How to relaunch securitisation?

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A true revival of securitization is now urgent

The need to relaunch securitization has been discussed for quite some time, without any concrete progress. Now is urgent time to transform intentions into workable solutions, as banks see their balance sheets loaded by Covid-related loans and will have to play a central role in the financing of the recovery.

Indeed, securitization enables private risk-sharing by taking risks out of the banking sector and transferring them to other investors, thereby increasing the diversification of funding available to the economy. In these times of crisis, scaling-up the European securitization market by addressing the regulatory obstacles to their development must be a top priority.

The relaunching of the Capital Market Union provides an opportunity for a drastic change in mindset, from considering securitization as a toxic product (when used to securitize badly originated sub-prime mortgage loans in the US), to recognizing that securitization in Europe has been used for healthy risk transfer from banks to educated investors, and should be given an important role in the post-Covid toolkit.

I strongly support the set of proposals on securitization recently presented in the HLF report, which results from extensive technical work, in particular to:

- Unlock the Significant Risk Transfer Assessment process
- Recalibrate capital charges applied to senior tranches, in line with their risk profile
- Enlarge STS benefits to synthetic securitisation beyond SMEs
- Upgrade eligibility of senior STS tranches in the LCR ratio
- Review the Solvency II calibration of senior tranches
- Simplify disclosure requirements for private transactions

I am grateful to the Commission and the EBA that some of those measures are already on the table, in the targeted package submitted by the Commission in July and in the upcoming SRT report by the EBA. However, these proposals should not derail from their initial objective to address the current flaws. While the extension of the STS framework to non-SME synthetic securitizations is a concrete step in the right direction, even if limited to a better treatment for the senior tranches only, the other proposals in their current form do not address the real issues:

- NPE securitization: while the EBA's October 2019 opinion was recognizing the excessive conservatism of the current framework, and recommending useful adaptations to the NPL securitization framework, the BCBS has in the meantime made proposals that would make this instrument value destroying for the issuing bank, and hence de facto eliminate NPL securitization from the post crisis toolkit.
- SRT assessment: the initial proposals presented by the EBA to the industry are driven by a welcome intention to make the SRT assessment process more transparent and predictable. However, the process proposed, whereby the ECB has a 3-months delay after origination to remove its ex-ante approval is totally counterproductive, as it creates a major regulatory risk. No bank would want to issue an instrument in the market, at a significant cost, without having certainty that the risk transferred to investor will result into a commensurately lower capital charge. We sincerely hope that further dialogue with the industry can help converge on a workable process.

The currently proposed amendments have to be significantly improved to achieve their intended goal. This first step needs also to be followed promptly by a holistic implementation of HLF securitization recommendations as all those proposals are jointly necessary to create a viable securitization ecosystem. I urge the Commission to reconsider its target of Q4 2021 for the broader securitization package and to rather give it priority over the implementation of Basel IV, in order to pragmatically fuel the most needed economic recovery in 2021. ●

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Strengthening the role of securitisation in the EU

The macro-economic and financial market shock caused by the COVID-19 pandemic puts additional emphasis on the securitisation market and on the need to contribute to the Capital Markets Union objectives. On 24 July 2022, the Commission proposed targeted amendments to the securitisation framework[1]. On the basis of the work of the European Banking Authority[2] and the Basel Committee on Banking Supervision[3], the Commission proposed to amend the Securitisation Regulation (SECR) and the Capital Requirements Regulation (CRR) to encourage a broader use of securitisation in the recovery phase.

The proposal defines STS criteria for on-balance-sheet synthetic securitisations that are consistent with those for traditional STS securitisations, and introduces new criteria to capture the specificities of using guarantees or similar instruments to tranche and transfer credit risk. This is coupled with a more risk-sensitive capital ▶

treatment for the senior tranche, held by the originator bank. The reduced capital charge reflects the fact that agency and modelling risks are substantially mitigated by the adherence to the STS criteria, and that these securitisations are no riskier than traditional securitisations. This proposal aims to provide additional incentives for securitisation to take place within the robust EU framework for STS securitisation, and help banks find ways to share risk with capital market actors.

