

## **ANNEX 2K**

### **IMPLICIT SUPPORT FOR SECURITISATION TRANSACTIONS BY CREDIT INSTITUTIONS AUTHORISED UNDER THE BANKING ACT 1994**

#### **SCOPE AND APPLICATION**

1. This scope of this Annex is to adopt and implement the requirements outlined in the *EBA Guidelines on implicit support for securitised transactions (EBA/GL/2016/08)*.
2. This Annex specifies what constitutes arm's length conditions and when a transaction is not structured to provide support, according to Article 250 of Regulation (EU) 2017/2401 of the European Parliament and the Council of 12 December 2017 amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms ("the Regulation").
3. This Annex also elaborates further on the notification and documentation requirements of Article 250(1), (2) and (3) of the Regulation.
4. This Annex applies to credit institutions in relation to the support provided to securitisations by sponsor institutions and originator institutions beyond their contractual obligations as further specified in paragraph 7 of this Annex, in accordance with Article 250 of the Regulation and the conditions set out therein. This Annex is without prejudice to the on-going assessment of significant risk transfer during the life of the securitisation.

#### **DEFINITIONS**

5. For the purposes of the Annex, unless the context otherwise requires, the following shall apply:

"originator" means an entity which:

- (a) itself or through related entities, directly or indirectly, was involved in the original agreement which created the obligations or potential obligations of the debtor or potential debtor giving rise to the exposures being securitised; or
- (b) purchases a third party's exposures on its own account and then securitises them.

"securitisation" means a transaction or scheme, whereby the credit risk associated with an exposure or a pool of exposures is tranching, having all of the following characteristics:

- (a) payments in the transaction or scheme are dependent upon the performance of the exposure or of the pool of exposures;
- (b) the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme;
- (c) the transaction or scheme does not create exposures which possess all of the characteristics listed in Article 147(8) of Regulation (EU) No 575/2013 ("the CRR").

“sponsor” means a credit institution, whether located in the Union or not, as defined in point (1) of Article 4(1) of the CRR, or an investment firm as defined in point (1) of Article 4(1) of Directive 2014/65/EU other than an originator, that:

- (a) establishes and manages an asset-backed commercial paper programme or other securitisation that purchases exposures from third-party entities, or
  - (b) establishes an asset-backed commercial paper programme or other securitisation that purchases exposures from third-party entities and delegates the day-to-day active portfolio management involved in that securitisation to an entity authorised to perform such activity in accordance with Directive 2009/65/EC, Directive 2011/61/EU or Directive 2014/65/EU.
6. Unless otherwise specified, terms used and defined in the CRR and the Regulation have the same meaning in this Annex.

## **IMPLICIT SUPPORT**

### Existing contractual obligations

7. Any transaction (for the avoidance of doubt, including, but not limited to, any amendments to the securitisation documentation and changes to the coupons, yields or other features of the securitisation positions) entered into by (i) a sponsor institution or (ii) an originator institution or (iii), subject to the provisions of paragraph 22 of this Annex, an entity connected to the originator institution in relation to a securitisation or positions therein after the closing of such securitisation, which, pursuant to the terms of the securitisation documentation as in force prior to the entering into of such transaction, the originator institution or, as the case may be, the sponsor institution or the entity connected to the originator institution:
- (a) is under no contractual obligation to enter into; or
  - (b) is not under a contractual obligation to enter into on the specific terms of such transaction

shall be considered to have been entered into beyond the scope of existing contractual obligations, its particulars shall be notified in accordance with paragraph 23 of this Annex and it shall be assessed, in accordance with paragraph 8 of this Annex, whether the transaction is structured to provide support or not. Transactions which, pursuant to the terms of the securitisation documentation as in force prior to the entering into of such transactions, the relevant institution is under a contractual obligation to enter into on the specific terms of such transactions constitute existing support and are not subject to the prohibition set out in Article 250 of the Regulation.

