements for investment in certain classes of long-term finance which provide management of long-term risk for insurers. In December 2013, EIOPA produced that report, entitled "Technical Report on Standard Formula Design and Calibration for Certain Long-Term Investments" (The **"2013 Report"**). In the 2013 Report, the classes of securitisation transaction which qualify as "Type A" and therefore attract lower capital charges expressly exclude CLOs other than SME CLOs. The criteria for qualification as "Type A" securitisation in the 2013 Report have now been included in Part I of EIOPA's "Technical Specification for the Preparatory Phase" of Solvency II based on the working documents of the Level II delegated Acts to be published later this year, which was published on 30 April (the **"Technical Specifications"**). Our belief is that if CLOs were to remain in the "Type B" category proposed by EIOPA, there is a real risk that insurers required to use the Solvency II Standard formula may pull out of investing in CLOs altogether as an asset-class.

We believe that the categorisation of CLOs as "Type B" by EIOPA is based i) on a misunderstanding of the nature of the risk-mitigating structural features of managed CLO transactions and ii) a focus on the widening spreads which resulted from rating downgrades of CLO tranches during the financial crisis - which downgrades were not borne out by default rates, and have since been largely reversed.

The 2013 Report states (at page 121) "The underlying of CLOs and CDOs is typically speculative-grade corporate debt". This is only part of the picture. The vast majority of CLO "2.0" portfolios consist of 90% or more *senior secured* bonds or loans to sub-investment-grade corporates, and a typical CLO portfolio will contain no ABS or synthetic exposures. Whilst the category of assets securitised by managed CLOs is leveraged loans, overwhelmingly it is only the senior secured portion of the leveraged loan which goes into the CLO. There is typically a minimum rating requirement for the underlying assets going into the portfolio. The portfolios are actively managed in accordance with strict portfolio tests. Furthermore, mark to market haircuts are applied to portfolio assets in breach of CCC excess requirements and to defaulted obligations which can result in the failure of the CLO to meet coverage tests thereby triggering cash flow sweeps in the interest priority of payments to repay note-holders in order of seniority. When coverage tests are triggered, all cash is diverted to repay investors, including cash which would have paid the majority of the CLO manager's fees. The transactions also benefit from credit enhancement provided by subordinated notes, to ensure that the rated notes are supported to a level justifying their rating.

We also believe that EIOPA's focus on rating downgrades as the main indicator of quality of an asset class is inappropriate. The 2013 report places CLOs in "Type B" on the basis that 72.3% of leveraged loan CLOs were downgraded between mid-2007 and end of 2012. We would dispute this figure as representative of the performance of European CLO tranches.

Firstly, a significant amount of downgrades were a result of a change in the default models in rating criteria, and not actual default rates. S&P had updated their criteria in September 2009, and acknowledged that "Virtually all of the "AAA" downgrades resulted predominantly from the application of the updated criteria, rather than transaction performance."[4]

Moody's updated their criteria on 4th February 2009, also changing their default probability model[5], and reviewed CLO tranches against the new criteria. Of the 395 Aaa-rated CLO tranches in Europe at the start of 2009, 47% retained their rating, while 53% were downgraded.[6]

Secondly, CLO transactions continued to perform well in relation to other asset classes following the downgrades to end of 2012, and S&P and Moody's both upgraded a significant proportion of tranches in CLO transactions as a result. As stated in the S&P research paper relied upon by EIOPA[7], S&P subsequently upgraded a number of tranches in CLOs due to the operation of "structural deleveraging" (explained below). In November 2011 Moody's announced that 81% of the European CLO tranches originally rated Aaa were back to their original ratings, as a result of revised rating criteria in June 2011 together with improved par coverage and credit quality[8]. The downgrade figure of 72.3% relied upon by EIOPA is therefore not representative either of default rates in CLOs, or in fact downgrades in existing CLO tranches in Europe.

Furthermore, CLOs should be able to fulfil the structural requirements of "Type A" securitisations proposed by EIOPA. Annex I to this letter contains our comments on compliance by CLOs with the various EIOPA requirements contained in the Technical Specifications.

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4 "Summary of Rating Actions on European CLOs Following Corporate CDO Criteria Update" – S&P Ratings Direct, 15 June 2010.

5 "Moody's updates Key Assumptions for rating CLOs" – Moody's Global Credit Research 4 February 2009.

6 "Moody's Completes European CLO rating review" – Moody's Global Credit research 21 January 2010.

7 Pre-Crisis European Structured Finance Still Exhibits Few Defaults" Standard and Poors April 2013", page 6

8 See "Moody's completes European CLO rating sweep, upgrades 969 tranches" – Moody's Global Credit Research, 22 Nov 2011.

With respect to the content of the portfolio- whilst our view is that historical default rates paint a much better picture of CLO asset performance than the 2013 Report would seem to suggest, our proposal in our response to question 9 below contains portfolio requirements aimed at enhancing the credit quality of the portfolio – something which is happening anyway in more recent CLOs.

2.2 *Risk Retention*

The European risk retention requirements in the Capital Requirements Regulation (**"CRR"**) and the Alternative Investment Fund Managers Directive (**"AIFMD"**) have proved a significant challenge for investors in the CLO market. Despite the recommendations of IOSCO[9] that an exemption from retention be considered for managed CLOs, the "one-size fits all" nature of the retention requirement was imposed and has presented significant difficulty for CLO structures. As managers have struggled to fund and hold the retention and the related capital, so investors have struggled with the requisite assurance that the transaction is compliant if any mechanism is used other than simply the manager holding and funding the retention from its own balance sheet (see below).

Similar requirements are due to apply to insurer investors once Solvency II comes into force, and to UCITS funds once the implementing regulations are made under the new UCITS Directive.

Apart from the structuring of the retention itself at the outset of the transaction, there are ongoing difficulties with the retention rules which potentially affect returns to investors and investors' ability to remove a failing manager.

2.3 *Change in sponsor or originator*

The retention rules as yet contain no clarification as to how compliance can be achieved in circumstances where the CLO manager holds the retention and is subsequently removed. CLO documentation allows a CLO manager to resign or be removed under certain circumstances, but in such circumstances, the CLO manager would no longer be a "sponsor" or an "originator" once it is no longer managing the CLO. In addition, requiring the transfer of the retention to the replacement CLO manager may in fact make it difficult for investors to find a replacement CLO manager and any removal of a CLO manager is only effective if a replacement CLO manager is appointed. This is an example of where the rules which are clearly intended to protect the interests of investors may actually serve to prejudice them.

2.4 *Inability to reinvest trading gains when holding first loss*

As the rule requires retention by way of a first loss position to be measured by reference to the nominal value of the underlying assets, CLO managers who realise trading gains are unable to reinvest them to buy assets with a greater par value, as this would mean having to restructure the transaction so that they hold a higher notional amount as a first loss position. Instead, trading gains are having to be paid out to noteholders rather than reinvested. It would be in the interests of noteholders to allow the CLO manager to choose to reinvest receipts from trading gains, and with this in mind we would suggest that the measure of the retained interest be consistent – either to reflect a percentage of the amount invested in the assets on day one of the deal, or a percentage of the tranches sold to investors.

2.5 *Basel II and new Basel Proposals for the securitisation framework.*

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[9] "Global Developments in Securitisation Regulation" – IOSCO, 16th November 2012, page 48

We agree with the remarks made in the DP that the BCBS proposals fail to reflect the true position with regard to losses incurred in European securitisations.

At this stage (and as we agree with the remarks made in the DP on this subject) we do not propose to specifically analyse here the treatment proposed for securitisation exposures which are CLOs under the Basel Committee on Banking Supervision's (**"BCBS"**) second consultation "Revisions to the Securitisation Framework" published in December 2013. However we note that the BCBS has rejected strict capital neutrality as a premise for the application of risk weights to the tranches of a securitisation when compared with the capital treatment of the underlying exposures. There is also a risk weight floor of 15% for senior AAA positions in securitisations, whereas under the current framework these can achieve a risk weight of 7%. The risk weight cap and the limited "look-through" approach for senior securitisation exposures mitigates this to some extent, but the capital neutrality of the Basel II framework has been removed.

We believe that capital neutrality should be a basic premise for the regulatory capital treatment of securitisation exposures. The capital charges applied to a pool of exposures prior to securitisation should be broadly equal to the total capital charge applied to the tranches of the securitisation, to reflect the unchanged economic risk across the pool. With respect to senior tranches, a cap on the capital charge of a senior tranche to the level of the look-through approach in Basel II should be preserved, to reflect the benefit of the credit enhancement in the securitised tranche.

In the case of a managed CLO, the portfolio is managed to ensure compliance with strict debt coverage tests and collateral quality tests which meet rating agency requirements. This added layer of protection is not available to direct investors in the loan portfolio, and the capital charge should reflect this. Furthermore, whilst the BCBS has as yet not made a distinction in the December 2013 paper between "Type A" and "Type B" securitisation, any proposal to ascribe higher capital charges to banks investing in CLOs would be in our view detrimental, and could pose a real risk that bank investors would pull out of the CLO market, leaving the universe of CLO investors insufficient to keep CLO issuance economically viable.

3. **DO RESPONDENTS AGREE WITH THE IMPEDIMENTS TO AND ECONOMIC CONCERNS OF ISSUERS THAT HAVE BEEN IDENTIFIED? DO RESPONDENTS AGREE THAT THE INFRASTRUCTURE CONCERNS RAISED ABOVE AFFECT THE ECONOMICS OF SECURITISATION?**

The main economic concerns of issuers of CLOs (and in this context we equate CLO managers with issuers) centre on the impact of risk retention rules. These fall largely into two areas – structuring the retention itself, and dealing with funding and cost of capital.

3.1 *Risk Retention*

The main problem for CLO managers in complying with the retention requirement is funding the retention and the related capital requirement. Whilst banks in the normal course take credit risk on the portfolios they originate prior to securitisation, CLO managers do not. Banks hold capital against that credit risk before any securitisation, and by securitising, hope to achieve significant risk transfer (SRT) and reduce the capital they are required to hold. Even if they fail to achieve SRT, the capital charge to a bank is capped at the charge applicable to the original portfolio.

Contrast a CLO manager – the CRR applies a less onerous own funds requirement to an investment manager which doesn't deal as principal or underwrite financial instruments, recognising that these managers do not usually take credit risk. Managers can, and do, use an own funds calculation equal to a portion of fixed overheads where they do not take significant credit risk. In complying with the retention requirement, managers are effectively being penalised by having to hold credit risk, and the corresponding capital, following a securitisation, where prior to it they held none. Banks meanwhile will never have to increase their capital charge on a portfolio they securitise, and are reducing their credit exposure by securitising, not increasing it. This seems incongruous, when the aim of the retention requirements is to realign the interests of those who repackage risk with those of investors.

Our view is that there are clear structural and economic differences between independently-managed CLOs and balance-sheet securitisations in which the originate to distribute model could exist. As a result, retention is not the most suitable method of alignment of interest for managed CLO transactions.

CLO managers are not transferring credit exposures from their balance sheets, unlike a typical securitisation. CLO managers are selecting and trading assets in the liquid markets, to create an investment return for third party clients, much as other portfolio managers do in the same asset classes globally. MiFID and AIFMD both address the conflicts of interest which Article 405 was intended to address. These directives require CLO managers to act honestly, fairly and professionally and in the best interests of their clients, and to manage conflicts of interest so as to avoid damage to clients' interests. CLO managers in the United States are subject to similar requirements under the Investment Advisor's Act. Accordingly, firms must comply with these obligations when managing the portfolios of CLOs and other funds.