As regards securitisation of non-performing exposures (NPE), the proposal recognizes that, by definition, this type of securitisation differs from typical securitisations because the securitised loans are already defaulted at the issuance of the instrument. The discount on the purchase price of the NPEs at the inception of the transaction is the key element in the valuation of the loans that are securitised. Thus, the proposals adjust the risk retention requirement so that the 5% material net economic interest is calculated on the basis of the discounted value of the exposures. In addition, a new prudential treatment of NPE securitisations is proposed in the CRR. The senior tranche of a traditional NPE securitisation would be subject to a flat risk weight of 100%, provided that the price discount applied when the underlying exposures were sold is at least 50% of the notional value of those exposures in the securitisation. This would be in line with the approach on which the BCBS is currently consulting. The proposal also clarifies how to calculate the maximum capital requirement provided for in Article 268 of the CRR for NPE securitisations.

> *Strengthening the role of securitisation in the recovery phase in the EU.*

The Commission remains fully committed to revive EU securitisation on a sustainable basis. The EU securitisation framework will also be subject to a comprehensive review, which is planned to take place in the course of 2021 accompanied, if appropriate, by legislative proposals. In addition, the EBA is working on a report on significant risk transfer in securitisation, which will also feed in the broader review.

1. https://ec.europa.eu/info/publications/200722-proposal-capital-markets-recovery_en
2. https://eba.europa.eu/eba-proposes-framework-sts-synthetic-securitisation; https://eba.europa.eu/eba-publishes-opinion-regulatory-treatment-non-performing-exposure-securitisations
3. https://www.bis.org/bcbs/publ/d504.htm

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The development of STS securitization is a must have

The development of securitization is a real opportunity to face both short term and medium term challenges the European Union has to cope with. The recent sanitary crisis shows how much it was necessary for corporates – especially SMEs – to have access to a diversified set of financing solutions, securitization being one of them. In this regard, by transforming loans and other illiquid receivables into tradable securities, securitization could free up bank capital for further lending and allow a broader range of investors to fund the economic recovery. In the long run, securitization should ease the ecological the transition, contribute to the building of a real Capital Market Union and, to a certain extent, support banks' efforts to adapt to the likely increase in RWA coming from the finalized Basel III standards.

Although European legislators agreed to strengthen the securitization framework in 2015, the effects have been rather subdued especially regarding the volume of issuance that has diminished in year 2019. The Simple, Transparent and Standardised securitization label has been implemented from 1st January 2019 to avoid perverse effects that led to the 2008 crisis. This was necessary but it is now time to improve European regulation in order to benefit from the securitization's positive effects. As of today, it is an understatement to say that securitization remains underused in EU: in 2018, while private securitization issuance amounted to USD 787 bn in US, there was only EUR 139 bn of placed securitization issued in Europe; all the recent surveys reports a decrease of securitization issuances in 2019 (between 6% and 15%, figures varying according to data sources).

> *Last but not least, green securitization has an important role to play to increase the capital allocated to sustainable projects and activities.*

Having this in mind, the European Commission has recently proposed to "quick fix" the securitization framework as part of a broader initiative to facilitate the economic recovery. First, the EC has proposed amending the framework to extend the STS label to balance-sheet synthetic securitization and to grant banks a preferential capital treatment to the senior tranche of STS synthetic securitizations, irrespective of the nature of the underlying exposures (whereas it was only limited to certain types of guaranteed SME loans). It is justified because synthetic securitization is easier and quicker to execute, often with tighter margins, than traditional cash securisation. Second, according to the wide consensus among supervisors that the current EU bank capital requirements overstate the actual risk and reduce bank's incentives to engage in NPL securitisations, the EC has proposed targeted adjustments to the framework.

The forthcoming 2022 review of the securitization framework should be the occasion to introduce more fundamental changes in it. Clarifications to the SRT test (significant risk transfer) would increase legal certainty for market participants; the margin for discretion, beyond the explicit criteria set out in CRR, should be framed. The EBA is expected to publish soon an analysis of supervisory practice in this regard. When it comes to risk weights, additional adjustments should be made to ensure quasi "neutrality" of this framework compared to RW that would be applicable to underlying exposures. The treatment of securitization in insurers' balance sheets should be made more risk-sensitive too, which would help broaden the investor base. Finally, although due diligence requirements should be the same for public and private transactions, there is room for substantially different sets of disclosure requirements.