### Transaction not structured to provide support

8. For the purposes of Article 250 of the Regulation, a transaction shall be considered as not being structured to provide support in any of the cases referred to in paragraphs 9 and 10 of this Annex, taking into account the provisions of paragraph 16 of this Annex.

9. Subject to paragraph 22 of this Annex, where the transaction is carried out by a sponsor institution, the transaction shall be considered as not being structured to provide support if it meets either of the following conditions:
  - (a) it is executed at arm's length conditions, in accordance with paragraph 12 of this Annex; or
  - (b) it is executed on conditions which are more favourable to the sponsor institution than arm's length conditions.
10. Where the transaction is carried out by an originator institution which has transferred significant credit risk associated with the underlying exposures of the securitisation in accordance with Article 244 and 245 of the Regulation, the transaction shall be considered as not being structured to provide support if it meets the following conditions:
  - (a) the transaction is executed:
    - i. at arm's length conditions, in accordance with paragraph 12 of this Annex; or
    - ii. on conditions which are more favourable to the originator institution than arm's length conditions; and
  - (b) either (i) the securitisation continues to meet the conditions for significant risk transfer as set out in Article 244 of the Regulation or, as the case may be, Article 245 of the Regulation, in accordance with this Annex and with *EBA Guidelines on significant risk transfer (EBA/GL/2014/05)*, or (ii) if such conditions are no longer met, the transaction was not entered into with a view to reducing potential or actual losses to investors.
11. If the conditions for significant risk transfer are no longer met, the originator institution shall hold own funds against all of the securitised exposures as if they had not been securitised.

#### Arm's length conditions

12. For the purposes of Article 250 of the Regulation, a transaction shall be considered to be executed at arm's length, where the terms of the transaction are such that they would be in a normal commercial transaction if:
  - (a) the parties had no relations with each other (including, but not limited to, any special duty or obligation and any possibility to control or influence each other); and
  - (b) each party:
    - i. acted independently;
    - ii. entered into the transaction of its own volition;
    - iii. acted in its own interests; and
    - iv. did not enter into the transaction on the basis of extraneous considerations which are not directly connected with the transaction in question (such extraneous considerations including, but not being limited to, any reputational

risk which might arise in respect of the originator institution or the sponsor institution shall it not proceed with the transaction).

13. In the course of the assessment referred to in paragraph 12 of this Annex, due regard shall be given to the information available to each of the parties at the time when the transaction is entered into and not to such information as becomes available thereafter.

#### Significant risk transfer

14. When a sponsor or an originator is evaluating a transaction in accordance with Article 250 of the Regulation, any assessment of whether the conditions for significant risk transfer as set out in Article 244 or, as the case may be, Article 245 of that Regulation continue to be met, shall be carried out in accordance with this Annex and with the *EBA Guidelines on significant risk transfer (EBA/GL/2014/05)*.
15. A transaction shall be deemed to invalidate the conditions for significant risk transfer if, as a result of the transaction, the reduction in risk-weighted exposure amounts the originator institution initially achieved is no longer justified by a corresponding transfer of credit risk to third parties. The factors to be considered shall include:
  - (a) the credit risk of the originator institution after undertaking the transaction; and
  - (b) the extent to which the capital or liquidity position of the originator institution is affected by the transaction.

#### Relevant factors for assessment

16. When assessing whether a transaction is not structured to provide support as set out in paragraph 8 of this Annex, all relevant circumstances shall be considered, including the criteria set out in paragraphs 17 – 21 of this Annex.
17. The factor contemplated in point (a) of Article 250(2) of the Regulation (the repurchase price) shall also be applied to transactions other than a repurchase and, in such cases, the amounts payable or, as the case may be, receivable by the originator institution or by the sponsor institution shall be considered. For all transactions, measures of market value shall be considered, including quoted prices in active markets for similar transactions that the institution can access at the measurement date. If such measures are not identifiable, then inputs other than quoted prices that are directly or indirectly observable for the asset shall be considered; and, if such inputs are not identifiable, then unobservable inputs for the asset shall be considered. In the case of unobservable inputs, the originator institution or sponsor institution shall provide evidence to the authority regarding how the receivable or payable amounts have been valued and which inputs were used. The originator institution or sponsor institution shall also demonstrate that this assessment is in line with its credit review and approval process. A transaction shall be considered as not having been executed at arm's length conditions if the amounts receivable by the originator institution or, as the case may be, the sponsor institution are materially lower than, or the amounts payable by the originator institution or sponsor institution are materially higher than, the relevant market value.