Furthermore, CLO managers are already incentivised to act in the best interest of the CLO noteholders through the structure of their fees. CLO managers have always had an alignment of interest due to the unique structural features of these transactions. This was the case pre-crisis and continues to be the case now. Only a small fee (typically 15 basis points) is paid to the manager prior to the payments of interest to noteholders, and this fee covers only a portion of the manager's operating overheads. There is also a subordinated fee (typically 35 basis points) to cover any remaining running expenses of the manager, but this fee is only payable following the payment of all interest due to the rated noteholders. In the event there is under-performance by the manager these fees are "switched off" and amounts are instead used to repay the noteholders in accordance with their ranking in the priority of payments. Lastly, CLO managers are usually entitled to an incentive fee which is only paid if the interest due on interest-bearing notes has been paid and the unrated subordinated debt has received a pre-agreed rate of return. This compensation structure ensures that the interests of CLO managers are appropriately aligned with those of CLO investors throughout the life of the transaction.

It should be noted that asset managers managing the same underlying assets in other types of investment vehicle, including those with leverage but which are not securitisations, are not required to hold a retention.

As a result in the context of the EBA's continuing workstream to review the CRR retention requirement, we have argued for an exemption for CLOs, as per the IOSCO recommendation. In the event that CLOs cannot be exempted, we would advocate a smaller retention requirement for sponsors such as CLO managers who are not originating the portfolio being securitised, in keeping with the manager's MiFID permissions (or third country equivalents) and in line with the exemptions from certain own funds requirements for portfolio managers with limited MiFID permissions under CRR. Nonetheless, it is recognised that any different treatment for CLOs in Europe may have to be based on explicit conditions which provide assurance that (i) investors' interests will be protected and any potential conflict of interest appropriately managed, and (ii) this treatment will only be available to vehicles which meet objective criteria. Our proposals for exemption or less onerous retention requirements are set out in Question 9 below.

3.2 *Cost of retention for CLO managers*

CLO sponsors meet the retention requirement using one of two of the five retention options – option 405(1) (a) ("vertical slice") or option 405(1)(d) ("first loss").

As most CLO managers do not deal as principal or underwrite financial instruments, they need to hold capital in an amount of i) the greater of their capital requirement for credit risk, or ii) an amount representing a quarter of their fixed overheads, under CRR. Prior to the retention requirements coming into force, many managers did not take any credit risk, and were therefore calculating capital based on their fixed overheads.

In holding the retention by way of first loss, assuming an unrated tranche of subordinated debt, managers applying the standardised approach to credit risk would have to apply a 1250% risk weight to their securitisation position. With a typical deal size in a CLO 2.0 being around €400m, a 5% holding as a first loss position will require capital of €20m.

To hold a vertical slice of the transaction, the manager needs to hold 5% of each of the tranches sold to investors (including 5% of the first loss tranche). Assuming a transaction with a total issuance of €400m, including €45m of subordinated debt. The capital charge on a 5% vertical slice is set out below:

Class of Notes	**Amount (€m)**	**Rating**	**Credit Quality Step**	**Risk Weight %**	**5% (€m)**	**Capital Charge (€m)**
Class A	215	AAA	1	20	10.75	0.17
Class B	50	AA	1	20	2.50	0.04
Class C	30	A	2	50	1.50	0.06
Class D	20	BBB	3	100	1.00	0.08
Class E	30	BB	4	350	1.50	0.42
Class F	10	B	5	1250	0.50	0.5
Sub Notes	45	N/A	N/A	1250	2.25	2.25
Total					**€20m**	**€3.52m**

The total capital charge to the CLO manager for holding a vertical slice on this example transaction is €3.52m, against a €20m capital requirement for holding a first loss position. As mentioned in Question 10, most CLO managers do not hold any of the underlying portfolio prior to the CLO transaction and the retention rule will always involve a significant increase in capital and costs, unlike bank originators who (i) can benefit from lower capital charges by securitising, or at least have those capital charges capped at the capital charge which applied to the underlying portfolio and (ii) are able to apply the IRB approach in calculating their capital charge for the retention, which will in many cases result in a lower capital charge than that produced by the standardised approach typically used by CLO managers.

As well as their own capital cost, most CLO managers will also require funding for the purchase of the retention positions. This comes with additional costs to the CLO manager - even if the retained positions are used as collateral in a secured financing they are likely to require significant initial margin to be paid to the counterparty.

4. **DO RESPONDENTS THINK THAT THERE ARE ANY ADDITIONAL IMPEDIMENTS TO ISSUERS, AND IF SO, WHAT ARE THEY?**

Whilst we agree with the issues raised in the section of the DP entitled "Impediments to Issuers", we believe that there are additional regulatory constraints which impact managers in structuring CLO transactions, contracting with counterparties to the transaction and ensuring the optimum management of the portfolio for investors.

4.1 Regulatory impediments

EMIR and availability of Swap Providers

Whilst CLO vehicles will only be entering derivatives for the purpose of hedging currency and interest rates between the underlying assets and the notes issued by the vehicle, the clearing obligation in EMIR is measured by reference to the group of which the vehicle is part. As swap counterparties cannot determine the level of OTC derivatives entered by any such group, and as the boundary of such a group is unclear in any given case due to lack of clarity in the EMIR text, they typically require issuers to represent that the CLO vehicle is a non-financial counterparty below the clearing threshold. Should this be incorrect at any time during the term of the swap, the swap counterparty will then be able to terminate the swap.

However, for the same reason, Issuers are often unable to determine the boundaries of their EMIR "group" for the purpose of the clearing threshold. This leaves uncertainty as to whether the CLO vehicle will be able to enter into its rate and currency swaps at the point at which the manager buys non-euro assets into the portfolio, as if the vehicle were above the clearing threshold due to group derivative contracts, any such swap would need to be cleared and margin provided to the CCP. As the issuer will have no additional collateral to answer margin calls, there could potentially be a failure to pay and a swap termination. As a result, managers now need to disclose to investors that in the event the issuer is or becomes part of a group whose notional value of derivative contracts is over the clearing threshold, the CLO will not be able to invest in non-euro assets due to being unable to enter the hedge. The result of that is that the regulation is fettering the manager's ability effectively to manage the portfolio.

A specific exemption from the clearing obligation for securitisation vehicles which are only using derivatives for qualifying hedges would potentially have removed this issue.

Similarly, the trade reporting obligations under EMIR have led to CLO vehicles and their managers having to delegate reporting to the hedge counterparty. This increases costs in the transaction which inevitably are passed on to investors. Again, an exemption for securitisation SPVs would have solved this issue - whilst the trade would still be reported by the financial counterparty, and would be part of the financial counterparty's risk mitigation obligation.

The recently-published draft Regulatory Technical Standards detailing the requirements for exchange of collateral under Article 11(3) of EMIR (the "Margin RTS") compound the problem as again there is no specific exemption for securitisation vehicles. Typically, credit support arrangements between the SPV and the swap counterparty would operate in one direction, so that margin is only posted to the SPV as collecting party. This is a result both of rating agency requirements that the counterparty posts collateral, and the fact that the SPV has no ability to post cash or securities as collateral to the swap provider. Whilst CLO vehicles are usually incorporated in the EU and may be able to make use of the various opt-outs available in the Margin RTS, again this will depend on the SPV being below the clearing threshold and the attendant problems this raises. Furthermore it is not clear that the opt-out can work in one direction, so as to allow securitisations to continue their present hedging arrangements.

As mentioned in the DP, the universe of swap providers who can meet rating agency requirements for CLOs is already limited. Those who are operating in this market require comfort as to the issuer's NFC- status under EMIR. It is becoming commonplace for swap providers to insist on termination rights in the event that the issuer is deemed to be over the clearing threshold due to the OTC derivatives position.

AIFMD and "AIFs"

AIFMD fails clearly to exempt CLO vehicles from the definition of an Alternative Investment Fund (**"AIF"**). The exemption for securitisation special purpose vehicles (the **"SSPE Exemption"**) is drafted with reference to a different definition of securitisation from that used in CRR, and refers to an SPV acquiring obligations from "an originator", whereas a CLO vehicle acquires assets by purchasing them in the market. Whilst most EU competent authorities appear to be taking the view that a CLO issuing vehicle will nevertheless not be treated as an AIF, ESMA has not as yet given any guidance on whether the SSPE Exemption extends to CLOs and as a result, there is uncertainty as to whether CLO transactions could effectively be brought within the AIFMD compliance regime. Quite apart from the increased costs of compliance, which would ultimately be passed on to investors, if required to register as AIFMs, CLO managers would be unable also to hold the requisite MiFID authorisation which will allow them to qualify as a sponsor under CRR.

As some jurisdictions have not given clear indications that CLO vehicles are exempt from the definition of an AIF, managers have no clear guidance as to whether they can market CLOs into those jurisdictions.

5. **DO RESPONDENTS AGREE THAT MARKET LIQUIDITY MAY BE A BARRIER TO A WELL-FUNCTIONING SECURITISATION MARKET?**

Although we are not sure what else is meant by a "well-functioning" market besides liquidity (default rates are dealt with below), the question appears somewhat self-evident. Liquidity is a vicious (or virtuous) circle. If the CLO market is constrained in size by regulation it will inevitably be less liquid, whilst more issuance results in greater liquidity. However the CLO market does not currently suffer from liquidity problems. There are no public data available on trading volumes for European CLOs, but in the U.S. some, though not all, trades are reported in TRACE. Recent data there show that in 2013, some $78.7 billion of CLO paper was traded, so this is a market that investors understand and continue to support.

6. **THE VIEW OF THE BANK OF ENGLAND AND THE ECB IS THAT A 'QUALIFYING SECURITISATION' SHOULD BE DEFINED AS A SECURITY WHERE RISK AND PAY-OFFS CAN BE CONSISTENTLY AND PREDICTABLY UNDERSTOOD. DO RESPONDENTS AGREE WITH THIS DEFINITION? WHAT CHARACTERISTICS OF A 'QUALIFYING SECURITISATION' NOT ALREADY INCLUDED IN THE PRINCIPLES IN BOX 3 SHOULD WARRANT SUCH TREATMENTS?**

6.1 *Consequences of certification need to be addressed*

The DP does not specify what the consequences of classification as a qualifying securitisation may be. As such, it is not possible to answer this question on the basis of the DP as it is currently presented. With that in mind we have the following comments:

If it is the case that a qualifying certification means, for instance, that the due diligence requirements for investors are to be streamlined, or standard form reports produced, then "a security where risks and pay-offs can be consistently and predictably understood" is appropriate. This suits some securitisation asset-classes better than others - managed CLOs are backed by a portfolio which is traded and the constitution of which can change significantly over time. Thus the value of standard-form loan-by-loan reporting on day one is diminished, and the value of reporting that confirms compliance with the tests is heightened. However, investors are in fact able to see the portfolio on a regular basis, and can model through stress scenarios themselves using Intex, and potentially price the underlying portfolio using third party providers such as LoanX and Markit. This is a level of transparency which is not available to investors in other securitisation asset-classes.

If however a qualifying certification results in reduced capital requirements for those securitisations which qualify, and increased capital for those that do not, then this should be based on probability of default and loss given default in the securitisation position being addressed, and should not be based primarily either on asset class or standardisation of reporting. Capital is a "creditors' buffer", and exists to absorb losses before creditors will suffer a loss. Standardisation of documentation, nor conformed prospectuses, nor the level of understanding of the investor have any effect at all on the probability of and loss given default in the transaction. As such, our view is that structural characteristics of transactions which reduce the risk to the investor should also reduce the capital charge. With respect to CLOs, these are outlined in response to Question 7 below.

