



**AUTORITÉ  
DES MARCHÉS  
FINANCIERS**

# **SECURITIZATION RISK MANAGEMENT GUIDELINE**

**March 2019**

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## Introduction

The AMF published the *Securitization Risk Management Guideline* in 2009 in response to the financial crisis and in order to draw the attention of financial market participants to the importance of establishing sound securitization practices.<sup>1</sup> Since then, the core principles and guidance published by the Basel Committee on Banking Supervision (the “Basel Committee”) have evolved, providing for a more robust and transparent framework consistent with changing securitization practices. It is also important to note that the original guideline applied solely to deposit institutions. Given that securitization transactions are now increasingly part of the business strategy of certain insurers, this updated guideline applies to insurers as well.

In order to make markets more resilient, on July 23, 2015, the Basel Committee and the International Organization of Securities Commissions (“IOSCO”)<sup>2</sup> published the final criteria for identifying long-term simple, transparent and comparable securitizations. In May 2018, the Basel Committee established simple, transparent and comparable (STC) criteria for identifying short-term securitizations (asset-backed commercial paper).<sup>3</sup> The ultimate purpose of these criteria is to enable comparability across institutions and jurisdictions.

In December 2014, the Basel Committee published a revised version of the securitization framework.<sup>4</sup> This version was updated in 2016 and came into effect in January 2018. The revised framework contains the following enhancements: better risk sensitivity; better management of credit risk transfers and better allocation of capital; harmonization of securitization oversight in order to create a simple, transparent and comparable framework; and a decreased reliance on credit rating agencies and the importance of calculating capital based on internal ratings.<sup>5</sup> This revision will allow the AMF to increase the level of risk sensitivity and improve the securitization framework while making it more transparent.

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<sup>1</sup> Securitization is a technique used by financial institutions, in particular, to generate supplemental cash flows. Securitization is a transaction through which a lender or creditor, generally a financial institution, can refinance a group of loans, exposures or credit claims or receivables, such as residential mortgage loans, automobile loans and leases, consumer loans, credit cards and trade receivables, by converting them into negotiable instruments. The lender groups and repackages a loan portfolio, which it organizes into different risk categories tailored to different investors. There are two types of securitization: classic securitization and synthetic securitization. For more information, consult the Ligne directrice sur les normes relatives à la suffisance du capital de base – Coopératives de services financiers (*Capital Adequacy Guideline* – financial services cooperatives (in French only)).

<sup>2</sup> Basel Committee on Banking Supervision and the Board of the International Organization of Securities Commissions. *Criteria for identifying simple, transparent and comparable securitisations*, July 2015.

<sup>3</sup> Basel Committee on Banking Supervision and the Board of the International Organization of Securities Commissions. *Criteria for identifying short-term “simple, transparent and comparable” securitisations*, May 2018.

<sup>4</sup> Basel Committee on Banking Supervision. *Basel III Document. Revisions to the Securitisation Framework*, July 2016.

<sup>5</sup> Basel Committee on Banking Supervision. *Basel III: Finalising post-crisis reforms*, December 2017.

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## 1. Securitization risk management

The AMF expects a securitization risk management framework to be supported by effective, responsible and transparent governance.

In addition to the expectations expressed in the *Governance Guideline*<sup>6</sup> with regard to securitization risk management, the AMF expects the board of directors to:

- ensure that senior management properly detects, assesses, monitors and controls securitization risks.

The concept and implications of securitization must be fully understood, failing which it would be advisable not to engage the financial institution in securitization.

- obtain assurance that the financial institution acts prudently and diligently regardless of the roles it assumes in the securitization process.

For example, where a financial institution originates a securitization transaction, credit standards should be applied as rigorously to the assets transferred to a special purpose entity (SPE) as they would be to the assets remaining on the institution's balance sheet. In a simple, transparent and comparable (STC) securitization transaction, prudence and diligence would entail compliance with the eligibility criteria for the transaction.<sup>7</sup>

- obtain information on a regular basis from individuals responsible for risk management.
- ensure that senior management acts transparently at each step of the securitization process with respect to each stakeholder.

In addition, the AMF expects members of senior management to have the knowledge and skills to effectively manage securitization transactions. They should also put in place an appropriate framework for securitization risk management which will be subject to board approval.

This framework should:

- set out a clear and distinct policy that distinguishes strategic and risk position-taking activities from transaction processing, distribution and risk analysis activities:
  - Where institutions issue or manage asset-backed securities (ABS), the framework should ensure independence between, on the one hand, the parties originating the assets (originators) and those making strategic decisions (managers) and, on the other hand, the parties processing ABS transactions (servicers) and those distributing and marketing ABS (distributors).
  - As regards institutions investing in ABS, the framework should ensure independence among personnel who are responsible for investing in these instruments (front office) and other personnel who analyze risks (middle office) and process related transactions in these instruments (back office).
- provide the institution with strong internal controls over securitization risk tolerance, which should be adjusted to reflect the complexity, volatility and innovations specific to securitization.
- ensure that these same internal controls enable the identification and mitigation of real or apparent conflicts of interest.<sup>8</sup>

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<sup>6</sup> Autorité des marchés financiers. *Governance Guideline*.

<sup>7</sup> For the STC criteria, refer to the third part of this guideline.

<sup>8</sup> In the case of a group, a number of entities from the group may be involved in the securitization structure. In this case, the institution must put in place the necessary mechanisms to mitigate, to the extent possible, potential conflicts of interest.

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For example, financial institutions that assume the role of originator should have controls in place covering relations with the other parties issuing or managing ABS (manager, servicer, distributor). Measures taken by the institution to mitigate conflicts of interest should generally include adequate timely disclosure to investors.

- provide for the use of highly specialized resources:
  - Where the financial institution issues or manages ABS that involves setting up complex, highly leveraged securitization structures containing portions of classic securitization and synthetic securitization with resecuritization. In such structures, institutions are required to interface with multiple parties and control the numerous legal and financial aspects of these structures.
  - Where financial institutions invest in ABS related to complex securitization structures.
- provide a securitization remuneration policy<sup>9</sup> based on the institution's overall performance which does not encourage excessive or inappropriate risk-taking and which takes into account the long-term interests of the institution and its stakeholders.

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<sup>9</sup> For a detailed analysis of the remuneration policy, refer to the *Governance Guideline*.

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## 2. Risk management related to classic and synthetic securitizations

### 2.1 Securitization process management

The AMF expects financial institutions to adopt sound and prudent securitization risk management practices throughout the securitization process.

The securitization process generally encompasses three phases: pre-securitization positioning, securitization process execution and securitization monitoring. However, these phases may overlap.

#### 2.1.1 Phase I – Pre-securitization positioning

Financial institutions that assume the role of originator should, in particular:

- ensure market receptiveness via investors;
- segregate the roles of issuing or managing ABS, where the institution assumes more than one role, to prevent conflicts of interest;
- assess the performance and reputation of the different parties that could be involved in structuring the securitization, such as the servicer, the manager and the distributor;
- possess quality data (integrity and completeness) on the assets to be securitized, since this aspect is crucial to the success of the securitization process;
- ensure that assets are securitizable to mitigate the risk that subsequent securitization may not be possible. Financial institutions should ensure they have sufficient liquidity and capital to hold any assets that cannot be securitized;
- ensure greater market presence so as to enhance their profile as an originator;
- have appropriate expertise in line with the complexity of securitization structures and the associated risks;
- have, on an ongoing basis, a comprehensive understanding of the risk characteristics of individual securitizations and the underlying exposures. Financial institutions should be able to have timely access to performance data for the underlying portfolios;<sup>10</sup>
- have in-depth knowledge of all the structural characteristics of a securitization transaction that could significantly impact their performance;
- for resecuritizations,<sup>11</sup> have information not only on the underlying securitization tranches, such as the issuer name and credit quality, but also on the characteristics and performance of the pools underlying the securitization tranches;
- implement policies to ensure ongoing monitoring of securitizations and underlying exposures in order to be able to react quickly to adverse or unanticipated changes; and
- perform stress tests to better understand the performance of the underlying asset pool.