18. The factor contemplated in point (b) of Article 250(2) of the Regulation (the institution's capital and liquidity position before and after repurchase) shall be considered as also being relevant in the case of transactions other than a repurchase. The conditions for significant risk transfer shall be considered as no longer being satisfied if, as a result of the transaction, the reduction in risk-weighted exposure amounts the originator institution initially achieved is no longer justified by a commensurate transfer of credit risk to third parties, which shall be the case if the originator institution's capital or liquidity position is materially and adversely affected, directly or indirectly, by the transaction. In making such assessment, among other things, the accounting entries that the participants to the transaction made with respect to the transaction and the changes in their liquidity position shall be considered.
19. Regarding the factor contemplated in point (c) of Article 250(2) of the Regulation , on the performance of the underlying exposures, if the underlying exposures being subject to the transaction have been underperforming relative to other securitised exposures or have been reported as non-performing, it shall be considered that the transaction is not executed at arm's length conditions if either such underperformance or the foreseeable future performance of such exposures as a result of the circumstances having caused such underperformance is not adequately reflected in the price of the purchase or repurchase.
20. Regarding the factor contemplated in point (d) of Article 250(2) of the Regulation (the performance of the securitisation positions), if the securitisation positions being subject to the transaction have been underperforming relative to other securitisation positions or have been reported as non-performing, it shall be considered (i) whether the cost of measures taken to improve the performance of these securitisation positions has been fully borne by the relevant securitisation investors and (ii) whether the institution which participated in the transaction is negatively affected, directly or indirectly, by the transaction.
21. Regarding the factor contemplated in point (e) of Article 250(2) of the Regulation (the impact of support on the losses expected to be incurred by the originator relative to investors), it shall be considered whether the expected losses of a securitisation position are materially increased or reduced, having regard, among other things, to changes in the market price of the position, in the risk-weighted exposure amounts and in the ratings of securitisation positions.

#### Notification and documentation

22. The requirement of notification to the competent authority of any transaction, regardless of whether it provides support to the securitisation, referred to in Article 250(3) of the Regulation shall apply to any transaction which is entered into by an originator institution or by a sponsor institution or which meets the following conditions:
  - (a) it is entered into by an entity, other than the originator institution, (i) which is a parent undertaking of the originator institution, a subsidiary undertaking of the originator institution or a subsidiary undertaking of a parent undertaking of the originator institution or (ii) to or with which the originator institution or another entity contemplated in item (i) provided, directly or indirectly, any financing, support or instructions or entered into any arrangement in relation to the entering into of such transaction; and

(b) it would be subject to this Annex had it been entered into by the originator institution.

Where the conditions set out in subparagraphs (a) and (b) of this paragraph 22 of this Annex are met, the transaction shall be assessed as if it had been entered into by the originator institution.

23. When notifying a transaction to the competent authority as required pursuant to Article 250 of the Regulation (as further specified in paragraph 22 of this Annex), the originator or, as the case may be, the sponsor shall:

(a) if it claims that the transaction does not constitute implicit support, provide adequate evidence of meeting the relevant conditions set out in this Annex; and

(b) if the transaction is undertaken by one of the entities referred to under item (i) or (ii) of paragraph 22(a) of this Annex, the originator institution shall also provide documentation on the type of relationship between the originator institution and the relevant entity or, as the case may be, the financing, support, instructions or arrangements provided or entered into by the originator institution to or with that entity for the purposes of undertaking the relevant transaction.