7. **DO RESPONDENTS HAVE ANY COMMENTS ON THE PRINCIPLES IN BOX 3?**

Paragraph 124 in Box 3 states that "securitisations with particular structural features – with respect to underlying assets and structural safeguards – have performed better than for the structured finance market as a whole". We agree with this statement. However we strongly urge the ECB and the Bank of England to determine "performance" in this context based on actual default rates and not based on the occurrence of rating downgrades on securitisation tranches.

Our view is that EIOPA, in its distinction between Type A and Type B securitisations, has focused too heavily on rating actions, to the exclusion of actual performance and the structural features driving it. The following table updates the default and downgrade rates for various ABS asset-classes in Europe between mid-2007 and Q4 2013, (the Q3 figures were relied on by EIOPA in the 2013 report):

Summary of Mid-2007 to Q4 2013 Ratings Transition, Default, and Withdrawal Rates						
Asset class	**Total (bil. €)**	**Upgraded (%)**	**Stable (%)**	**Downgraded (%)**	**Defaulted (%)**	**Withdrawn (%)**
ABS	170.3	4.9	66.8	28.3	0.1	82.1
Non-credit card consumer ABS	68.0	8.9	61.5	29.6	0.1	87.8
Other ABS	69.1	3.4	57.6	39.1	0.0	70.6
Leveraged loan CLOs	70.6	2.3	31.4	66.3	0.1	23.9
RMBS	756.0	0.9	58.7	40.2	0.1	59.7
SME	103.0	0.8	52.8	46.4	0.4	69.7

Source – S&P "Transition Study: 12-Month Rolling Default Level Drops To Its Lowest Since Mid-2010"- 28 April, 2014.

The table shows that despite downgrades, Leveraged Loan CLOs have a *default* rate of only 0.1% - *the same as overall RMBS and non-credit-card consumer ABS*, both of which asset-classes are included in EIOPA's "Type A" securitisation category. Furthermore, securitisations of SME loans, which are also included in Type A, have a default rate *4 times* that of CLOs. We comment above in our response to Question 2 on the principal drivers of the upgrade/downgrade statistics - which are explained in part by amendments in rating agency criteria and not actual performance. Furthermore, these figures are largely based on the performance of CLO 1.0 transactions, issued pre-crisis.

CLO 2.0 transactions, issued since 2013, have generally been structured more conservatively than their pre-crisis counterparts. European CLO 1.0 structures typically featured lower senior debt attachment points (around 30%) than those which are featuring in CLO 2.0s (typically at least 40%) meaning that senior note-holders benefit from increased levels of subordination in CLO 2.0 structures. In addition, CLO 2.0 governing documentation places more restrictions on manager behaviour relative to their CLO 1.0 counterparts. Shorter re-investment periods (3-4 years versus 5 years) reduces the time-frame over which the manager can re-invest proceeds. There are more onerous restrictions over what assets can be purchased, with synthetic or structured finance exposures not permitted and, on occasion, strict limits placed on the purchase of loans from peripheral economies and those "covenant-lite" in nature.

Aside from this, the following structural features of CLOs reduce risk to investors and should be considered in applying any quality certification which affects the capital risk weight applied to the securitisation position:

7.1 *Risk-reducing characteristics of managed CLOs*

We cannot stress too heavily the fact that the assets in a CLO portfolio are only a part of the performance of the CLO itself. As we state above, CLOs give investors the ability to invest in the loan market with the benefit of structural enhancements and active management which significantly reduce risk to the senior noteholders when compared with a direct investment, or with a static loan portfolio. The EIOPA Type A criteria, in focusing on the asset-class, have failed to recognise the weight that should be given, uniquely in this asset class within the securitisation space, to structural deleveraging and active management.

7.2 *Structural deleveraging*

In summary, structural deleveraging in a CLO interrupts the normal priority of payments in the event that the quality of the portfolio falls below a certain level. The debt coverage tests measure the amount of over-collateralisation in the CLO. In a managed CLO transaction, there is typically a maximum of 7.5% CCC (or below) rated assets in the portfolio. If these low-rated assets rise above that percentage, those assets will be treated as valued at market value rather than at the usual par value in meeting the debt coverage tests. If the debt coverage tests fail as a result, no interest can be paid out on the junior notes, the majority of the CLO management fees and all receipts from the assets will go to pay principal on the senior notes sequentially until the pool complies again with the coverage tests. The same applies to failure of the coverage tests as a result of defaulted assets. Thus the senior notes benefit both from the credit enhancement provide by the junior tranches *and* the protection of senior income and principal *prior to* any default. In a static-pool securitisation, whilst mechanisms may be built in to ensure excess income supports deficiencies on the senior notes, this is not done on a managed basis. This structural deleveraging was partly responsible for the subsequent upgrades on many of the AAA CLO tranches which were downgraded by S&P in 2009.

In addition, post the expiry of a CLO reinvestment period, to the extent that portfolio collateral is repaying and the manager is unable to reinvest these proceeds (the circumstances are usually related to note ratings or certain test compliance), these proceeds are ultimately repaid to note holders in order of seniority. This is another mechanism by which structural deleveraging can occur and is an inherent characteristic across European CLO 1.0 and 2.0 structures.

7.3 *Portfolio management*

Management of a CLO portfolio is subject to collateral quality tests, overcollateralization tests and concentration limitation tests (the **"Tests"**) - rigorous rating agency tests measuring over-collateralisation and various portfolio characteristics which the manager is required to comply with in order to continue to be able to reinvest in new assets. These portfolio-level tests are already industry-standard and are particular to managed CLOs as opposed to securitisations of static portfolios. The Collateral Manager has to meet the Tests on an ongoing basis or cash will be used to redeem the transaction.

The Tests also allow the manager to provide detailed and transparent disclosure to investors in respect of the portfolio (see below). They cover data such as diversity of obligor by industry and geography, weighted average spread on the assets, weighted average fixed rate coupon, weighted average rating and weighted average life of the underlying assets.

Unlike traditional asset-backed securities, the underlying portfolios of CLOs are typically not purchased from one originator or seller but are typically sourced in the primary or secondary market by regulated investment managers who are independent of any originator or seller of the loans. The CLO investment manager is able to independently assess the quality of the portfolio and is free of the negative incentives which can arise in an originate-to-distribute securitisation model.

Maturity mismatch should not lead to a concern for managed CLOs. The portfolio eligibility criteria typically include the condition that no asset can have a maturity date falling after that of the notes. Furthermore, the Tests include a weighted average life test, which must continue to be satisfied, or if failing, improved in order for the manager to continue to reinvest proceeds from the portfolio. The weighted average life test works to ensure smoother repayments of principal over the life of the transaction. To the extent that assets in the portfolio are maturing following the end of the reinvestment period, the notes can be repaid and will amortise, and at any time during the transaction a clean-up call is typically available to the manager once the value of the portfolio falls below a target amount.

7.4 *Prepayment risk reduced*

As outlined above, during the reinvestment period which continues for 4-5 years after closing principal proceeds are reinvested by the CLO in new assets. Following the end of the reinvestment period, unscheduled principal proceeds can still be reinvested subject to there being no breach of the portfolio tests. This means that there is a reduced risk of pre-payment of notes prior to their scheduled amortisation when compared with a static pool of loan assets.

7.5 *Credit quality of underlying assets*

As mentioned above, we believe that the assumptions regarding the quality of underlying assets which have led to CLOs falling outside the proposed class of "high-quality" securitisations in the EIOPA 2013 report are incomplete.

The assets in a CLO portfolio are purchased according to the eligibility criteria, which specify the conditions for individual loans, such as jurisdiction, rating, non-convertibility, tax and regulatory conditions etc., and as at the effective date the portfolio profile and collateral quality tests must be satisfied. CLO managers may also only invest in assets during the reinvestment period if following investment, the portfolio profile and collateral quality tests remain satisfied or if not satisfied, they must be improved following such investment. These tests ensure diversification of assets by industry, limit maximum concentration in a single borrower or borrower type, and ensure quality of loan covenants etc. The active management of the portfolio ensures the continued compliance with these tests. Thus CLOs have built-in protection for the quality of the assets in the portfolio.

Furthermore, it is worth noting recent trends in certain illustrative credit metrics of the underlying loans in which CLOs typically invest. The trend speaks to more conservative leveraged loan deal structuring which helps to lower the overall risk of an investment opportunity the CLO chooses to participate in:

- The increasing level of retained equity in the underlying leveraged loan transactions in which CLOs invest (42.37% in 2013 versus 33.64% in 2007[10] indicates that, as a percentage of the value of the business in question, private equity sponsors are contributing more of their own funds and are less reliant on debt to help fund the overall purchase price. Investors in the debt benefit from higher valuation coverage and increased equity subordination.
- Ratios of EBITDA to cash interest on debt are one way to analyse the ability of businesses to service the cash interest component of their debt service obligations. Increasing multiples of EBITDA to cash interest (4.18x in 2013 versus 2.47x in 2007)[11] indicate that, from the outset of any particular transaction, businesses can more easily cover their debt interest obligations compared to pre-crisis transactions.
- Finally, specifically looking at the senior secured component of a company's capital structure (to reflect where a CLO is most likely to lend money), ratios of senior secured debt to EBITDA have been trending down (3.73x in 2013 versus 4.56x in 2007).[12] This generally reflects more conservative deal structuring, resulting in more sustainable capital structures over the lifecycle of these leveraged loan transactions when compared to pre-crisis counterparts.

Our response to Question 20 contains comments on the specific criteria proposed in Box 3.

8. **DO RESPONDENTS THINK THAT A LIQUID MARKET FOR 'QUALIFYING' SECURITISATIONS USED FOR FUNDING WOULD RESULT FROM A 'QUALIFYING CERTIFICATION'?**

There will almost inevitably be a better perception of a product with a qualifying certification than of one without, and a probable increase in liquidity. However this does not mean that the quality of that product is increased. See our response to Question 9 below.

The corollary of this is that products without the qualifying certification could see a substantial reduction in liquidity, and a widening in spreads, although default rates will not have changed. Ultimately, certification could be yet another regulatory hurdle which may prove worthless as it does not alter the underlying level of risk of investing in a product.

9. **THESE PRINCIPLES MAY THEN PROVIDE A FRAMEWORK TO AID VARIOUS AUTHORITIES AND MARKET PARTICIPANTS TO SET THEIR OWN ELIGIBILITY CRITERIA. HOW MIGHT SUCH A FRAMEWORK BE DEVELOPED? WHAT ROLE COULD THE APPROPRIATE AUTHORITIES PLAY IN THE PROCESS OF CERTIFYING THAT A TRANSACTION IS A 'QUALIFYING SECURITISATION'? WHAT ARE THE ASSOCIATED RISKS?**

Again, the appropriateness of development of a framework which certifies some transactions as "high quality" depends on the consequences of such a certification. An implicit regulatory stamp of approval will inevitably mean that investors rely to an extent on that stamp as a representation that the product is lower-risk, particularly if the associated capital risk-weights are lower than other similar products without such a stamp. This could actually result, not in investors taking necessarily better investment

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[10] Source - S&P LCD

[11] Source- S&P LCD

[12] Source - S&P LCD

decisions, but instead investing in a smaller universe of securitisation instruments. The resulting positive correlation in an investor's portfolio would mean potentially greater losses should default levels in an asset-class increase.