Financial institutions that assume the role of servicer should, in particular:

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<sup>10</sup> This data could include the type of exposure, the percentage of loans that are 30, 60 and 90 days past due, the default rates, the prepayment rates, the recovery rates, the rate of use of collateral, mortgage loans in which there has been a seizure, credit scores or other credit quality measurements for underlying exposures, and loan to value ratios for sensitivity analyses.

<sup>11</sup> A resecuritization exposure is a securitization exposure in which the risk associated with an underlying pool of exposures is tranching and at least one of the underlying exposures is a securitization exposure. See the *Capital Adequacy Guideline – financial services cooperatives*, March 2019, Chapter 6 (in French only).

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- ensure that they can obtain, periodically, from the originator, information on the assets to be securitized (underlying assets); and
  - have sufficient resources, for example, computer expertise and equipment, to process information on the underlying assets.

Financial institutions that assume the role of manager should, in particular:

- have the legal expertise necessary to set up the SPE;
- assess the performance (especially operational and credit risks) and reputation of the originator, as well as the quality of the underlying assets;
- assess the performance (especially operational and credit risks) and reputation of the servicer and the distributor; and
- assess the performance (especially operational and credit risks) and reputation of the parties involved in hedging ABS risks, such as credit enhancers and liquidity support providers.

Financial institutions that assume the role of distributor should, in particular:

- carefully determine the most appropriate period for the distribution, since the securitized instrument is an investment that is often geared to a specific class of investor.

Financial institutions that invest in ABS or are involved in hedging ABS risks should, in particular:

- have the appropriate investment or risk hedging expertise; Securitization exposes financial institutions to a number of risks, which could make this activity highly complex. and
- evaluate the depth of the secondary market for public securitization offerings.

### **2.1.2 Phase II – Securitization process execution**

Financial institutions that assume the role of originator should, in particular:

- identify securitization risks and, where possible, mitigate them during the securitization process by relying on experts. Risks that are not considered could have an adverse impact on the performance of the securitization transaction and result in unexpected legal implications. Therefore, it is important for institutions to focus their risk mitigation efforts on:
  - operational risk, by setting out, for example, clear asset selection criteria and ensuring compliance with these criteria; and
  - legal risk, by clarifying, for example, the relations with the SPE.

Institutions that assume the role of originator should ensure that the accompanying ABS-related documentation sets out the financial institution's limits of legal liability with regard to the SPE, for example, the party that would have to assume the SPE's future losses or take over the transferred assets. In this respect, the financial institution could rely on legal opinions generally drafted as part of securitization structures.

Financial institutions that invest in ABS or are involved in hedging ABS risks should, in particular:

- develop internal ABS credit quality analyses to limit reliance on credit rating agencies;
- demonstrate greater vigilance where the institution elects to limit itself to analyses by credit rating agencies; such vigilance should encompass:
  - the importance of properly understanding the meaning of ratings and the types of anticipated risk and the fact that external credit ratings are only one factor in evaluating transaction risk; and

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- a preference for obtaining ratings from at least two credit rating agencies recognized by the AMF; where this is not possible, the additional risk resulting from relying on the credit rating of only one agency should be considered;
  - set risk tolerance levels for complex securitization structures; For example, in the case of an investment in ABS resulting from a securitization structure containing portions of classic securitization and synthetic securitization with resecuritization, risk tolerance levels should be set based on the risks stemming from the ultimate underlying assets;
  - view the investment in securitized products primarily as a buy-and-hold strategy, since these products usually have a secondary market whose liquidity is limited;
  - establish capital and liquidity plans based on the potential need to finance asset increases on the balance sheet as a result of early amortization or maturity events.

The terms and conditions of all transactions between the financial institution and the SPE should be at market terms and conditions and meet the institution's normal credit standards. Moreover, an independent committee should be in place to approve individual transactions.

In order to enhance the transparency and visibility of transactions, financial institutions or other types of entities involved in a securitization transaction that originate or facilitate the transaction should, throughout the process:

- help investors to act with due diligence and avoid unexpected disruptions involving servicing contracts and cash flow management;<sup>12</sup>
- provide details about the transaction structure; In practical terms, the initial offering document (or the prospectus) and the underlying documentation should clearly define the contractual obligations and the fiduciary duties and responsibilities of all parties to the securitization and of the ancillary service providers.
- provide investors with access to documentation regarding derivatives, any agreements between creditors, and loan and liquidity agreements;
- notify investors about any failure, insolvency or other deterioration of creditworthiness of a counterparty to the securitization; and
- in their communications to investors, distinguish and report the securitization's income and disbursements, as well as delinquent, defaulted and restructured amounts.

### **2.1.3 Phase III - Securitization monitoring**

Once the securitization process is completed and the risk transferred from the originator to investors, financial institutions should monitor the securitization.

For financial institutions that assume the role of originator, the securitization-monitoring phase comprises two sub-phases: management of securitization risks and disclosure of information regarding the securitization.

With respect to securitization risk management, financial institutions that assume the role of originator should, in particular:

- closely manage the credit risk associated with any untransferred securitization positions, which are usually the most subordinate and carry the largest risk;
- implement a systematic process for analyzing the quality and performance of the underlying assets to control the impact of any deterioration in these assets and limit the risk of damage to their reputation;

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<sup>12</sup> Financial institutions acting as investors should consult the expectations in the *Investment Management Guideline*.



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- consider the possibility that securitization exposures will have to be taken back on the balance sheet, even though the institution has no legal obligation to do so, in order to limit any negative impact on its reputation;
  - segregate the roles of issuing or managing ABS, where the institution assumes more than one role, to prevent conflicts of interest;
  - ensure, where entities issuing or managing ABS are separate from the originator, that these entities deliver quality service to investors; and
  - take into account systemic risk related to a credit rating downgrade of the entities responsible for hedging ABS risks. A downgrade could have significant consequences on the originator's activities simply by association; the complexity of securitization increases systemic risk.

Where information about the securitization is disclosed, financial institutions that assume the role of originator should, in particular:

- consider that they are primarily responsible for the quality of the information disclosed about the underlying assets by ensuring, for example, that the servicer adequately carries out its duties (where the originator is not also the servicer); and
- ensure that all significant characteristics of ABS, such as inherent risk and conflicts of interest, are disclosed in such a way that investors and the parties involved in hedging ABS risks are able to evaluate the investment. For example, institutions that assume the role of originator should ensure continued information transparency, particularly with respect to the underlying assets, by indicating asset concentration (sectors, geographic regions, industries, obligors, etc.).

Financial institutions that assume the role of servicer should be diligent in collecting and transmitting payments of principal and interest on the underlying assets.

Financial institutions that assume the role of manager should, among other things, manage the SPE's exposure to liquidity risk, particularly where the SPE is issuing asset-backed commercial paper (ABCP), that is, an issue of short-term securities that are backed by long-term assets.

Financial institutions that invest in ABS or are involved in hedging ABS risks should, in particular:

- manage the operational risk attributable to the numerous parties involved in a securitization structure and the possibility that one of the parties, the servicer for example, may not be able to honour its commitments.

Financial institutions that invest in ABS should also ensure that they manage the credit risk arising from exposure to the parties hedging ABS risks.

## **2.2 Scenario analyses and stress tests**

Given the risks associated with securitization, the sound and prudent management practices outlined in the *Stress Testing Guideline* require scenario and stress testing.<sup>13</sup>

Scenario analyses enable financial institutions to examine, using different probable assumptions, the impact of changes in certain variables on their financial situation. For example, financial institutions that assume the role of originator could estimate the impact on securitization revenues of unanticipated delays in the securitization process. Financial institutions that assume the role of investor could assess the impact on ABS investment income of changes in the number of delinquent payments or in the rate of prepayments related to the pool of underlying assets.

Financial institutions should also conduct stress testing to identify potential losses and liquidity requirements in highly unusual market conditions. For example, financial institutions that assume the role of originator could

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<sup>13</sup> For more information on stress tests, refer to the *Stress Testing Guideline*.

