EUROFI VIEWS MAGAZINE - ZAGREB APRIL 2020

Paul Tang

MEP, Committee on Economic and Monetary Affairs, European Parliament

Securitisation done right

Securitisation done right has benefits for lenders and institutional investors alike. Securitisation done wrong, however, can amplify economic crises and bring the global economy to its knees. The EU's securitisation regulation created a standard that allows for the benefits of securitisation, while avoiding the pitfalls. Under the right economic circumstances and with the endorsement of regulators, securitisation can play a pivotal role in recapitalising banks in the post-COVID, Basel III regulatory environment.

Pooling illiquid assets into tradable securities allows lenders to increase lending capacity while transferring risks to investors according to their preferences. It is important however, that these risks do not remain in (the systemic part of) the financial sector, so that overall stability is guaranteed. Besides, when low trenches of asset-backed securities are repeatedly packed in collateralised debt obligations, it quickly becomes impossible to analyse the product's creditworthiness. Since such CDOx products helped propel a US housing crisis into a global financial meltdown, it is only right that a certain stigma is attached to – complex – securitisation.

When, after the financial crisis, European securitisation remained subdued, the European Institutions reset the market through a regulatory framework for "good" securities. It set rules on due diligence, risk retention and transparency for all securities, and enabled the identification of simple, transparent and secure (STS) products. With level-2 measures published, we now see the first early results. In 2019, 143 transactions were notified to ESMA as STS. In the first two months of 2020 over 30. STS is thus a workable standard, allowing the reaping of securitisation's rewards, without suffering its drawbacks.

Expansionary monetary policy means the use of securitisation to increase lending capacity is limited. Why pay fees to a range of credit rating agencies, underwriters or credit enhancers, when you can secure cheap capital with the ECB? But, with EBA estimating that banks need over €100bn to fulfil Basel III requirements, securitisation can help reduce risk and improve one's capital base. Given the sector's efforts during the current COVID-19 crisis, this amount is only set to increase. Securitising outstanding loans will be essential to reach Basel III standards.

However, the EU regulatory environment means that using STS securities is not yet fully rewarded. For example, the standards for other financial products have not caught up with those for securities. Products such as covered bonds lack securities' transparency and due diligence requirements. With ambitious regulation on these products, the EU can set off a race to the top while guaranteeing a level playing field.

As EU we can be proud to have eliminated the most stringent risks associated with "bad" securitisation while creating the global standard for the "good" kind. Yet, the combination of expansive monetary policy with an imbalanced regulatory environment means the EU is not fully capitalising on this standard. With lenders seeking the capital base increase that securitisation provides, this is something to set right. Upcoming reviews of financial legislations provide a good opportunity to do so. ●