In order to reduce the risk of such positive correlation, we would argue for a greater set of asset-classes being included in any "high-quality" certification - and instead the certification to be based on the structural protections built in to the transaction. Existing protections in CLOs are outlined above in response to Question 7.

In addition to those protections, we would suggest that a CLO which complies with the following criteria should be included in any "high-quality" class of ABS which receives preferential regulatory treatment:

(a) the securitised exposures must be managed on a continuing, discretionary basis by:

  (i) an EEA investment firm which is required to be regulated in its Home member State and which is subject to the Markets in Financial Instruments Directive ("**MiFID**") or an affiliate thereof; or

  (ii) a firm authorised under the Alternative Investment Fund Managers' Directive ("**AIFMD**") or an affiliate thereof; or

  (iii) a firm or an affiliate thereof which would fall within (A) or (B) above if its head office was situated in the EEA and which is subject to equivalent regulation in relation to the conduct of its business and its management of conflicts as a firm established in the EEA (for instance investment advisors registered under the US Investment Advisers Act of 1940, as amended);

(b) the CLO investment manager of the securitised exposures must undertake to the investors in the securitisation to comply with the regulatory requirements applying to it in relation to the management of conflicts of interest, in connection with its management of the securitised exposures (i.e. compliance with MiFID and/or AIFMD);

(c) the securitisation must contain provisions whereby the interests of the CLO asset manager are appropriately aligned with the interests of the investors during the whole life of the securitisation. It is recognised that this may be achieved by a material part of the manager's compensation for carrying out its duties being structured as an incentive fee, which will only become payable upon appropriate performance thresholds of the securitised exposures having been met;

(d) Investor reports should be provided monthly;

(e) In addition, the following portfolio characteristics could be provided for in a definition of CLOs to ensure that only certain types of structures would actually constitute a CLO:

  (i) it contains a high percentage of senior secured bonds or loans to corporates;

  (ii) it does not contain any asset-backed securities or synthetic securities; and

  (iii) it is managed by an independent investment firm or an affiliate thereof which satisfies paragraph (a) above and who independently reviews, and individually selects, each asset to purchase in the primary or secondary market (with no obligation to purchase from any individual bank or originator);

In terms of the role of the authorities in the certification process, questions of liability for losses incurred by investment in instruments certified by the authorities would need to be addressed. The certification process could also cause potentially costly delay in closing, as disclosure would need to be made as to the certified status of the notes in the Prospectus.

10. **DO RESPONDENTS THINK THAT HARMONISATION AND FURTHER CONVERSION SOFTWARE COULD BRING BENEFITS TO SECURITISATION MARKETS? IF SO, WHICH ASSET CLASSES SHOULD BE TARGETED? HOW CAN ACCESSIBILITY TO THE EXISTING LOAN LEVEL DATA BE IMPROVED, SO THAT IT PROVIDES MOST VALUE TO INVESTORS?**

As there are no current ECB and Bank of England disclosure templates for CLO transactions, the question regarding conversion software is not applicable to this product.

Some harmonisation is of benefit to the CLO market. In principle, we have no objection to harmonised prospectuses and investor reports as long as the industry is involved in their development and issues of confidentiality are addressed. However, as the portfolio is managed, its composition changes over time and as a result our view is that loan-by-loan information is of less importance for managed CLOs than it would be for a static pool. See further our responses to question 12 below.

11. **DO RESPONDENTS THINK THAT INITIATIVES CURRENTLY UNDERTAKEN BY AUTHORITIES IN THE AREA OF STANDARDISATION OF PROSPECTUSES AND INVESTOR REPORTS AND TRADE TRANSPARENCY ARE SUFFICIENT OR IS THERE SCOPE FOR FURTHER IMPROVEMENTS? WOULD THE AVAILABILITY OF PROSPECTUSES AND STANDARDISED INVESTOR REPORTS IN A SINGLE LOCATION BE HELPFUL TO SECURITISATION MARKETS?**

We do not have strong views on this.

12. **DO RESPONDENTS AGREE THAT FACILITATING INVESTORS' ACCESS TO CREDIT DATA IN AN APPROPRIATE MANNER COULD SUPPORT THE EMERGENCE OF SECURITISATION MARKETS? WOULD CREDIT REGISTERS BE HELPFUL IN THIS RESPECT? IF SO, WHICH ASSET CLASSES SHOULD BE TARGETED? IN WHAT FORM COULD ACCESS BE GRANTED TO ENSURE THAT BORROWERS' CONFIDENTIALITY IS PRESERVED?**

The Bank of England Discussion Paper "Should the availability of UK credit data be improved?" from May 2014 suggests that the availability of credit data is not a concern in the large corporate credit market. We have no reason to disagree with this conclusion. Investors are attracted to private debt as it gives them access to a higher degree of control over assets and the ability to limit the downside through covenants, step-in rights and security, and access to credit data is not currently a concern.

13. **IN ORDER TO AID PERFORMANCE MEASUREMENT AND TO PROVIDE INVESTORS WITH INDUSTRY-LEVEL DATA, WOULD IT BE HELPFUL IF CERTAIN MACRO-ECONOMIC DATA WERE DISCLOSED OR IF BANKS/ NON-BANKS PUBLISHED CERTAIN AGGREGATED STANDARDISED DATA? WHAT ARE THE CHALLENGES OF PROVIDING POTENTIAL INVESTORS WITH SUFFICIENT BORROWER AND LOAN-LEVEL DATA TO ENABLE THEM TO MODEL CREDIT RISK, AND HOW CAN THESE BE OVERCOME? WHAT OTHER ELEMENTS WOULD IN YOUR VIEW HELP TO IMPROVE SECONDARY MARKET FUNCTIONING FOR HIGH-QUALITY SECURITISATION?**

Current disclosure to investors in the CLO market

As investors are returning to the CLO market our view is that they are finding the pre-investment disclosure adequate to comply with their due diligence requirements. The eligibility criteria for the assets are set out in the prospectus. The prospectus also tells investors what the content of investor reports will be on an ongoing basis following investment. If it would assist the ECB and the Bank of England we would be very happy to supply some more detail around the types of information included in monthly CLO investor reports. Our view is that this information is sufficient.

Investor reports are issued monthly to investors, containing the information set out in the Prospectus. These reports provide, subject to any confidentiality restrictions binding on the CLO vehicle, the principal balances of underlying loans, the location of the security, the domicile of the obligor, the rating, the industry category and the stated maturity.

Compliance with collateral quality, concentration limits and debt coverage tests will also be confirmed in the monthly investor reports along with the loan disclosure already provided. In this way, investors receive a wealth of information on the loans in the CLO portfolio on which to base their due diligence, and on which they can run their own models using Intex. Additional loan-by-loan information is of little additional value as there is no assurance that an individual loan will remain in the portfolio from month to month - what investors are really buying is the expertise of the Collateral Manager to manage a portfolio of loans in accordance with certain known parameters.

14. **DO RESPONDENTS THINK THAT AUTHORITIES SHOULD CONSIDER ENCOURAGING THE INDUSTRY TO DEVELOP SUCH BENCHMARK INDICES? WHAT RISKS MIGHT THESE GIVE RISE TO? WHAT INDICES WOULD BE USEFUL AND WHICH COULD BE EASILY PRODUCED?**

The CLO industry already uses benchmark indices for tracking the performance of underlying collateral, e.g. the Credit Suisse Leveraged Loan index.

With regard to benchmark indices of CLO tranches, we believe these are not necessary - investors already look at historic new-issue spreads, and ratings actions on existing tranches, and benchmarks of tranche performance will not add significantly to the information already available, whilst potentially creating reliance by investors on the benchmark rather than comprehensive due diligence.

15. **DO RESPONDENTS AGREE THAT ADDITIONAL INFORMATION IN THE FORM OF A MATRIX SHOWING IMPLIED RATINGS IF THE SOVEREIGN AND ANCILLARY FACILITIES RATING CAPS WERE TO BE SET AT HIGHER LEVELS WOULD BE HELPFUL IN SUPPORTING THE INVESTMENT PROCESS AND CONTRIBUTE TO INCREASED TRANSPARENCY AND LIQUIDITY?**

Sovereign ratings caps do not generally impact leveraged-loan CLOs as they are geographically diverse and therefore not dependent on the rating of a single sovereign.

16. **HOW IMPORTANT DO RESPONDENTS SEE THE IMPEDIMENT RELATED TO THE AVAILABILITY OF ANCILLARY FACILITIES? WOULD THE BENEFITS OF FACILITATING SPV BANK ACCOUNTS THAT FALL OUTSIDE THE ORIGINATOR'S INSOLVENCY ESTATE OUTWEIGH THE COSTS OF SUCH AN INITIATIVE? ARE THERE OTHER INITIATIVES IN THIS AREA THAT WOULD BE BENEFICIAL?**

(*NB: The reference to the originator's insolvent estate in Question 16 seems to differ from the context - the DP here talks about the account bank's insolvent estate and therefore our response concentrates on that. Issuer/transaction accounts will already be outside the Originator's insolvent estate in a CLO*).

Whilst this could in theory increase the number of banks able to act as account providers to the SPV, finding a way to isolate cash in an account from the account bank's insolvent estate is extremely difficult as a bank account is simply an unsecured contractual claim against the bank for the return of the cash standing to the account. For example, as a matter of English law, isolation of assets from the asset-holder's insolvent estate would require a an outright assignment (or "true sale"). It is not possible for a bank to assign to the SPV the debt it already owes to the SPV and thus not possible for the bank to isolate the account balance from its insolvent estate. A legal framework for creating such isolation would be useful however it would require changes to insolvency law throughout Europe.

However, there is no real shortage of bank account providers for CLO transactions. There are limited options for swap providers, but this is largely due to rating agency counterparty criteria, which require stringent protection against downgrade of the swap counterparty rather than the complexity of the swaps themselves.

17. **WITH REGARD TO THE POLICY OPTIONS MENTIONED, ARE THERE ANY OTHER CONSIDERATIONS AUTHORITIES SHOULD BE MINDFUL OF?**

See Conclusion below

18. **DO RESPONDENTS THINK THERE ARE OTHER POLICY OPTIONS AUTHORITIES SHOULD CONSIDER TO SUPPORT THE EMERGENCE OF SIMPLE, TRANSPARENT AND ROBUST SECURITISATION MARKETS?**

See Conclusion below

19. **BEYOND SECURITISATION, MIGHT THERE BE OTHER WAYS OF ACHIEVING (SOME OF) THE BENEFITS OF SECURITISATION AS OUTLINED IN SECTION 2? WHAT MIGHT BE THE ASSOCIATED RISKS OF SUCH OPTIONS?**

See Conclusion below

20. **DO THE PRINCIPLES SET OUT IN BOX 3 SEEM BROADLY SENSIBLE GIVEN THE OBJECTIVE OF ENCOURAGING A SET OF SECURITISATIONS THAT ARE MORE AMENABLE TO RISK ASSESSMENT? ARE THERE ANY OBVIOUS UNINTENDED CONSEQUENCES?**

We refer to our responses to Questions 6 to 9 above. Further, Annex II sets out our specific comments on the individual criteria within Box 3 when applied to a CLO transaction.

