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EU regulatory framework: enabler or barrier to securitisation in CMU?

The EU securitisation law came into force on 1 January 2019 without the full set of enabling regulations ready. This led to an initial delay and subsequent crowding of deal supply, which in turn led to pricing distortions. Some of the key RTSs (e.g. data templates) are unlikely to be implemented before year end, i.e. one year after the law came into force. The extra-territorial reach of the regulation impaired the global investment reach and returns of EU regulated investors. The inadequate grandfathering and limited transition period did not help either.

STS deal flow picked up in 2Q19 and the STS securitisation sector is gradually building up. Over time we believe STS will become an established market and, some suggest, a global benchmark. The non-STS sector will tag along, as has done so far successfully. STS was meant to address some borrowed-from-the-US reputational issues of the EU securitisation market, whose credit and rating performance since EU market's inception has been excellent, in line with initial expectations. However, STS alone is not enough to restore EU securitisation market.

To reach the full potential of securitisation to foster long-term investments in the EU financial sector a number of barriers need to be overcome. Some of the barriers are associated with the interpretation of the securitisation regulation, such as the lack of differentiation between public widely-distributed deals and private bi-lateral deals between sophisticated counterparties, several operational issues, extra-territoriality of investor due diligence, etc. Other barriers arise from biases embedded in the prudential regulations, related to capital charges, reporting, liquidity, etc., which in turn distort issuer and investor behaviour. The SRT discussion is already raising concerns.

Overall, a quick look at the capital charges for financial institutions suggests that insurers are dis-incentivised from taking securitisation longer-term mezzanine risk, which they are otherwise uniquely qualified to do. Insurers are incentivised to take illiquid loan and residential mortgages exposure directly rather than through securitisation bonds; the cliff between STS and non-STS capital charges cannot be justified, in our view. Banks are incentivised to buy each other's covered bonds, often collateralised by the same mortgage exposures they hold on their own balance sheets; this is further enhanced by the unjustified gap in LCR treatment of covered bonds and STS securitisation. In public debate the systemic risks created by covered bond and loan holdings are glossed over, while the risks of securitisation exposures are overstated. The unjustifiable gaps in cost of different funding instruments (rating, reporting, verification, penalties, enforcement, etc.) biases issuers' choice: banks prefer covered bonds, fincos - securitisation. ESN, if introduced, will distort banks' motivation further.

STS securitisation volume is picking up, but the recovery of the securitisation market is far from assured. In order to advance the CMU and foster a long-term positive economic effect of securitisation in the EU the above distortions must be addressed, the capital and liquidity cliffs eliminated or reduced, the capital markets' playing field levelled. ●