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simulate the impact of their obligation to quickly take back transferred assets on the balance sheet. Institutions that assume the role of investor or that are involved in hedging ABS risks could conduct simulations of the impact of prolonged periods of extreme illiquidity in the ABS market by focusing on ABS in complex securitization structures.

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### 3. Process of developing criteria for simple, transparent and comparable (STC) securitizations

The objective of the STC criteria and the treatment of capital<sup>14</sup> associated with STC securitizations is to foster the development of simple, transparent and comparable securitization structures within the financial sector.

Insurers' capital is not affected by compliance with these criteria. However, if insurers conduct loan securitization transactions, they are encouraged to comply with these criteria for sound risk management purposes.

The AMF expects senior management to ensure compliance with the conditions for attributing an "STC" designation to any securitization designated as such.

An STC securitization transaction should have three characteristics:

- **Simplicity:** simplicity refers to the homogeneity of underlying assets with simple characteristics, and a transaction structure that is not overly complex.
- **Transparency:** criteria on transparency provide investors with sufficient information on the underlying assets, the structure of the transaction and the parties involved in the transaction, thereby promoting a more comprehensive and thorough understanding of the risks involved. The manner in which information is made available should not hinder transparency, but instead support investors in their assessment.
- **Comparability:** criteria promoting comparability could assist investors in their understanding of their investments and enable more straightforward comparison across securitization products within an asset class.

Investing institutions should evaluate compliance with the STC criteria in order to determine the treatment of capital that should apply to their exposures. Originating institutions should nevertheless provide sufficient disclosure to investors to allow them to assess the STC criteria. Institutions could be held liable for any misrepresentations or inaccurate information.

Where the AMF believes a transaction does not comply with the STC criteria, it could take corrective measures. For example, it could refuse to give preferential treatment to capital for the particular transaction and, possibly, for other transactions.

The STC criteria have been designed according to the type of securitization: long-term securitization or short-term securitization (particularly ABCP-related exposures).

#### 3.1 Eligibility criteria for long-term STC securitizations

In all, sixteen criteria have been established for long-term STC securitizations. These criteria<sup>15</sup> were developed based on the principal types of risks present in securitization transactions:

- **Asset risk:** criteria relating to the underlying asset pool.

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<sup>14</sup> The AMF expects financial institutions to comply with capital requirements for their exposures resulting from classic or synthetic securitizations or similar structures containing features common to both. For the treatment of capital for securitization transactions (classic or STC), refer to the *Capital Adequacy Guideline – Financial Cooperatives* (available in French only).

<sup>15</sup> Committee on Banking Supervision and the BOARD OF THE INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS. *Criteria for IDENTIFYING simple, transparent and comparable securitisations*, July 2015. BASEL COMMITTEE ON BANKING SUPERVISION. Basel III Document. Revisions to the Securitisation Framework, July 2016.

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- Structural risk: criteria relating to the structure of the securitization transaction.
  - Fiduciary and servicer risk: criteria that emphasize the roles and responsibilities of the various parties to the securitization process.
  - Additional guidance and criteria have been developed specifically to differentiate between the capital treatment of STC securitizations and the capital treatment of other securitizations transactions.

Before certifying a securitization transaction as STC, financial institutions that assume the role of originator and/or manager in an STC securitization transaction should satisfy the following criteria:

## **A. Asset risk**

### **A1. Nature of assets**

In STC securitizations, the assets underlying the securitization should be credit claims or receivables that are homogeneous. In assessing homogeneity, consideration should be given to asset type, jurisdiction, legal system and currency.

As exotic asset classes require complex and deep analysis, credit claims or receivables should have contractually identified periodic payment streams relating to rental,<sup>16</sup> principal, interest, or principal and interest payments. Any referenced interest payments or discount rates should be based on commonly encountered market interest rates,<sup>17</sup> but should not reference complex formulae or exotic derivatives.

### **Additional guidance for capital purposes**

#### **Homogeneity**

For capital purposes, this criterion should be assessed taking into account the following principles:

- The nature of assets should be such that investors would not need to analyze and assess materially different legal and/or credit risk factors and risk profiles when carrying out risk analysis and due diligence checks. For example, when originating the transaction, the asset pool should consist of only one asset class, such as consumer loans or mortgage loans.
- Homogeneity should be assessed on the basis of common risk drivers, including similar risk factors and risk profiles.
- Credit claims or receivables included in the securitization should have standard obligations, in terms of rights to payments and/or income from assets, that result in a periodic and well-defined stream of payments to investors. Credit card facilities should be deemed to result in a periodic and well-defined stream of payments to investors for the purposes of this criterion.
- Repayment of noteholders should rely mainly on the principal and interest proceeds from the securitized assets. Partial reliance on refinancing or resale of the asset securing the exposure may occur provided that refinancing is sufficiently distributed within the pool and the residual values on which the transaction relies are sufficiently low and that the reliance on refinancing is thus not substantial.

#### **Commonly encountered market interest rates**

Examples of these would include:

- interbank rates and rates set by monetary policy authorities, such as Libor, Euribor and the fed funds rate; and
- sectoral rates reflective of a lender's cost of funds, such as internal interest rates that directly reflect the market costs of a bank's funding or that of a subset of institutions.

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<sup>16</sup> Payments on operating and financing leases are typically considered to be rental payments rather than payments of principal and interest.

<sup>17</sup> Commonly encountered market interest rates may include rates reflective of a lender's cost of funds, to the extent that sufficient data are provided to investors to allow them to assess their relation to other market rates.

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## Exotic derivatives

Interest rate caps and/or floors would not automatically be considered exotic derivatives.

### A2. Asset performance history

In order to enable investors to conduct appropriate due diligence and accurately calculate expected loss in different stress scenarios, they must have access to sufficient information on an asset class. Therefore, verifiable loss performance data, such as delinquency and default data, should be available for credit claims and receivables with substantially similar risk characteristics to those being securitized. Additionally, these data should be presented for a time period long enough to permit meaningful evaluation by investors. Sources of and access to data and the basis for claiming similarity to credit claims or receivables being securitized should be clearly disclosed to all market participants.

In addition to the history of the asset class within a jurisdiction, investors should consider whether the originator, sponsor, servicer and other parties with a fiduciary responsibility to the securitization have an established performance history for substantially similar credit claims or receivables to those being securitized and for an appropriately long period of time.

It is not the intention of the criteria to form an impediment to the entry of new participants to the market, but rather that investors should take into account the performance history of the asset class and the transaction parties when deciding whether to invest in a securitization.

### Additional requirement for capital purposes

The originator/sponsor of the securitization, as well as the original lender who underwrites the assets, must have sufficient experience in originating exposures similar to those securitized.

For capital purposes, investors must determine whether the performance history of the originator and the original lender for substantially similar claims or receivables to those being securitized has been established for an “appropriately long period of time”. This performance history must be no shorter than a period of seven years for non-retail exposures. For retail exposures, the minimum performance history is five years.

### A3. Payment status

Non-performing credit claims and receivables are likely to require rigorous analysis. In order to ensure that only performing credit claims and receivables are assigned to a securitization, credit claims or receivables being transferred to the securitization may not, at the time of inclusion in the pool, include obligations that are in default or delinquent or obligations for which the transferor<sup>18</sup> or parties to the securitization<sup>19</sup> are aware of evidence indicating a material increase in expected losses or of enforcement actions.

### Additional requirement for capital purposes

To prevent credit claims or receivables arising from high-risk borrowers from being transferred to the securitization, the originator or sponsor should verify that the credit claims or receivables meet the following conditions:

- a) The obligor has not been the subject of an insolvency or debt restructuring process due to financial difficulties within three years prior to the date of origination;<sup>20</sup> and
- b) The obligor is not recorded on a public credit registry of persons with an adverse credit history; and
- c) The obligor does not have a credit assessment by an external credit assessment institution or a credit score indicating a significant risk of default; and

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<sup>18</sup> The originator or sponsor.

<sup>19</sup> The servicer or a party with a fiduciary responsibility.