Conclusion

Managed CLOs sit uncomfortably in the securitisation space. They do not have a single originator who is involved in the transaction. There is no significant risk transfer. The sponsor (being the CLO manager) did not (prior to the retention rules) take significant exposure to credit risk. The assets are not static, and whilst clearly they provide the cash flows which provide the payments on the notes, the structure of the transaction is equally important to the CLO's risk profile. As such, new securitisation regulation frequently impacts CLOs in ways which are possibly unintended, and are certainly disproportionate when compared with actual default rates.

In creating any new distinction between "high quality" securitisations and what will inevitably (though inaccurately) be seen as "low quality" securitisation, we would strongly urge the regulators to engage with us in depth to consider the impact of generic treatment of securitisation on the CLO universe, and the knock-on effect on lending to the real economy.

We would be very happy to answer any further questions you may have and are keen to assist the Central Banks further in considering any proposals which may affect CLOs. If you would like us to do so, please contact Nicholas Voisey of the Loan Market Association (nicholas.voisey@lma.eu.com), or David Quirolo (david.quirolo@ashurst.com) or Anne Tanney (anne.tanney@ashurst.com) of Ashurst.

Yours faithfully

N A Voisey

Nicholas Voisey

ANNEX I - EIOPA "Type A" Securitisations CLO comments

Requirement		CLO comments
(a)	the exposure has been assigned to credit quality step 3 or better;	Senior CLO notes will meet this requirement
(b)	the securitisation is listed in a regulated market of a country which is a member of the EEA or the OECD;	CLOs in Europe are currently mainly listed on unregulated markets (such as GEM in) Ireland and also the regulated market in Ireland. There would be no difficulty for CLOs to list on the regulated market if required.
(c)	after the delivery of an enforcement notice and where applicable an acceleration notice, the tranche is not subordinated to other tranches of the same securitisation transaction or scheme in respect of receiving principal and interest payments;	The Class A notes of a CLO will meet this requirement
(d)	the underlying assets have been acquired by the SSPE in a manner that is enforceable against any third party and are beyond the reach of the seller (originator or sponsor) and its creditors including in the event of the seller's insolvency;	The CLO will purchase underlying assets in the open market and the originator will not be involved in the securitisation and will have no recourse to the assets. Market standard loan purchase documentation includes solvency representations from the seller. True sale opinions are delivered on some transactions.
(e)	there are no severe clawback provisions in the jurisdiction of the seller (originator or sponsor); this includes but is not limited to provisions under which the sale of the underlying assets can be invalidated by the liquidator of the seller (originator or sponsor) solely on the basis that it was concluded within a certain period before the declaration of the seller's insolvency or provisions where the SSPE can prevent such invalidation only if it can prove that it was not aware of the insolvency of the seller at the time of sale;	In the typical jurisdictions in Western Europe whose laws govern the transferor's insolvency, there is no clawback available to the insolvency official or administrator of the transferor. Market standard loan purchase documentation includes solvency representations from the seller. True sale opinions are delivered on some transactions.
(f)	the securitisation includes provisions to ensure that a	Servicing continuity is provided for in a CLO, as managers cannot step down until

	default of the servicer does not result in a termination of servicing and provisions to ensure the replacement of derivative counterparties and liquidity providers if applicable;	a suitable replacement is appointed. Similarly, swap counterparty replacement is hard-wired into the documentation and must comply with rating criteria.
(g)	all the assets underlying the securitisation belong to only one of the following categories:	
	[(i) lists eligible asset classes]	Does not include CLOs - CLOs cannot currently comply
The pool of underlying assets may only include derivatives if these are used strictly for hedging currency risk and interest rate risk.		CLO 2.0 portfolios do not include derivatives. Swaps are only entered by the issuer if the CLO needs to hedge currency (or interest rate).
(h)	the pool of underlying assets do not include loans that were granted to credit-impaired obligors; where a credit-impaired obligor is a borrower (or where applicable, a guarantor) which:	
	(i) has declared bankruptcy, agreed with his creditors to a debt dismissal or reschedule or had a court grant his creditors a right of enforcement or material damages as a result of a missed payment within three years to the date of origination; or	Defaulted Assets are not eligible to be purchased for CLOs.
	(ii) is on an official registry of persons with adverse credit history; or	Not applicable as CLO assets are loans to corporates.
	(iii) has a credit assessment by an ECAI or has a credit score indicating a significant risk that contractually agreed payments will not be made compared to the average obligor for this type of loans in the relevant	All assets require a rating from each rating agency rating to CLO.

	jurisdiction.	
(i)	the pool of underlying assets do not include loans in default within the meaning of Article 178(1) of Regulation 575/2013 (Mortgage Credit Regulation) at the time of issuance of the securitisation or when incorporated in the pool of underlying assets at any time after issuance;	Loans in a CLO are to corporate entities - defaulted loans will not be included in the portfolio as defaulted either at the date of securitisation or on subsequent purchase
(j)	except for securitisations where the underlying assets are credit card receivables, at least one payment has been made by obligors on the loans or lease;	CLO assets are comprised of loans to corporate borrowers. Some of these loans are primary insurance and will not yet have a payment date. Given loans are to corporates rather than individuals, our view is that this requirement should not apply to CLOs.
(k)	to (l) apply to mortgages and consumer loans and as such do not apply here;	Not applicable to CLOs
(l)	where the issuer, originator or sponsor of the securitisation is established in the Union, it discloses information, in accordance with Article 8b of Regulation 1060/2009, on the credit quality and performance of the underlying assets, the structure of the transaction, the cash flows and any collateral supporting the exposures as well as any information that is necessary for investors to conduct comprehensive and well-informed stress tests; where the issuer, originator and sponsors are established outside the Union, comprehensive loan-level data in compliance with standards generally accepted by market participants is made available to existing and potential investors and regulators at issuance and on a regular basis.	CLOs are currently not required to comply with ESMA's regulatory technical standards for disclosure made under Article 8(b) of 1060/2009 as there is currently no ECB template for loan-by-loan disclosure for CLOs. They cannot comply and are not proposed by ESMA to be treated as in breach of the requirements of Article 8(b) as a result. Consequently, whilst we agree that high-quality disclosure is necessary, if CLOs are included in "Type A" securitisations, we propose that the disclosure is instead satisfied by satisfaction of the requirements of Article 409 of Regulation 575/2013 in the case of CLOs. As discussed above, CLO investors receive monthly reports.

ANNEX II - Box 3 proposals

ECB/BofE Criteria	CLO comments
128. **Nature of assets:** The receivables or assets underlying the securitisation must be credit claims or receivables with defined terms relating to rental payments or principal and interest payment. Any referenced interest payments should be based on commonly encountered market interest rates and may include terms for caps and floors, but should not reference complex formulae or exotic derivatives.	CLO portfolios will meet this requirement
129. **Underlying asset performance history:** Verifiable loan loss performance should be made available for substantially similar receivables to those being securitised, for a sufficient time period of at least the effective life cycle of the receivables and covering at least one period of significant market stress.	The S&P European Leveraged Loan Index shows default rates by percentage of issuers and percentage of principal amount defaulted, over 12 month and rolling 12 month periods
130. **Primary obligors:** The securitisation will have recourse to the ultimate obligors for the underlying receivables, i.e. it may not rely upon contingent or derivative-linked claims or be a securitisation of other securitisations.	CLO portfolios will meet this requirement, however, some loan assets are purchased by way of participation agreement.
131. **Expectation of payment:** The originator must demonstrate that any receivables being transferred to the securitisation are loans, advances or financings that are homogenous in respect of their asset type and consistently originated in the ordinary course of the originator's business. These can be loans, advances or financings to: • obligors who have satisfied prudent and consistent underwriting criteria and have been assessed as having ability and volition to make timely payments on obligations; or	References to the "originator" are inappropriate in typical CLO transactions. In our view an equivalent requirement could be that the manager is a regulated entity required to act in the best interests of the investors in managing the portfolio - see our response to question 9

	• granular pools of retail consumers for which the expected cash flows have been modelled to meet stated obligations of the securitisation under prudently stressed loan loss scenarios.	
132.	**Current and self-liquidating:** Any receivables being transferred to the securitisation should be current in payment, i.e. they should not include delinquent obligations. In addition they should be self-liquidating from intrinsic cash flows, i.e. they may not rely on future borrowings, or asset sales to pay timely interest and principal.	CLO assets (at the time of purchase) are current payment obligations. The eligibility criteria require that no asset has a longer-dated maturity than the legal maturity of the notes. This means that following the end of the reinvestment period, when principal proceeds are paid to noteholders in accordance with the priorities of payments, assets may liquidate to an extent prior to maturity of the notes - however most underlying loans will be required to be refinanced rather than being self-liquidating. However, debt coverage tests are required to be met on a continuous basis. Following any breach of debt coverage test for a class of notes, interest will be used to redeem only that class of notes and those above it, until the debt coverage tests are complied with. It should be noted that other types of corporate lending including SME loans also rely on refinancing of underlying assets, so CLOs are no less robust from this perspective than SMEs, which are included in EIOPA's "Type A".
133.	**Security:** Where underlying receivables are secured on specified tangible assets, such security must be first-ranking or, if lower ranking, rights associated with all prior ranking security should all be transferred to the securitisation.	CLOs do permit a small percentage of the assets to be more junior ranking (less than 10% of the portfolio in most cases).
134.	A non-exhaustive list of examples of underlying assets that may comply with the above principles, (subject to meeting all other criteria) could include: residential mortgages, certain commercial real estate mortgages, loans to SMEs, automobile loans/leases, consumer finance loans, credit card receivables and leasing receivables.	

Structure	
135. **Perfection of interest:** The securitisation should effect true sale in its transfer of underlying receivables from the seller on terms such that the transfer of these assets: • is enforceable against any third party; and • is beyond the reach of the seller, its creditors or liquidators; and • is not effected through credit default swaps or derivatives; and • is not subject to identifiable re-characterisation or claw-back risks. Legal opinion should confirm these.	The CLO will purchase underlying assets outright in the open market and the originator will not be involved in the securitisation and will have no recourse to the assets In the typical jurisdictions in Western Europe whose laws govern the transferor's insolvency, there is no clawback available to the insolvency official or administrator of the transferor. However, as the portfolio is granular and usually purchased in the market there is typically not always separate legal opinion governing the true sale unless the portfolio is substantially coming from one seller.
136. **Observability:** To aid risk assessment, the securitisation must be able to distinguish and report all income and disbursements, i.e. scheduled principal, scheduled interest, prepaid principal, past due interest and fees and charges.	CLOs will comply with this requirement and this is included in the monthly reports.
137. **Debtor payments:** Definitions, remedies and actions relating to delinquency and default of underlying debtors must be given, in clear and consistent terms.	CLO Managers do not originate the loans. As there are multiple original lenders the terms may differ, although the syndicated loan market uses standard market documentation (such as the LMA standard loan agreements).
138. **Payment priorities:** The priorities of payments for all liabilities in all circumstances must be clearly defined at the time of securitisation.	CLOs comply with this requirement
139. **Rights:** All voting and enforcement rights related to the assets must be transferred to the securitisation and the rights associated with liabilities of the securitisation under all circumstances must be clearly defined, with the most senior rights afforded to the most senior liabilities.	CLOs comply with this requirement though the most junior class can call the CLO after a fixed period of time provided there is sufficient value in the portfolio to repay all of the notes.
Transparency	
140. **Initial data:** Sufficient loan-level or	CLOs comply with this requirement

