EUROFI VIEWS MAGAZINE - ZAGREB APRIL 2020

Alexander Batchvarov

Managing Director, Bank of America

STS: unleasing the potential of EU-27 Securitisation Market

In each of the last two years EU-27 issued €370-€400bn of covered bonds, placed €7-€9bn of RMBS, and €50-€60bn of other securitisation bonds. The STS introduction in 2019 did not boost issuance volumes; it is unlikely to do so in 2020. By way of comparison, securitisation represents 12.5% of GDP in the US (excluding GSE securitisations) and 12% in the UK vs. 3% in the EU-27; covered bonds represent 21% of the EU GDP and 4% of UK GDP.

Securitisation represents 6% of all green bonds in China and about 1% in the EU. Many factors affect securitisation activity: ECB policy, non-bank lending, bank capital needs, but they alone cannot explain the low utilisation of securitisation in EU-27. Securitisation has an important role to play in the EU-27. The introduction of Basel 3 will increase bank capital requirements by an estimated EUR100bn. The focus on sustainable finance and ESG impose new criteria on bank balance sheets. Banks must address the new capital and financing needs through sale of assets, balance sheet optimisation and/ or securitisation. Banks offload assets to asset managers and finance companies, which in turn finance their acquisition via securitisation. If half of the bank capital increase is due to residential mortgages and half of that is addressed via securitisation, then a need for EUR800bn of RMBS issuance in the next 5-10 years will arise.

Funding the EU Green Plan also needs a functioning EU securitisation market. EU-27 needs to scale up its securitisation market, but it remains underutilised. With the introduction of STS in 2019 the regulatory capital for securitisation increased on average under CRR, remained unjustifiably high under Solvency 2, there was no change in liquidity and repo treatment of securitisation bonds, and detailed disclosure and due diligence requirements (unparalleled in any other fixed income sector and in any other jurisdiction) were imposed. The calibration of regulatory capital for EU securitisation does not reflect its historical performance and is subject to non-neutrality.

The securitisation regulatory regime must be realigned with that of other fixed income sectors, especially loans, corporate and covered bonds. Several changes can be introduced in the near term to allow for the EU securitisation market to scale up and to provide the much needed support for the EU economy and banking sector: A/ Modify securitisation capital and liquidity treatment under CRR (e.g. LCR treatment, p factor, WAM); B/ Recalibrate capital treatment for securitisation for insurers under Solvency 2 in line with covered bonds for STS and corporate bonds for non-STS securitisations; C/ Simplify significant risk transfer requirements for cash and synthetic securitisations, expand the STS for synthetics beyond SMEs to include other granular exposures. D/ Differentiate between disclosure and due diligence requirements for public and private securitisations applying proportionality and allow for longer-term use of ND fields.

EU-27 securitisation market has a crucial role to play in deepening of CMU, in greening the EU economy, in strengthening bank balance sheets while introducing new capital and sustainable finance requirements. Key measures necessary to ensure that it fulfils that role lie in the hands of the EU policymakers. ●