<sup>20</sup> This condition would not apply to borrowers that previously had credit incidents but were subsequently removed from credit registries as a result of the borrower cleaning their records. This is the case in jurisdictions in which borrowers have the “right to be forgotten”.

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d) The credit claim or receivable is not subject to a dispute between the obligor and the original lender.

The assessment of these conditions should be carried out by the originator or sponsor no earlier than 45 days prior to the closing date. Additionally, at the time of this assessment, there should, to the best knowledge of the originator or sponsor, be no evidence indicating likely deterioration in the performance status of the credit claim or receivable.

Additionally, at the time of their inclusion in the pool, at least one payment should have been made on the underlying exposures, except in the case of revolving asset trust structures such as those for credit card receivables, trade receivables, and other exposures payable in a single instalment, at maturity.

#### **A4. Consistency of underwriting**

Investor analysis should be simpler where the securitization is of credit claims or receivables that satisfy materially non-deteriorating origination standards. To ensure that the quality of the securitized credit claims and receivables is not affected by changes in underwriting standards, the originator should demonstrate to investors that any credit claims or receivables being transferred to the securitization have been originated in the ordinary course of the originator's business to materially non-deteriorating underwriting standards. Where underwriting standards change, the originator should disclose the timing and purpose of such changes. Underwriting standards should not be less stringent than those applied to credit claims and receivables retained on the balance sheet.

These should be credit claims or receivables which have satisfied materially non-deteriorating underwriting standards and for which the obligors have been assessed as having the ability and volition to make timely payments on obligations or on granular pools of claims or receivables originated in the ordinary course of the originator's business where expected cash flows have been modelled to meet stated obligations of the securitization under prudently stressed loan loss scenarios.

#### **Additional requirement for capital purposes**

In all circumstances, all credit claims or receivables must be originated in accordance with sound and prudent underwriting criteria based on an assessment that the obligor has the ability and volition to make timely payments on its obligations.

The originator/sponsor of the securitization is expected, where underlying credit claims or receivables have been acquired from third parties, to review the underwriting standards of these third parties and to ascertain that they have assessed the obligors' ability and volition to make timely payments on their obligations.

#### **A5. Asset selection and transfer**

While recognizing that credit claims or receivables transferred to a securitization will be subject to defined criteria,<sup>21</sup> the performance of the securitization should not rely upon the ongoing selection of assets through active management<sup>22</sup> on a discretionary basis of the securitization's underlying portfolio. Credit claims or receivables transferred to a securitization should satisfy clearly defined eligibility criteria. Credit claims or receivables transferred to a securitization after the closing date may not be actively selected, actively managed or otherwise cherry-picked on a discretionary basis. Investors should be able to assess the credit risk of the asset pool prior to their investment decisions.

In order to meet the principle of true sale, the securitization should effect true sale such that the underlying credit claims or receivables:

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<sup>21</sup> The size of the obligation, the age of the borrower or the loan-to-value ratio of the property, debt-to-income ratio and/or debt service coverage ratio.

<sup>22</sup> Provided they are not actively selected or otherwise cherry-picked on a discretionary basis, the addition of credit claims or receivables during the revolving periods or their substitution or repurchasing due to the breach of representations and warranties do not represent active portfolio management.

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- a) are enforceable against the obligor, and their enforceability is included in the representations and warranties of the securitization;
  - b) are beyond the reach of the seller, its creditors or liquidators and are not subject to material recharacterization or clawback risks;
  - c) are not effected through credit default swaps, derivatives or guarantees, but by a transfer<sup>23</sup> of the credit claims or the receivables to the securitization; and
  - d) demonstrate effective recourse to the ultimate obligation for the underlying credit claims or receivables and are not a securitization of other securitizations.

In applicable jurisdictions, securitizations employing transfers of credit claims or receivables by other means should demonstrate the existence of material obstacles preventing true sale at issuance [The immediate realization of transfer duties or the requirement to notify all obligors<sup>24</sup> of the transfer and should clearly demonstrate the method of recourse to ultimate obligors. In such jurisdictions, any conditions where the transfer of the credit claims or receivables is delayed or contingent upon specific events and any factors affecting timely perfection of credit claims or receivables by the securitization should be clearly disclosed.

The originator should provide representations and warranties that the credit claims or receivables being transferred to the securitization are not subject to any condition or encumbrance that can be foreseen to adversely affect enforceability in respect of collections due.

#### **Additional requirement for capital purposes**

An independent third-party legal opinion must support the claim that the true sale and the transfer of assets under the applicable laws comply with points a) through d) above.

#### **A6. Initial and ongoing data**

To assist investors in conducting appropriate due diligence prior to investing in a new offering, sufficient loan-level data in accordance with applicable laws or, in the case of granular pools, summary stratification data on the relevant risk characteristics of the underlying pool should be available to potential investors before pricing of a securitization.

To assist investors in conducting appropriate and ongoing monitoring of their investments' performance, timely loan-level data in accordance with applicable laws or granular pool stratification data on the risk characteristics of the underlying pool and standardized investor reports should be readily available to current and potential investors at least quarterly throughout the life of the securitization. This will enable investors that wish to purchase a securitization in the secondary market to have sufficient information to conduct appropriate due diligence. Cut-off dates of the loan-level or granular pool stratification data should be aligned with those used for investor reporting.

To provide a level of assurance that the reporting of the underlying credit claims or receivables is accurate and that the underlying credit claims or receivables meet the eligibility requirements, the initial portfolio should be reviewed<sup>25</sup> by an appropriate legally accountable and independent third party, such as an independent accounting practice or the calculation agent or management company for the securitization.

### **B. Structural risk**

#### **B7. Redemption cash flows**

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<sup>23</sup> The requirement should not affect jurisdictions whose legal frameworks provide for a true sale with the same effects as described above, but by means other than a transfer of the credit claims or receivables.

<sup>24</sup> For example, an equitable assignment or a perfected contingent transfer.

<sup>25</sup> The review should confirm that the credit claims or receivables transferred to the securitization meet the portfolio eligibility requirements. The review could, for example, be undertaken on a representative sample of the initial portfolio, with the application of a minimum confidence level. The verification report need not be provided, but its results, including any material exceptions, should be disclosed in the initial offering documentation.

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Liabilities subject to the refinancing risk of the underlying credit claims or receivables are likely to require more rigorous analysis. To help ensure that the underlying credit claims or receivables do not need to be refinanced over a short period of time, there should not be a reliance on the sale or refinancing of the underlying credit claims or receivables in order to repay the liabilities, unless the underlying pool of credit claims or receivables is sufficiently granular and has sufficiently distributed repayment profiles. Rights to receive income from the assets specified to support redemption payments should be considered as eligible credit claims or receivables in this regard.<sup>26</sup>

## **B8. Currency and interest rate asset and liability mismatches**

To reduce the payment risk arising from the different interest rate and currency profiles of assets and liabilities and to improve investors' ability to model cash flows, interest rate and foreign currency risks should be appropriately mitigated at all times, and if any hedging transaction is executed, the transaction should be documented according to applicable master agreements. Only derivatives used for genuine hedging of asset and liability mismatches of interest rate and/or currency should be allowed.

### **Additional requirement for capital purposes**

The term "appropriately mitigated" should be understood as not necessarily requiring a matching hedge. The appropriateness of the mitigation of interest rate and foreign currency through the life of the transaction must be demonstrated by making available to potential investors, in a timely and regular manner, quantitative information including the fraction of notional amounts that are hedged, as well as a sensitivity analysis that illustrates the effectiveness of the hedge under extreme but plausible scenarios.

If hedges are not performed through derivatives, then those risk-mitigating measures are only permitted if they are specifically created and used for the purpose of hedging an individual and specific risk, and not multiple risks at the same time (such as credit and interest rate risks). Non-derivative risk mitigation measures must be fully funded and available at all times.

## **B9. Payment priorities and observability**

To prevent investors being subjected to unexpected repayment profiles during the life of a securitization, the priorities of payments for all liabilities in all circumstances should be clearly defined at the time of securitization and appropriate legal comfort regarding their enforceability should be provided.