	granular pool stratification data should be available at the time of securitisation to potential investors in order to permit construction and analysis of cash flow models. Cash flow models should also be made available.	Cash-flow models are generally available in the CLO market - see our response to Question 10.
141.	**Ongoing data and information:** Updated loan-level performance data and standardised investor reports should be made available to current and potential investors on a monthly/quarterly basis throughout the life of the securitisation.	CLOs provide monthly investor reports
142.	**Conformance with Prospectus Directive:** Notes should provide investors with access to the full range of disclosure of legal and commercial information, along with comprehensive risk factors, in conformance with those required in the Prospectus Directive.	Some (but not all) CLOs are admitted to trading on a regulated market. The disclosure standard is the same.
143.	**Servicing and counterparties:** Transaction level information, such as servicing responsibilities (and special servicing responsibilities), as well as the identity, roles, and responsibilities of all parties to the transactions should be clearly set out in the transaction documentation. The servicer should apply the same servicing policies, procedures and standards to the underlying assets that it applies to other similar non-securitised assets. Provisions should be documented for the replacement of servicers, derivative counterparties and liquidity providers in the event of failure or non-performance or insolvency (or other deterioration of creditworthiness) of any such counterparty to the securitisation.	CLOs comply with these requirements. However as the CLO Manager does not underwrite the loans, the requirement to apply the same servicing policies to non-securitised assets is not applicable.
External Parties		
144.	The securitisation should be subject to ongoing independent credit assessment, for example, by two recognised external credit assessment institution (ECAIs).	CLOs comply with this requirement
145.	The terms and documentation of the securitisation should be reviewed and verified by an authorised legal	CLOs comply with this requirement

	practice.	
146.	The initial and ongoing terms and reports for the securitisation should be reviewed by an authorised accounting practice or the Calculation Agent of the transaction	An effective date report is audited at the time the portfolio is completely ramped up. Given the frequency of reporting (monthly) it would be difficult to audit all the reports. Reports are however prepared by a calculation agent who is independent from the CLO manager.

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13 January 2015

Dear Sirs

EBA Discussion Paper on Simple Standard and Transparent Securitisations 14 October 2014 (the "DP").

Introduction

The Loan Market Association ("**LMA**") welcomes the opportunity to give feedback to the European Banking Authority (the "**EBA**") on the issues raised in the DP, and thank the EBA for their continued engagement with the CLO market.

Our representations are limited to managed CLOs as opposed to other securitisations, in the hope that we can engage in productive dialogue with you around that asset class. The LMA would be pleased to provide additional information on the CLO market following the closure of this consultation, and would also be keen to meet in the coming months to assist the EBA on a bilateral basis with any questions pertaining to the CLO market.

As discussed in more detail at question 8 below, we are very concerned that the labelling of certain types of securitisations as "simple, standard and transparent" will create a "cliff" effect for securitisations which do not meet the criteria. In our view, as currently proposed very few securitisations will be able to meet the criteria. Securitisations which do not satisfy the criteria may be seen by the market as sub-standard thus discouraging investment in securitisations which do not obtain the label. In addition, favourable LCR and regulatory capital treatment for securitisations which meet the criteria is likely to discourage investment by regulated entities in securitisations which do not qualify.

CLOs securitise the debt of sub-investment grade corporates. European corporates need capital in order to grow their businesses. A robust corporate debt market is an essential component to grow the European economy particularly in an environment where traditional lenders are capital constrained. CLOs offer this much needed capital to European corporates. CLOs should not be disadvantaged because they are actively managed. As discussed in more detail below, the expertise of a CLO manager can add a great deal of value to a transaction through managing recoveries on credit impaired and defaulted credits. In fact CLO managers have consistently outperformed static loan indexes. For example, the default rate for US sub-investment grade corporate debt median is 3.61% but the median percentage of defaulted loans held in CLOs is at 0%[1]. Even through the credit crisis, default rates on European CLOs remained very low at just 0.1%[2].

Whilst CLOs returned to Europe during 2013, with new issuance expected to reach 55 CLOs with a value of approximately €22 billion some challenging obstacles remain for the market in the medium term.

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1 Morgan Stanley CLO Market Tracker Dec 14-2015 CLO Outlook, December 5, 2014

2 S&P European Structured Finance 12-months Rolling Default Line Drops to its lowest since March 2010 28 April 2014

European CLO issuance is limited to a small number of CLO managers (approximately 24) issuing multiple CLOs with some CLO managers issuing up to seven CLOs contrast this with the US CLO market where in 2014 alone, 105 CLO managers have issued CLOs[3]. The risk retention rules make it very difficult for new managers or small managers to issue. This lack of diversity is not beneficial to investors. It is important to note that, an increasing proportion of pre-crisis CLOs have reached the end of their re-investment period. The vast majority of present European CLO investment capacity is rolling off and is not being replaced in sufficient volume by the new issue market owing in part to regulatory constraints.

CLOs differ from most static-pool securitisations in some fundamental ways most notably a CLO is not a balance sheet capital tool, it is a securitisation offering investors tranched exposure to a managed pool of corporate debt.

Below is a brief description of a CLO:

A CLO portfolio will not usually be complete on closing of the securitisation. During the warehousing period, prior to issue of bonds by the CLO vehicle, the CLO vehicle accumulates assets from the open loan market, and these assets must meet the eligibility criteria.

Once these assets reach a critical mass, the CLO vehicle securitises them by issuing notes to investors in the market. Following note issuance, the manager continues to purchase assets on behalf of the CLO vehicle, using the proceeds from the notes issuance, until the target value of the portfolio is reached. This "ramp-up" period may continue for up to six months after closing.

There follows a reinvestment period (typically four to five years after closing), during which the manager i) can trade assets up to a certain percentage (usually 20-30% annually), and any assets which are "credit improved", "credit impaired" or defaulted provided the new assets meet the eligibility criteria and certain tests (described in our response to Question 7 below) are met, and ii) reinvest principal proceeds from the assets in buying new assets.

After the reinvestment period finishes, i) unscheduled principal payments received from the underlying assets and ii) sale proceeds from "credit improved" and "credit impaired" assets may also be reinvested by the CLO manager (to the extent they are not required to pay items in the principal priority of payments such as any interest shortfalls on senior notes). Other principal receipts after the reinvestment period are used to redeem the notes sequentially, and many deals also have a clean-up call once the portfolio falls to 15-20% of its original target size.

Such "managed" CLOs provide banks, pension funds, insurance companies and other institutional investors with access to investment in the European corporate debt market but with robust portfolio quality requirements, structural protections and credit enhancement built in to the transaction to reduce risk. These features are outlined below. Typically, CLO notes are not designed to amortise earlier than 4-5 years, hence are longer-term than some securitisations, which makes them attractive for investors who need to match their investment to their longer-term liabilities. CLOs do not rely on refinancing as the portfolio is comprised of assets in which there is an open market. Principal is paid to noteholders as assets amortise or are sold (to the extent not reinvested) following the end of the reinvestment period.

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[3] LCD European Leveraged Lending Review, 4Q14, LCDComps

More detail as to the composition of the portfolio and the structural features of CLOs is given in our answers to the specific questions below.

List of Questions

1 DO YOU AGREE WITH THE IDENTIFIED IMPEDIMENTS TO THE SECURITISATION MARKET?

We broadly agree with the impediments outlined in the DP. In addition we would like to highlight some additional impediments

1.1 Grouping of CLOs with CDOs of ABS

The data included in the DP includes an analysis of default rates for "AAA" and "BBB" rated classes of securitisations. CLOs and ABS CDOs share some common structural features as do many other types of securitisation, ***however*** the composition of CLOs are very different. While the underlying portfolios of CDOs of ABS consisted primarily of other types of ABS securities, CLO portfolios generally consist of:

(a) 90% or more senior secured loans and senior secured bonds to sub-investment-grade corporates; and

(b) the portfolios contain no ABS or synthetic exposures.

Whilst the category of assets securitised by managed CLOs is sub-investment grade corporate debt, overwhelmingly it is only the senior secured portion of such loans which compose a CLO portfolio. There is also a minimum rating requirement for the underlying assets going into the portfolio. The portfolios are actively managed in accordance with strict portfolio tests. Furthermore, mark to market haircuts are applied to portfolio assets whose ratings are "CCC" or below and to defaulted obligations which can result in the failure of the CLO to meet coverage tests thereby triggering cash flow sweeps in the interest priority of payments to repay principal to noteholders in order of seniority.

The default rates set-out in the DP do not accurately reflect the actual default rates of European CLOs. Default rates for European CLOs between 2007 and 2013 was 0.1%.[4]

1.2 Basel II and new Basel Proposals for the securitisation framework.

We do not believe that the Basel Committee on Banking Supervision's (**"BCBS"**) proposals have been very helpful. They fail to reflect the true position with regard to losses incurred in European securitisations.

We believe that capital neutrality should be a basic premise for the regulatory capital treatment of securitisation exposures. The capital charges applied to a pool of exposures prior to securitisation should be no worse than the total capital charge

[4] Source S&P European Structured Finance 12-months Rolling Default level Drops to its Lowest since mid-2010 28 April 2014.

applied to the tranches of the securitisation, to reflect the unchanged economic risk across the pool.

In the case of a managed CLO, the portfolio is managed to ensure compliance with strict debt coverage tests and collateral quality tests which meet rating agency requirements. This added layer of protection is not available to direct investors in the loan portfolio, and the capital charge should reflect this. Any proposal to ascribe higher capital charges to banks investing in CLOs would be in our view detrimental, and could pose a real risk that bank investors would pull out of the CLO market, leaving the universe of CLO investors insufficient to keep CLO issuance economically viable. This would have a damaging effect on the ability of European sub-investment grade corporates to raise capital.

1.3 Solvency II and the EIOPA technical report

The proposed capital treatment of CLOs in the Solvency II regime gives us significant cause for concern. In September 2012, the European Commission requested EIOPA to review the calibration of capital requirements for investment in certain classes of long-term finance which provide management of long-term risk for insurers. In December 2013, EIOPA produced that report, entitled "Technical Report on Standard Formula Design and Calibration for Certain Long-Term Investments" (the "**2013 Report**"). In the 2013 Report, the classes of securitisation transaction which qualify as "Type A" and therefore attract lower capital charges expressly exclude CLOs other than SME CLOs. The criteria for qualification as "Type A" securitisation in the 2013 Report have now been included in Part I of EIOPA's "Technical Specification for the Preparatory Phase" of Solvency II based on the working documents of the Level II delegated Acts to be published later this year, which was published on 30 April (the "**Technical Specifications**"). Our belief is that if CLOs were to remain in the "Type B" category proposed by EIOPA, there is a real risk that insurers required to use the Solvency II Standard formula may pull out of investing in CLOs as an asset-class.

We believe that the categorisation of CLOs as "Type B" by EIOPA is based i) on a misunderstanding of the nature of the risk-mitigating structural features of managed CLO transactions and ii) a focus on the widening spreads which resulted from rating downgrades of CLO tranches during the financial crisis - which downgrades were not borne out by default rates, and have since been largely reversed.

The 2013 Report states (at page 121) "The underlying of CLOs and CDOs is typically speculative-grade corporate debt". As stated above, this is only part of the picture:

(a) the vast majority of CLO "2.0" portfolios consist of 90% or more senior secured loans and senior secured bonds to corporates; and

(b) the portfolios contain no ABS or synthetic exposures.

Whilst the category of assets securitised by managed CLOs is sub-investment grade corporate debt, overwhelmingly it is only the senior secured portion of such debt which goes into the CLO. There is typically a minimum rating requirement for the underlying assets going into the portfolio. The portfolios are actively managed in accordance with strict portfolio tests.

We also believe that EIOPA's focus on rating downgrades as the main indicator of quality of an asset class is inappropriate. The 2013 report places CLOs in "Type B" on the basis that 72.3% of CLOs were downgraded between mid-2007 and end of 2012. We would dispute this figure as representative of the performance of European CLO tranches.

Firstly, a significant amount of downgrades were a result of a change in the default models in rating criteria and methodology (some of which has been subsequently revised), and not actual default rates. S&P had updated their criteria in September 2009, and acknowledged that "Virtually all of the "AAA" downgrades resulted predominantly from the application of the updated criteria, rather than transaction performance."[5]

Moody's updated their criteria on 4th February 2009, also changing their default probability model[6], and reviewed CLO tranches against the new criteria. Of the 395 Aaa- rated CLO tranches in Europe at the start of 2009, 47% retained their rating, while 53% were downgraded[7].

Secondly, CLO transactions continued to perform well in relation to other asset classes following the downgrades to end of 2012, and S&P and Moody's both upgraded a significant proportion of tranches in CLO transactions as a result. As stated in the S&P research paper relied upon by EIOPA[8], S&P subsequently upgraded a number of tranches in CLOs due to the operation of "structural deleveraging" (explained below). In November 2011 Moody's announced that 81% of the European CLO tranches originally rated Aaa were back to their original ratings, as a result of revised rating criteria in June 2011 together with improved par coverage and credit quality[9]. The downgrade figure of 72.3% relied upon by EIOPA is therefore not representative either of default rates in CLOs, or in fact downgrades in existing CLO tranches in Europe.

1.4 Risk Retention

The European risk retention requirements in the Capital Requirements Regulation (**"CRR"**) and the Alternative Investment Fund Managers Directive (**"AIFMD"**) have proved a significant challenge for investors in the CLO market. Despite the recommendations of IOSCO[10] that an exemption from retention be considered for

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5 "Summary of Rating Actions on European CLOs Following Corporate CDO Criteria Update" - sap Ratings Direct, 15 June 2010.

6 "Moody's updates Key Assumptions for rating CLOs" - Moody's Global Credit Research 4 February 2009.

7 "Moody's Completes European CLO rating review" - Moody's Global Credit research 21 January 2010.

8 Pre-Crisis European Structured Finance Still Exhibits Few Defaults" Standard and Poors April 2013", page 6

9 See "Moody's completes European CLO rating sweep, upgrades 969 tranches" - Moody's Global Credit Research, 22 Nov 2011.

10 "Global Developments in Securitisation Regulation" - IOSCO, 16th November 2012, page 48

managed CLOs, the "one-size fits all" nature of the retention requirement was imposed and has presented significant difficulty for CLO structures. As managers have struggled to fund and hold the retention and the related capital, so investors have struggled with the requisite assurance that the transaction is compliant if any mechanism is used other than simply the manager holding and funding the retention from its own balance sheet (see below).

Similar requirements are due to apply to insurer investors once Solvency II comes into force, and to UCITs funds once the implementing regulations are made under the new UCITS Directive.

Apart from the structuring of the retention itself at the outset of the transaction, there are ongoing difficulties with the retention rules which potentially affect returns to investors and investors' ability to remove a failing manager.

1.5 Cost of retention for CLO managers

CLO sponsors meet the retention requirement using one of two of the five retention options - option 405(1) (a) ("**vertical slice**") or option 405(1)(d) ("**first loss**").

As most CLO managers do not deal as principal or underwrite financial instruments, they need to hold capital in an amount of i) the greater of their capital requirement for credit risk, or ii) an amount representing a quarter of their fixed overheads, under CRR. Prior to the retention requirements coming into force, many managers did not take any credit risk, and were therefore calculating capital based on their fixed overheads.

In holding the retention by way of first loss, assuming an unrated tranche of subordinated debt, managers applying the standardised approach to credit risk would have to apply a 1250% risk weight to their securitisation position. With a typical deal size in a CLO 2.0 being around €400m, a 5% holding as a first loss position will require capital of €20m.

To hold a vertical slice of the transaction, the manager needs to hold 5% of each of the tranches sold to investors (including 5% of the first loss tranche). Assuming a transaction with a total issuance of €400m, including €45m of subordinated debt, the capital charge on a 5% vertical slice is set out below:

Class of Notes	Amount (€m)	Rating	Credit Quality Step	Risk Weight %	5% (€m)	Capital Charge (€m)
Class A	215	AAA	1	20	10.75	0.17
Class B	50	AA	1	20	2.50	0.04
Class C	30	A	2	50	1.50	0.06

Class D	20	BBB	3	100	1.00	0.08
Class E	30	BB	4	350	1.50	0.42
Class F	10	B	5	1250	0.50	0.5
Sub Notes	45	N/A	N/A	1250	2.25	2.25
Total					**€20**	**€3.52**

The total capital charge to the CLO manager for holding a vertical slice on this example transaction is €3.52m, against a €20m capital requirement for holding a first loss position. Most CLO managers do not hold any of the underlying portfolio prior to the CLO transaction and the retention rule will always involve a significant increase in capital and costs, unlike bank originators who (i) can benefit from lower capital charges by securitising, or at least have those capital charges capped at the capital charge which applied to the underlying portfolio and (ii) are able to apply the IRB approach in calculating their capital charge for the retention, which will in many cases result in a lower capital charge than that produced by the standardised approach typically used by CLO managers.

As well as their own capital cost, most CLO managers will also require funding for the purchase of the retention positions. This comes with additional costs to the CLO manager - even if the retained positions are used as collateral in a secured financing they are likely to require significant initial margin to be paid to the counterparty. These additional costs to CLO managers will reduce the issuance of new CLOs which will in turn reduce the availability of capital to European corporates.

2 SHOULD SYNTHETIC SECURITISATIONS BE EXCLUDED FROM THE FRAMEWORK FOR SIMPLE STANDARD AND TRANSPARENT SECURITISATIONS? IF NOT, UNDER WHICH CONDITIONS/CRITERIA COULD THEY BE CONSIDERED SIMPLE STANDARD AND TRANSPARENT?

We do not have a view as to whether synthetic securitisations should be excluded.

3 DO YOU BELIEVE THE DEFAULT DEFINITION PROPOSED UNDER CRITERION 5(II) ABOVE IS APPROPRIATE? WOULD THE DEFAULT DEFINITION AS PER ARTICLE 178 OF THE CRR BE MORE APPROPRIATE

Our view is that the default definition should be consistent with the CRR definition. The market benefits from consistency across regulatory frameworks.

4 DO YOU BELIEVE THAT, FOR THE PURPOSES OF STANDARDISATION, THERE SHOULD BE LIMITS IMPOSED ON THE TYPE OF JURISDICTION (SUCH AS EEA ONLY, EEA AND NON-EEA G10 COUNTRIES, ETC): I) THE UNDERLYING ASSETS ARE ORIGINATED AND/OR II) GOVERNING THE ACQUISITION PROCESS OF THE SSPE OF THE UNDERLYING ASSETS IS REGULATED AND/OR III) WHERE THE ORIGINATOR OR INTERMEDIARY (IF APPLICABLE) IS ESTABLISHED AND/OR IV) WHERE THE ISSUER/SPONSOR IS ESTABLISHED?

Underlying Portfolio: We are of the view that such limitations should not be included. Portfolio diversity should be encouraged. Limiting the jurisdiction of the underlying portfolio would inhibit portfolio diversity. In addition, geographical limitations do not reflect underlying credit quality particularly where such limitations are arbitrarily drawn based on geography or economic groupings. However, if such limitations are included EEA and non-EEA G10 countries should be included.

5 DOES THE DISTRIBUTION OF VOTING RIGHTS TO THE MOST SENIOR TRANCHES IN THE SECURITISATION CONFLICT WITH ANY NATIONAL PROVISION? WOULD THIS DISTRIBUTION DETER INVESTORS IN NON-SENIOR TRANCHES AND OBSTACLE THE STRUCTURING OF TRANSACTIONS?

In CLOs, certain types of decisions such as the ability to accelerate and enforce are rights which vest solely with the most senior tranche of notes. Some decisions such as optional redemption of the structure are left to the vote of more junior classes of notes. In a CLO any exercise of an optional redemption by junior classes of notes requires that there are sufficient proceeds to repay all interest, principal and expenses which are senior to the most junior class of unrated debt. This ensures no optional redemption is exercisable by the most junior class of notes unless all rated debt can be repaid. If all decisions are left solely to the senior tranches, this could have negative consequences for the market. In order to obtain AAA ratings there must be a market for more junior classes in order to provide the subordination necessary to support the AAA rating. In addition, certain actions related to key "money terms" of a securitisation require all classes to vote. Disenfranchising junior classes in these instances, would allow the more senior classes of notes to unilaterally modify the economics of a securitisation with no consideration of the effect on more junior tranches. A prohibition on junior classes voting would diminish the appeal of the more junior classes of notes.

6 DO YOU BELIEVE THAT, FOR THE PURPOSES OF TRANSPARENCY, A SPECIFIC TIMING OF THE DISCLOSURE OF UNDERLYING TRANSACTION DOCUMENTATION SHOULD BE REQUIRED? SHOULD THIS DOCUMENTATION BE DISCLOSED PRIOR TO ISSUANCE?

Offering documents which comply with the Prospectus Directive are required to describe all material terms. While we do not object with the premise of making the transaction documents available (CLO transactions documents are made available to the market following the closing of the transaction), the practicalities of distributing these prior to issuance would be problematic. As is the case with most transaction timelines, documents are being negotiated and agreed up to the issue date of the securities. Investors are required to make their investment decision based on the offering document. Issuer, arrangers and collateral managers are required to include full, accurate and complete disclosure in the offering document. This is the case in Europe and the United States. Securitisations have multiple documents comprising many pages. Providing investors with the documents prior to issuance could distract investors from a full and complete review of the offering document which not only describes the material terms of the transaction in great detail but also highlights material risks which investors should be aware of. It should also be noted that under the European Credit Rating Agency Regulation, it has been proposed that transaction documents be posted to a public website set-up by ESMA. Again any such disclosure should be required after the transaction has closed.

7 **DO YOU AGREE THAT GRANULARITY IS A RELEVANT FACTOR DETERMINING THE CREDIT RISK OF THE UNDERLYING? DOES THE THRESHOLD VALUE PROPOSED UNDER CRITERION B POSE AN OBSTACLE TO THE STRUCTURING OF SECURITISATION TRANSACTIONS IN ANY SPECIFIC ASSET CLASS? WOULD ANOTHER THRESHOLD VALUE BE MORE APPROPRIATE**

We do not believe that imposing a large exposure limit is helpful. It is important to note that granularity of a portfolio does not necessarily equate to better credit quality. A granular portfolio of poorly underwritten assets does not create a less risky portfolio. CLOs are already subject to large loan exposure limits in the various tests which the CLO must satisfy (typically such limit is set to approximately 3%).