To ensure that junior noteholders do not have inappropriate preference over senior noteholders in respect of payments that are due and payable, throughout the life of a securitization, or, where there are multiple securitizations backed by the same pool of credit claims or receivables, throughout the life of the securitization program, junior liabilities should not have payment preference over senior liabilities which are due and payable. The securitization should not be structured as a "reverse" cash flow waterfall such that junior liabilities are paid where due and payable senior liabilities have not been paid.

To help provide investors with full transparency over any changes to the cash flow waterfall, payment profile or priority of payments that might affect a securitization, all events, commitments, standards or preconditions that could affect the cash flow waterfall, the amount of payments or distributions to be made under asset-backed securities, or the timing thereof, should be clearly and fully disclosed both in offering documents and in investor reports.

Securitizations featuring a revolving period should include provisions for appropriate early amortization events and/or triggers of termination of the revolving period, including, notably:

- a) deterioration in the credit quality of the underlying exposures;
- b) a failure to acquire sufficient new underlying exposures of similar credit quality; and
- c) the occurrence of an event related to the non-viability of the originator or the servicer team.

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<sup>26</sup> For example, associated savings plans designed to repay principal at maturity.



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Following the occurrence of a performance-related trigger, an event of default or an acceleration event, the securitization positions should be repaid in accordance with a sequential amortization priority of payments, in order of tranche seniority, and there should not be provisions requiring immediate liquidation of the underlying assets at market value.

To assist investors in their ability to appropriately model the cash flow waterfall of the securitization, the originator or sponsor should make available to investors, both before pricing of the securitization and on an ongoing basis, a liability cash flow model or information on the cash flow provisions allowing appropriate modelling of the securitization cash flow waterfall.

To ensure that debt forgiveness, forbearance, payment holidays and other asset performance remedies can be clearly identified, policies and procedures, definitions, remedies and actions relating to delinquency, default or restructuring of underlying debtors should be provided in clear and consistent terms, such that investors can clearly identify debt forgiveness, forbearance, payment holidays, restructuring and other asset performance remedies on an ongoing basis.

#### **B10. Voting and enforcement rights**

To help ensure clarity for securitization noteholders of their rights and ability to control and enforce on the underlying credit claims or receivables, upon non-viability of the originator or sponsor, all voting and enforcement rights related to the credit claims or receivables should be transferred to the securitization. Investors' rights in the securitization should be clearly defined in all circumstances, including the rights of senior versus junior noteholders.

#### **B11. Documentation disclosure and legal review**

To help investors to fully understand the terms and conditions and the legal and commercial information prior to investing in a new offering<sup>27</sup> and to ensure that this information is set out in a clear and effective manner for all programs and offerings, sufficient initial offering<sup>28</sup> and draft underlying<sup>29</sup> documentation should be made available to investors (and readily available to potential investors on a continuous basis) within a reasonably sufficient period of time prior to pricing, or when legally permissible, such that the investor is provided with full disclosure of the legal and commercial information and comprehensive risk factors needed to make informed investment decisions. Final offering documents should be available from the closing date and all final underlying transaction documents shortly thereafter. These should be composed such that readers can readily find, understand and use relevant information.

To ensure that all the securitization's underlying documentation has been subject to appropriate review prior to publication, the terms and documentation of the securitization should be reviewed by an appropriately experienced third-party legal practice, such as a legal counsel already instructed by one of the transaction parties, for example, by the arranger or the trustee. Investors should be notified in a timely fashion of any changes in such documents that have an impact on the structural risks in the securitization.

#### **B12. Alignment of interest**

In order to align the interests of those responsible for the underwriting of the credit claims or receivables with those of investors, the originator or sponsor of the credit claims or receivables should retain a material net economic exposure and demonstrate a financial incentive in the performance of these assets following their securitization.

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<sup>27</sup> For the avoidance of doubt, any type of securitization should be allowed to fulfill the requirements of Criterion 11 once it meets its prescribed standards of disclosure and legal review.

<sup>28</sup> Draft offering circular, draft offering memorandum, draft offering document or draft prospectus, such as a "red herring."

<sup>29</sup> Asset sale agreement, assignment, novation or transfer agreement; servicing, backup servicing, administration and cash management agreements; trust/management deed, security deed, agency agreement, bank account agreement, guaranteed investment contract, constitution or incorporation documents, incorporated terms or master trust framework or master definitions agreement as applicable; any relevant inter-creditor agreements, swap or derivative documentation, subordinated loan agreements, start-up loan agreements and liquidity facility agreements; and any other relevant underlying documentation, including legal opinions.

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## **C. Fiduciary and servicer team risk**

### **C13. Fiduciary and contractual responsibilities**

To help ensure servicer teams have extensive workout expertise, thorough legal and collateral knowledge and a proven track record in loss mitigation, such parties should be able to demonstrate expertise in the servicing of the underlying credit claims or receivables, supported by a management team with extensive industry experience. The servicer team should at all times be prudent and act with reasonable diligence. Policies, procedures and risk management controls should be well documented and adhere to good market practices and relevant regulatory regimes. There should be robust systems and strong reporting capabilities in place.

The party or parties with fiduciary responsibility should act on a timely basis in the best interests of the securitization noteholders, and both the initial offering and all underlying documentation should contain provisions facilitating the timely resolution of conflicts between different classes of noteholders by the trustees, to the extent permitted by applicable law.

The party or parties with fiduciary responsibility to the securitization and to investors should be able to demonstrate sufficient skills and resources to comply with their duties of care in the administration of the securitization vehicle.

To increase the likelihood that those identified as having a fiduciary responsibility towards investors as well as the servicer team execute their duties in full on a timely basis, remuneration should be such that these parties are incentivized and able to meet their responsibilities in full and on a timely basis.

#### **Additional requirement for capital purposes**

In assessing whether “robust systems and strong reporting capabilities are in place”, well documented policies, procedures and risk management controls, as well as robust systems with strong reporting capabilities, may be substantiated by a third-party review for non-deposit-taking institutions.

### **C14. Transparency to investors**

To help provide full transparency to investors, assist investors in the conduct of their due diligence and to prevent investors being subject to unexpected disruptions in cash flow collections and servicing, the contractual obligations, duties and responsibilities of all key parties to the securitization, both those with a fiduciary responsibility and those providing ancillary services, should be defined clearly both in the initial offering and in all underlying documentation. Provisions should be documented for the replacement of servicers, bank account providers, derivatives counterparties and liquidity providers in the event of failure, non-performance, non-viability, insolvency or other deterioration of creditworthiness of any such counterparty to the securitization.

To enhance transparency and visibility over all receipts, payments and ledger entries at all times, the performance reports to investors should distinguish and report the securitization’s income and disbursements, such as scheduled principal, redemption principal, scheduled interest, prepaid principal, past due interest and fees and charges, delinquent, defaulted and restructured amounts under debt forgiveness and payment holidays, including accurate accounting for amounts attributable to principal and interest deficiency ledgers.

#### **Additional requirement for capital purposes**

The terms “initial offering” and “underlying transaction documentation” should be understood in the context defined by Criterion B11. The term “income and disbursements” should also be understood as including deferment, forbearance, and repurchases among the items described.

## **D. Additional criteria for capital purposes**

### **D15. Credit risk of underlying exposures**

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At the portfolio cut-off date, the underlying exposures have to meet the conditions under the standardized approach for credit risk, and after taking into account any eligible credit risk mitigation, for being assigned a risk weight equal to or smaller than:

- 40% on a value-weighted average exposure basis for the portfolio where the exposures are loans secured by residential mortgages or fully guaranteed residential loans;
- 50% on an individual exposure basis where the exposure is a loan secured by a commercial mortgage;
- 75% on an individual exposure basis where the exposure is a retail exposure; or
- 100% on an individual exposure basis for any other exposure.

#### **D16. Granularity of the pool**

At the portfolio cut-off date, the aggregated value of all exposures to a single obligor should not exceed 1%<sup>30</sup> of the aggregated outstanding exposure value of all exposures in the portfolio.