8 **DO YOU AGREE WITH THE PROPOSED CRITERIA DEFINING SIMPLE STANDARD AND TRANSPARENT SECURITISATIONS? DO YOU AGREE WITH THE PROPOSED CREDIT RISK CRITERIA? SHOULD ANY OTHER CRITERIA BE CONSIDERED?**

Criterion 2: We do not share the view that a securitisation should be excluded on the basis that it is actively managed. A regulated CLO manager adds an expertise to the transaction and monitors each credit in the portfolio. A CLO manager performs in depth credit analysis on each asset. The CLO manager has knowledge and experience in corporate credit and represents the CLO on creditor committees and in work-out scenarios. These are regulated entities responsible for ensuring the CLO can repay its obligations to investors. We also disagree that active portfolio management adds a layer of complexity to a transaction. Investors investing in CLOs analyse both the Tests (as defined below) and the performance of the CLO managers in the same way and with the same rigour that they analyse a static portfolio of assets. There is a great deal of information available to investors on past performance of CLO managers as well as their approach to credit selection and work-outs. This information is widely available from a variety of public sources.

Management of a CLO portfolio is subject to collateral quality tests, overcollateralization tests and concentration limitation tests (the "**Tests**") – these are rigorous rating agency tests measuring over-collateralisation and various portfolio characteristics which the manager is required to comply with in order to continue to be able to reinvest in new assets. These portfolio-level tests are already industry-standard and are particular to managed CLOs as opposed to securitisations of static portfolios. The CLO manager has to meet the Tests on an ongoing basis. The Tests and strict trading rules imposed on CLOs means that active management of the portfolio has a very limited effect (positive or negative) on the most senior tranches of a CLO.

The Tests also allow the CLO manager to provide detailed and transparent disclosure to investors on a monthly basis in respect of the portfolio. They cover data such as diversity of obligor by industry and geography, weighted average spread on the assets, weighted average fixed rate coupon, weighted average rating and weighted average life of the underlying assets.

Unlike traditional asset-backed securities, the underlying portfolios of CLOs are typically not purchased from one originator or seller but are typically sourced in the primary or secondary market by regulated investment managers who are independent of any originator or seller of the loans. The CLO manager is able to independently assess the quality of the portfolio and is free of the negative incentives which can arise in an originate-to-distribute securitisation model. This adds an additional level of credit analysis which is not a feature of other types of securitisation.

Risk-reducing characteristics of managed CLOs

We cannot stress too heavily the fact that the assets in a CLO portfolio are only a part of the performance of the CLO itself. As we state above, CLOs give investors the ability to invest in the loan market with the benefit of structural enhancements and active management which significantly reduce risk to the senior noteholders when compared with a direct investment, or with a static loan portfolio. The exclusion of managed portfolios fails to recognise the weight that should be given, uniquely in this asset class within the securitisation space, to structural deleveraging and active management.

Structural deleveraging

In summary, structural deleveraging in a CLO interrupts the normal priority of payments in the event that the quality of the portfolio falls below a certain level. The debt coverage tests measure the amount of over-collateralisation in the CLO. In a managed CLO transaction, there is typically a maximum of 7.5% CCC (or below) rated assets in the portfolio. If these low-rated assets rise above that percentage, those assets will be treated as valued at market value rather than at the usual par value in meeting the debt coverage tests. If the debt coverage tests fail as a result, no interest can be paid out on the junior notes, the majority of the CLO management fees and all receipts from the assets will go to pay principal on the senior notes sequentially until the pool complies again with the coverage tests. The same applies to failure of the coverage tests as a result of defaulted assets. Thus the senior notes benefit both from the credit enhancement provide by the junior tranches and the protection of senior income and principal prior to any default. In a static-pool securitisation, whilst mechanisms may be built in to ensure excess income supports deficiencies on the senior notes, this is not done on a managed basis. This structural deleveraging was partly responsible for the subsequent upgrades on many of the AAA CLO tranches which were downgraded by S&P in 2009.

In addition, post the expiry of a CLO reinvestment period, to the extent that portfolio collateral is repaying and the manager is unable to reinvest these proceeds (the circumstances are usually related to note ratings or certain test compliance), these proceeds are ultimately repaid to note holders in order of seniority. This is another mechanism by which structural deleveraging can occur and is an inherent characteristic across European CLO 1.0 and 2.0 structures.

In addition to those protections, we would suggest that a CLO which complies with the following criteria should be included in any "high-quality" class of ABS which receives preferential regulatory treatment:

(a) the securitised exposures must be managed on a continuing, discretionary basis by:

  (i) an EEA investment firm which is required to be regulated in its home member State and which is subject to the Markets in Financial Instruments Directive ("**MiFID**") or an affiliate thereof; or

  (ii) a firm authorised under the Alternative Investment Fund Managers' Directive ("**AIFMD**") or an affiliate thereof; or

  (iii) a firm or an affiliate thereof which would fall within (i) or (ii) above if its head office was situated in the EEA and which is subject to equivalent regulation in relation to the conduct of its business and its management of conflicts as a firm established in the EEA (for instance investment advisors registered under the US Investment Advisers Act of 1940, as amended);

(b) the CLO manager of the securitised exposures must undertake to the investors in the securitisation to comply with the regulatory requirements applying to it in relation to the management of conflicts of interest, in connection with its management of the securitised exposures (i.e. compliance with MiFID and/or AIFMD or equivalent regulations outside the EU);

(c) the securitisation must contain provisions whereby the interests of the CLO asset manager are appropriately aligned with the interests of the investors during the whole life of the securitisation. It is recognised that this may be achieved by a material part of the manager's compensation for carrying out its duties being structured as an incentive fee, which will only become payable upon appropriate performance thresholds of the securitised exposures having been met;

(d) Investor reports should be provided monthly;

(e) In addition, the following portfolio characteristics could be provided for in a definition of CLOs to ensure that only certain types of structures would actually constitute a CLO:

  (i) it contains a high percentage of senior secured loans and bond loans to corporates;

  (ii) it does not contain any asset-backed securities or synthetic securities; and

  (iii) it is managed by an independent investment firm or an affiliate thereof which satisfies paragraph (a) above and who independently reviews, and individually selects, each asset to purchase in the primary or secondary market (with no obligation to purchase from any individual bank or originator) ;

The assets in a CLO portfolio are purchased according to the eligibility criteria, which specify the conditions for individual loans, such as jurisdiction, rating, non-convertibility, tax and regulatory conditions etc., and as at the effective date the portfolio profile and collateral quality tests must be satisfied. CLO managers may also only invest in assets during the reinvestment period if following investment, the portfolio profile and collateral quality tests remain satisfied or if not satisfied, they must be improved following such reinvestment. These tests ensure diversification of assets by industry, limit maximum concentration in a single borrower or borrower type, and ensure quality of loan covenants etc. The active management of the portfolio ensures the continued compliance with these tests. Thus CLOs have built-in protection for the quality of the assets in the portfolio.

Criterion 3: (True Sale): This criterion is unclear and we do not believe it reflects the intention of its inclusion. The key concept here is that the assets should be isolated from the insolvency of the seller. Given the differing legal regimes of various jurisdictions and the numerous methods of transfer available, we would suggest that the requirement be re-phrased such that assets are transferred by way of a "true sale" (or similar isolation) such that the assets are isolated from the creditors of the seller including upon an insolvency of the seller.

Criterion 4: Homogenous in terms of asset type, currency and legal system: We do understand the need of a homogenous pool of assets however this requirement should be met by asset-type groupings, in the case of CLOs, corporate debt. We do not agree that there needs to be homogeneity in currency and legal system. Within the EEA itself there are different currencies and legal systems.

9 DO YOU ENVISAGE ANY POTENTIAL ADVERSE MARKET CONSEQUENCES OF INTRODUCING A QUALIFYING SECURITISATION FRAMEWORK FOR REGULATORY PURPOSES?

We have concerns over the possible "cliff effect" of classifying certain types of securitisations as simple, standard and transparent ("**Qualifying Securitisations**").

In particular, there is a real danger that securitisations which are not Qualifying Securitisations are seen as sub-standard by the market and thus discourage investment in securitisations which fall outside of the Qualifying Securitisation designation.

The appropriateness of a framework which certifies some transactions as Qualifying Securitisations depends on the consequences of such a certification. An implicit regulatory stamp of approval will inevitably mean that investors rely to an extent on that stamp as a representation that the product is lower-risk, particularly if the associated capital risk-weights are lower than other similar products without such a stamp. This could actually result, not in investors taking necessarily better investment decisions, but instead investing in a smaller universe of securitisation instruments. The resulting positive correlation in an investor's portfolio could mean potentially greater losses should default levels in an asset-class increase.

There is already concern in the market that the regulatory capital treatment of securitisations is unduly harsh and in some instances higher than a regulated entity holding the individual assets comprising the securitisation portfolio. Given the very low default rates for European CLOs the regulatory capital treatment of a "AAA" rated tranche of a CLO should not be treated as materially worse than a "AAA" tranche of a Qualifying Securitisation.

10 HOW SHOULD CAPITAL REQUIREMENTS REFLECT THE PARTITION BETWEEN QUALIFYING AND NON-QUALIFYING?

As stated above in question 9, we have concerns that the designation of some securitisations as Qualifying Securitisations has the potential to have a material adverse impact on securitisations which fall outside the scope of this designation. Any differentiation in terms of the capital requirements applicable to Qualifying Securitisations and those outside of scope increases the likelihood of such impact. The risk weights applicable in the current Basel proposals are in our view still too high across all securitisation asset classes. It should under no circumstance be more advantageous to hold an underlying pool of assets than investing in the same pool in a securitisation. Holding a position in a securitisation should result in a better capital charge when compared with holding a pool of underlying assets. If CLOs are not included in the "Qualifying Securitisation" category, we would encourage regulators to look at historical default rates on CLOs (and not CDOs) and reflect a capital requirement which is more in-line with historic default rates for the asset class.

11 WHAT IS A REASONABLE CALIBRATION ACROSS TRANCHES AND CREDIT QUALITY STEPS FOR QUALIFYING SECURITISATIONS? WOULD RE-ALLOCATING ACROSS TRANCHES THE OVERALL CAPITAL APPLICABLE TO A GIVEN TRANSACTION BY REDUCING THE REQUIREMENT FOR THE MORE JUNIOR TRANCHE AND INCREASING IT FOR THE MORE SENIOR TRANCHES OTHER THAN THE MOST SENIOR TRANCHE BE A FEASIBLE SOLUTION?

Any capital requirements should be based on the credit risk of the underlying portfolio taking into account the subordination and structural protections included in a securitisation. As stated in question 10 above, the risk weighting of securitisation positions should not be higher than a direct investment in the underlying portfolio.

12 CONSIDERING THAT RATING CEILINGS AFFECT SECURITISATION FROM CERTAIN COUNTRIES, HOW SHOULD THE CALIBRATION OF CAPITAL REQUIREMENTS ON QUALIFYING AND NON-QUALIFYING SECURITISATIONS BE UNDERTAKEN, WHILE ALSO ADDRESSING THIS ISSUE?

We do not have a view.

We remain very concerned that the labelling of certain securitisations as simple, standard and transparent could materially and adversely affect the wider securitisation market. CLOs are an important source of capital for European corporate borrowers. The availability of capital to the corporate section is essential to promote sustained growth in Europe. The exclusion of CLOs from being structured to meet the criteria set-out in the DP, particularly because they are actively managed is not necessary given the way the transactions are structured, the limited effect management has on the most senior tranches of a CLO and the information available to investors to evaluate CLO manager performance.

We would like to thank the EBA for its continued engagement on these issues. We are also grateful for the opportunity to comment on the DP. We would be very happy to answer any questions you may have. If you would like to do so, please contact Nicholas Voisey of the Loan Markets Association (nicholas.voisey@lma.eu.com) or David Quirolo (david.quirolo@cwt.com) of Cadwalader, Wickersham & Taft LLP.

Yours faithfully

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