### **3.2 Eligibility criteria for short-term STC securitizations**

For short-term securitizations, STC criteria must be met at two levels: at the transaction level and at the conduit (securitization vehicle) level. While most criteria are relevant to both levels, they have slightly different objectives based on risk differences, the stakeholders involved or the structure at each level. Seventeen STC criteria must be considered<sup>31</sup> for short-term securitizations (securitizations of asset-backed commercial paper (ABCP)):

#### **A. Asset risk**

##### **1. Nature of the assets**

###### **Relevant to the conduit level**

The sponsor should make representations and warranties to investors that the subsections of Criterion A1 defined at the transaction level are met, and explain how this is the case on an overall basis. Only if specified should this be done for each transaction. Provided that each individual underlying transaction is homogeneous in terms of asset type, a conduit may be used to finance transactions of different asset types. Program-wide credit enhancement should not prevent a conduit from qualifying for STC, regardless of whether such enhancement technically creates resecuritization.

###### **Relevant to the transaction level**

The assets underlying a transaction in a conduit should be credit claims or receivables that are homogeneous, in terms of asset type.<sup>32</sup>

The assets underlying each individual transaction in a conduit should not be composed of “securitization exposures” as defined in the *Capital Adequacy Guideline*.<sup>33</sup>

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<sup>30</sup> In jurisdictions with structurally concentrated corporate loan markets available for securitization subject to ex-ante supervisory approval and only for corporate exposures, the applicable maximum concentration threshold could be increased to 2% if the originator or sponsor retains subordinated tranche(s) that form loss absorbing credit enhancement, as defined in paragraph 55 of the December 2014 framework, and which cover at least the first 10% of losses. These tranche(s) retained by the originator or sponsor will not be eligible for the STC capital treatment.

<sup>31</sup> Basel Committee on Banking Supervision and the Board of the International Organization of Securities Commissions. Criteria for identifying short-term “simple, transparent and comparable” securitisations, May 2018. Since certain criteria for long-term securitizations are similar to the STC criteria for ABCP, only STC criteria applicable solely to ABCP will be outlined.

<sup>32</sup> For the avoidance of doubt, this criterion does not automatically exclude securitizations of equipment leases and securitizations of auto loans and leases from the short-term STC framework.

<sup>33</sup> Autorité des marchés financiers. *Capital Adequacy Guideline* (available in French only).

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Credit claims or receivables underlying a transaction in a conduit should have contractually identified periodic payment streams relating to rental,<sup>34</sup> principal, interest, or principal and interest payments. Credit claims or receivables generating a single payment stream would equally qualify as eligible. Any referenced interest payments or discount rates should be based on commonly encountered market interest rates,<sup>35</sup> but should not reference complex formulae or exotic derivatives.

## **2. Asset performance history**

### **Relevant to the conduit level**

In order to provide investors with sufficient information on the performance history of the asset types backing the transactions, the sponsor should make available to investors sufficient loss performance data on claims and receivables with substantially similar risk characteristics, such as delinquency and default data on similar claims and receivables, and for a time period long enough to permit meaningful evaluation. The sponsor should disclose to investors the sources of such data and the basis for claiming similarity to credit claims or receivables financed by the conduit. Such loss performance data may be provided on a stratified basis.<sup>36</sup>

### **Relevant to the transaction level**

In order to provide the sponsor with sufficient information on the performance history of each asset type backing the transactions and to conduct appropriate due diligence and to have access to a sufficiently rich data set to enable a more accurate calculation of expected loss in different stress scenarios, verifiable loss performance data, such as delinquency and default data, should be available for credit claims and receivables with risk characteristics substantially similar to those being financed by the conduit, for a time period long enough to permit meaningful evaluation by the sponsor.

## **3. Payment status**

### **Relevant to the conduit level**

The sponsor should, to the best of its knowledge and based on representations from sellers, make representations and warranties to investors that Criterion A3 at the transaction level is met with respect to each transaction. Relevant to the transaction level The sponsor should obtain representations from sellers that the credit claims or receivables underlying each individual transaction are not, at the time of acquisition of the interests to be financed by the conduit, in default or delinquent or subject to a material increase in expected losses or to enforcement actions.

## **4. Consistency of underwriting**

### **Relevant to the conduit level**

The sponsor should make representations and warranties to investors that it has taken steps to verify that, for the transactions in the conduit, any underlying credit claims and receivables have been subject to consistent underwriting standards, and explain how. When there are material changes to underwriting standards, the sponsor will receive from sellers disclosure about the timing and purpose of such changes.

The sponsor should also inform investors of the material selection criteria applied when selecting sellers (including where they are not financial institutions).

### **Relevant to the transaction level**

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<sup>34</sup> Payments on operating and financing leases are typically considered to be rental payments rather than payments of principal and interest.

<sup>35</sup> Commonly encountered market interest rates may include rates reflective of a lender's cost of funds, to the extent that sufficient data are provided to investors to allow them to assess their relation to other market rates.

<sup>36</sup> "Stratified" means, by way of example: • all materially relevant data on the conduit's composition (outstanding balances, industry sector, obligor concentrations, maturities, etc.) and the conduit's overview; and • all materially relevant data on the credit quality and performance of underlying transactions, allowing investors to identify collections, and, as applicable, debt restructuring, forgiveness, forbearance, payment holidays, repurchases, delinquencies and defaults.

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The sponsor should ensure that sellers (in their capacity as original lenders) in transactions with the conduit demonstrate to it that:

- any credit claims or receivables being transferred to or through a transaction held by the conduit have been originated in the ordinary course of the seller's business subject to materially non-deteriorating underwriting standards.

Those underwriting standards should be as stringent as those applied to credit claims and receivables retained on the balance sheet of the seller and not financed by the conduit; and

- the obligors have been assessed as having the ability and volition to make timely payments on obligations.

The sponsor should also ensure that sellers disclose to it the timing and purpose of material changes to underwriting standards.

## **5. Asset selection and transfer**

### **Relevant to the conduit level**

The sponsor should:

- provide representations and warranties to investors about the checks, in terms of their nature and frequency, it has conducted regarding enforceability of underlying assets; and
- disclose to investors the receipt of appropriate representations and warranties from sellers that the credit claims or receivables being transferred to the transactions in the conduit are not subject to any condition or encumbrance that can be foreseen to adversely affect enforceability in respect of collections due.

### **Relevant to the transaction level**

The sponsor should ensure that credit claims or receivables transferred to or through a transaction financed by the conduit:

- satisfy clearly defined eligibility criteria; and
- are not actively selected after the closing date, actively managed<sup>37</sup> or otherwise cherry-picked.

The sponsor should be able to assess thoroughly the credit risk of the asset pool prior to its decision to provide full support to any given transaction or to the conduit.

The sponsor should ensure that the transactions in the conduit effect true sale such that the underlying credit claims or receivables:

- are enforceable against the obligor;
- are beyond the reach of the seller, its creditors or liquidators and are not subject to material recharacterization or clawback risks;
- are not made through credit default swaps, derivatives or guarantees, but by a transfer<sup>38</sup> of the credit claims or the receivables to the securitization; and
- demonstrate effective recourse to the ultimate obligation for the underlying credit claims or receivables and are not a resecuritization position.

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<sup>37</sup> Provided they are not actively selected or otherwise cherry-picked, the addition of credit claims or receivables during the revolving periods or their substitution or repurchasing due to the breach of representations and warranties do not represent active portfolio management.

<sup>38</sup> This requirement should not affect jurisdictions whose legal frameworks provide for a true sale with the same effects as described above, but by means other than a transfer of the credit claims or receivables.

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The sponsor should ensure that, in applicable jurisdictions, for conduits employing transfers of credit claims or receivables by other means, sellers can demonstrate to it the existence of material obstacles preventing true sale at issuance<sup>39</sup> and should clearly demonstrate the method of recourse to ultimate obligors. In such jurisdictions, any conditions where the transfer of the credit claims or receivables is delayed or contingent upon specific events and any factors affecting timely perfection of claims by the conduit should be clearly disclosed.

The sponsor should ensure that it receives from the individual sellers (in their capacity as either original lender or servicer) representations and warranties that the credit claims or receivables being transferred to or through the transaction are not subject to any condition or encumbrance that can be foreseen to adversely affect enforceability in respect of collections due.

## **6. Initial and ongoing data**

### **Relevant to the conduit level**

To assist investors in conducting appropriate due diligence prior to investing in a new program offering, the sponsor should provide to potential investors sufficient aggregated data that illustrate the relevant risk characteristics of the underlying asset pools in accordance with applicable laws.

To assist investors in conducting appropriate and ongoing monitoring of their investments' performance and so that investors who wish to purchase commercial paper have sufficient information to conduct appropriate due diligence, the sponsor should provide timely and sufficient aggregated data that convey the relevant risk characteristics of the underlying pools in accordance with applicable laws. The sponsor should ensure that standardized investor reports are readily available to current and potential investors at least monthly. Cut-off dates of the aggregated data should be aligned with those used for investor reporting.

### **Relevant to the transaction level**

The sponsor should ensure that the individual sellers (in their capacity as servicers) provide it with:

- a) sufficient asset-level data in accordance with applicable laws or, in the case of granular pools, summary stratification data on the relevant risk characteristics of the underlying pool before transferring any credit claims or receivables to such underlying pool; and
- b) timely asset-level data in accordance with applicable laws or granular pool stratification data on the risk characteristics of the underlying pool on an ongoing basis. That data should allow the sponsor to fulfil its fiduciary duty at the conduit level in terms of disclosing information to investors, including the alignment of cut-off dates of the asset-level or granular pool stratification data with those used for investor reporting.

The seller may delegate some of these tasks, in which case the sponsor should ensure that there is appropriate oversight of the outsourced arrangements.

## **B. Structural risk**

### **7. Full support**

#### **Relevant to the conduit level**

The sponsor should provide the liquidity facilities and the credit protection support<sup>40</sup> for any ABCP program issued by a conduit. Such facilities and support should ensure that investors are fully protected against credit risks, liquidity risks and any material dilution risks of the underlying asset pools financed by the conduit. On that basis, investors should be able to rely on the sponsor to ensure timely and full repayment of the commercial paper.

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<sup>39</sup> For instance, the immediate realization of transfer duties or the requirement to notify all obligors of the transfer.

<sup>40</sup> A sponsor can provide full support either at the ABCP program level or at the transaction level, i.e. by fully supporting each transaction within an ABCP program.

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## **8. Redemption cash flow**

### **Relevant to the transaction level**

Unless the underlying pool of credit claims or receivables is sufficiently granular and has sufficiently distributed repayment profiles, the sponsor should ensure that the repayment of the credit claims or receivables underlying any of the individual transactions relies primarily on the general ability and willingness of the obligor to pay rather than the possibility of the obligor refinancing or selling the collateral and that such repayment does not primarily rely on the drawing of an external liquidity facility provided to this transaction.

## **9. Currency and interest rate asset and liability mismatches**

### **Relevant to the conduit level**

The sponsor should ensure that any payment risk arising from different interest rate and currency profiles: (i) not mitigated at the transaction level; or (ii) arising at the conduit level, is appropriately mitigated.

The sponsor should also ensure that derivatives are used for genuine hedging purposes only and that hedging transactions are documented according to industry-standard master agreements.

The sponsor should provide sufficient information to investors to allow them to assess how the payment risk arising from the different interest rate and currency profiles of assets and liabilities is appropriately mitigated, whether at the conduit level or at the transaction level.

### **Relevant to the transaction level**

To reduce the payment risk arising from the different interest rate and currency profiles of assets and liabilities, if any, and to improve the sponsor's ability to analyze cash flows of transactions, the sponsor should ensure that interest rate and foreign currency risks are appropriately mitigated. The sponsor should also ensure that derivatives are used for genuine hedging purposes only and that hedging transactions are documented according to industry-standard master agreements.

## **10. Payment priorities and observability**

### **Relevant to the conduit level**

The commercial paper issued by the ABCP program should not include extension options or other features which may extend the final maturity of the asset-backed commercial paper, where the right to trigger does not belong exclusively to investors.

The sponsor should:

- make representations and warranties to investors that this criterion is met at the transaction level and, in particular, that it has the ability to appropriately analyze the cash flow waterfall for each transaction which qualifies as a securitization; and
- make available to investors a summary (illustrating the functioning) of these waterfalls and of the credit enhancement available at the program level and at the transaction level.

### **Relevant to the transaction level**

To prevent the conduit from being subjected to unexpected repayment profiles from the transactions, the sponsor should ensure that:

- priorities of payments are clearly defined at the time of acquisition of the interests in these transactions by the conduit; and
- appropriate legal comfort regarding the enforceability is provided.

For all transactions which qualify as a securitization, the sponsor should ensure that all triggers affecting the cash flow waterfall, payment profile or priority of payments are clearly and fully disclosed to the sponsor

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in both the transactions' documentation and reports, with information in the reports that clearly identifies any breach status, the ability for the breach to be reversed and the consequences of the breach. Reports should contain information that allows sponsors to easily ascertain the likelihood of a trigger being breached or reversed. Any triggers breached between payment dates should be disclosed to sponsors on a timely basis in accordance with the terms and conditions of the transaction documents.

For any of the transactions where the beneficial interest held by the conduit qualifies as a securitization position, the sponsor should ensure that any subordinated positions do not have inappropriate payment preference over payments to the conduit (which should always rank senior to any other position) and which are due and payable.

Transactions featuring a revolving period should include provisions for appropriate early amortization events and/or triggers of termination of the revolving period, including, notably: (i) deterioration in the credit quality of the underlying exposures; (ii) a failure to replenish sufficient new underlying exposures of similar credit quality; and (iii) the occurrence of a non-viability-related event with regard to the individual sellers.

To ensure that debt forgiveness, forbearance, payment holidays, restructuring, dilution and other asset performance remedies can be clearly identified, policies and procedures, definitions, remedies and actions relating to delinquency, default, dilution or restructuring of underlying debtors should be provided in clear and consistent terms, such that the sponsor can clearly identify debt forgiveness, forbearance, payment holidays, restructuring, dilution and other asset performance remedies on an ongoing basis.

For each transaction which qualifies as a securitization, the sponsor should ensure that it receives, both before the conduit acquires a beneficial interest in the transaction and on an ongoing basis, the liability cash flow analysis or information on the cash flow provisions allowing appropriate analysis of the cash flow waterfall of these transactions.

## **11. Voting and enforcement rights**

### **Relevant to the conduit level**

To provide clarity to investors, the sponsor should make sufficient information available in order for investors to understand their enforcement rights on the underlying credit claims or receivables in the event of insolvency of the sponsor.

### **Relevant to the transaction level**

For each transaction, the sponsor should ensure that, in particular, upon non-viability of the seller or where the obligor is in default on its obligation, all voting and enforcement rights related to the credit claims or receivables are, if applicable:

- transferred to the conduit; and
- clearly defined under all circumstances, including with respect to the rights of the conduit versus other parties with an interest (e.g., sellers), where relevant.

## **12. Documentation disclosure and legal review**

### **Relevant to the conduit level**

To help investors understand fully the terms, conditions and legal information prior to investing in a new program offering and to ensure that this information is set out in a clear and effective manner for all program offerings, the sponsor should ensure that sufficient initial offering documentation for the ABCP program is provided to investors (and readily available to potential investors on a continuous basis) within a reasonable period of time prior to issuance, such that the investor is provided with full disclosure of the legal information and comprehensive risk factors needed to make informed investment decisions.

These should be composed so that readers can readily find, understand and use relevant information. The sponsor should ensure that the terms and documentation of a conduit and the ABCP program it issues are



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reviewed and verified by an appropriately experienced and independent legal practice prior to publication and in the event of material changes. The sponsor should notify investors in a timely fashion of any changes in such documents that have an impact on the structural risks in the ABCP program.

### **13. Alignment of interest**

#### **Relevant to the conduit level**

In order to align the interests of those responsible for the underwriting of the credit claims and receivables with those of investors, a material net economic exposure should be retained by the sellers or the sponsor at the transaction level, or by the sponsor at the conduit level.

Ultimately, the sponsor should disclose to investors how and where a material net economic exposure is retained by the seller at the transaction level, or by the sponsor at the transaction or the conduit level, and demonstrate the existence of a financial incentive in the performance of the assets.

### **14. Cap on maturity transformation**

#### **Relevant to the conduit level**

Maturity transformation undertaken through ABCP conduits should be limited. The sponsor should verify and disclose to investors that the weighted average maturity of all the transactions financed under the ABCP conduit is three years or less.

This number should be calculated as the higher of:

1. the exposure-weighted average residual maturity of the conduit's beneficial interests held or the assets purchased by the conduit in order to finance the transactions of the conduit;<sup>41</sup>
2. the exposure-weighted average maturity of the underlying assets financed by the conduit calculated by:
  - a) taking an exposure-weighted average of residual maturities of the underlying assets in each pool, and then
  - b) taking an exposure-weighted average across the conduit of the pool-level averages as calculated in Step 2a.

Where it is impractical for the sponsor to calculate the pool-level weighted average maturity in Step 2a (because the pool is very granular or dynamic), sponsors may instead use the maximum maturity of the assets in the pool as defined in the legal agreements governing the pool (e.g., investment guidelines).

### **C. Fiduciary and servicer team risk**

#### **15. Financial institution**

##### **Relevant to the conduit level**

The sponsor should be a financial institution that is licensed to take deposits from the public, and is subject to appropriate prudential standards and levels of supervision.<sup>42</sup>

#### **16. Fiduciary and contractual responsibilities**

##### **Relevant to the conduit level**

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<sup>41</sup> Including purchased securitization notes, loans, asset-backed deposits and purchased credit claims and/or receivables held directly on the conduit's balance sheet.

<sup>42</sup> The AMF sets guidelines for various financial institution categories. These guidelines provide an indication of the AMF's expectations in regard to financial institutions' legal obligation to follow sound and prudent management practices and sound commercial practices. In accordance with the Basel framework, the AMF has the following guidelines: Governance Guideline, Integrated Risk Management Guideline, Liquidity Risk Management Guideline, Liquidity Adequacy Guideline, Capital Management Guideline and Capital Adequacy Requirements Guideline (available in French only under the name "Ligne directrice sur les normes relatives à la suffisance du capital de base").

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The sponsor should, based on the representations received from the seller(s) and all other parties responsible for originating and servicing the asset pools, make representations and warranties to investors that:

- the various criteria defined at the level of each underlying transaction are met, and explain how;
- the seller's (sellers') policies, procedures and risk management controls are well documented, adhere to good market practices and comply with the relevant regimes; and that robust systems and strong reporting capabilities are in place to ensure appropriate origination and servicing of the underlying assets.

The sponsor should be able to demonstrate expertise in providing liquidity and credit support in the context of ABCP conduits, and that it is supported by a management team with extensive industry experience.

The sponsor should at all times act in accordance with reasonable and prudent standards. The policies, procedures and risk management controls of the sponsor should be well documented, and the sponsor should adhere to good market practices and relevant regulatory regimes. There should be robust systems and strong reporting capabilities in place at the sponsor.

The party or parties with fiduciary responsibility should act on a timely basis in the best interests of investors.

#### **Relevant to the transaction level**

The sponsor should ensure that it receives representations from the seller(s) and all other parties responsible for originating and servicing the asset pools that they:

- have well-documented procedures and policies in place to ensure appropriate servicing of the underlying assets;
- have expertise in the origination of assets that are the same as or similar to those in the asset pools;
- have extensive servicing and workout expertise, thorough legal and collateral knowledge, and a track record in loss mitigation for the same or similar assets;
- have expertise in the servicing of the underlying credit claims or receivables; and
- are supported by a management team with extensive industry experience.

### **17. Transparency to investors**

#### **Relevant to the conduit level**

To help provide full transparency to investors and to assist them in their conduct of their due diligence, the sponsor should ensure that the contractual obligations, duties and responsibilities of all key parties to the conduit, both those with a fiduciary responsibility and those providing ancillary services, are defined clearly both in the initial offering and in any relevant underlying documentation<sup>43</sup> of the conduit and the ABCP program it issues.

The sponsor should also make representations and warranties to investors that the duties and responsibilities of all key parties are clearly defined at the transaction level.

The sponsor should ensure that the initial offering documentation disclosed to investors contains adequate provisions regarding the replacement of key counterparties of the conduit (e.g., bank account providers and derivatives counterparties) in the event of failure or non-performance or insolvency or deterioration of creditworthiness of any such counterparty.

The sponsor should also make representations and warranties to investors that provisions regarding the replacement of key counterparties at the transaction level are well documented.

The sponsor should provide sufficient information to investors about the liquidity facilities and credit support provided to the ABCP program for them to understand its functioning and key risks.

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<sup>43</sup> "Underlying documentation" does not refer to the documentation of the underlying transactions.

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## Relevant to the transaction level

The sponsor should conduct due diligence with respect to the transactions on behalf of the investors.

To assist the sponsor in meeting its fiduciary and contractual obligations, the duties and responsibilities of all key parties to all transactions (both those with a fiduciary responsibility and those providing ancillary services) should be defined clearly in all documentation underlying these transactions and made available to the sponsor.

The sponsor should ensure that provisions regarding the replacement of key counterparties (in particular, the servicer team or liquidity provider) in the event of failure, non-performance, insolvency or other deterioration of any such counterparty for the transactions are well documented (in the documentation of these individual transactions).

To enhance the transparency and visibility of all receipts, payments and ledger entries at all times, the sponsor should ensure that, for all transactions, the performance reports include all of the following: the transactions' income and disbursements, such as scheduled principal, redemption principal, scheduled interest, prepaid principal, past due interest and fees and charges, and delinquent, defaulted, restructured and diluted amounts, as well as accurate accounting for amounts attributable to principal and interest deficiency ledgers.

STC securitizations, whether short- or long-term, receive preferential capital requirement treatment. The capital requirements for securitizations qualified as STC are described in the *Adequacy of Capital Base Guideline* (in French only) (Chapter 6).<sup>44</sup>

STC criteria should be met at all times. Verifying compliance with certain criteria may be necessary solely when the STC securitization is originated. Notwithstanding the foregoing, investors and holders of securitization positions should give consideration to developments that could invalidate a prior confirmation of compliance with the STC standard, such as gaps in the frequency and content of investor reports, discrepancies in the alignment of the parties' interests or changes in the transaction documentation that conflict with the STC criteria.

Compliance with STC requirements does not guarantee that all securitization transactions will be risk-free. These criteria should be construed as meaning that a prudent and diligent investor will be in a position to analyze the inherent risks of the securitization.

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<sup>44</sup> These elements have not been developed in this guideline.

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## Appendix 1 Possible securitization roles assumed by financial institutions

In a securitization transaction, financial institutions may assume various roles, directly or indirectly, through subsidiaries or related parties. These roles can be grouped into three categories: issuance or management of ABS, hedging of ABS risks, and investing in ABS.

If issuing or managing ABS, financial institutions may assume the following roles:

Title	Role
Originator/sponsor	Originate credit claims or receivables, loans or other financial assets that are pool assets; organize and execute the securitization transaction by selling or transferring assets to the SPE
Arranger	Analyze the needs of financial institutions that intend to assign pools of credit claims or receivables and structure the securitization transaction so as to achieve the objectives of the initiator and investors.
Special purpose entity (SPE)	Acquire or assume the risks related to a pool of credit claims or receivables and issue negotiable debt instruments whose value and returns are based on those risks.
Manager	Set up and manage an SPE by being responsible for strategic orientations and relations with the distributor, credit enhancer, liquidity support provider and credit rating agency.
Servicer	Collect principal and interest payments on the underlying assets and transmit these funds to the SPE or ABS investors, or a trustee representing them.
Distributor	Distribute and market ABS issued by an SPE
Credit enhancer	Guarantee ABS
Liquidity support provider	Provide liquidity support
Investor	The financial institution that invests in ABS