Last but not least, green securitization has an important role to play to increase the capital allocated to sustainable projects and activities. If the specific features of a green securitization framework still have to be defined, the creation of a European "green / Transition STS" label and an Energy Performance Certificates could be seen as first steps as this should allow the identification of exposures eligible to such a framework. ●

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Building on what has been achieved to date from the securitisation regulation

The impact of the Covid-19 health crisis is a major challenge facing the European and global economy. It is important that we take measures to support our economies and companies in whatever way we can.

The intervention of central banks globally has provided unlimited amounts of liquidity to the financial system. Despite this support, our banks will face pressures over coming quarters in generating the organic capital required to support lending to the real economy due to the impact of Covid-19 on our economies and from the low interest rate environment.

We see the use of securitisation as an important mechanism to ensure companies can access the financing they need to manage the post Covid-19 recovery and to ensure banks have the capital available to provide financing to them, especially to the SME sector. Securitisation allows investors access credit exposures such as SME loans that would not usually be available to them and provides a mechanism for banks to transfer credit risk to other parties, improving financial stability. In order to support this important alternative funding channel, it is key that we seek to make targeted amendments to the STS framework now and we fully support the Commission's inclusion of these amendments via the COVID-19 recovery package for financial services.

While the introduction of the Simple, Transparent and Standardised (STS) securitisation label has introduced welcome practices to Europe's securitisation framework, we should also acknowledge that since its introduction we have not seen the increased levels of issuance we would have hoped. The number of STS securitisations issued in Europe increased from 143 in 2019 to 183 year to date, but the overall volume of European securitisations fell between 2018 and 2019.

The introduction of the STS label to balance-sheet synthetic securitisations, along with extending the benefits of lower capital requirements to the senior tranche of the STS synthetic securitisation is a welcome development. These changes are timely, as they will help banks to undertake such transactions, in particular SME securitisations, freeing up balance sheet capacity to undertake new lending. Similarly, the changes to NPL securitisations will help reduce some of the obstacles to banks issuing such structures. In particular, the changes to the calculation of the risk retention part of the deal are sensible.

> *Allows investors access credit exposures such as SME loans that would not usually be available to them.*

It is important that within Council and Parliament we reach agreement on the package quickly to ensure it has the best chance to support our economies and companies in the recovery phase. We must also remember that securitisation is only one funding channel available to our companies and banks.

It is important that we as policy makers continue to consider how we can support the increased use of different types of funding channels such as IPOs, easier debt issuance for smaller companies, increased availability of private equity and venture capital to support our companies at all stages of their growth. Therefore, the other proposals in the Commission package are as equally important for us to agree quickly, to ensure we achieve the maximum impact from the changes as soon as possible and help further develop our capital markets. ●

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Securitization the key instruments for a post Covid recovery

Europe is currently lacking capital markets comparable to the depth and strength of the US market. As we experienced during the last financial crisis, this can have severe implication on the recovery prospects of the European economy, which still relies heavily on banking financing.

So, why would securitization be not only helpful, but actually the key instrument to ensure a sustainable recovery from the upcoming crisis? I would like to stress 3 points to back up my statement:

- Given the current setup of the European capital markets, banks will continue playing a central role to finance the real economy. Banks have the expertise and network to support local businesses. The question is: how to bring capital markets to those businesses? In my opinion, the answer is securitizations. They are the link between the Banking Union and the Capital Market Union. With securitizations, banks can reinforce their role as intermediaries between the real economy and international investors.
- In a time of turmoil, stability of the financial sector is critical. Securitizations allow redistributing risks across market participants, while increasing investing opportunities for national and international investors. As a consequence, banks become safer while improving their lending capacities to the real economy.
- The European economy and its labor market are built on the strength of its small and medium enterprises. SMEs do not, at the moment, engage actively in capital markets, and rely heavily on banking financing. Securitization would allow that the money flows from international investors can reach those who are at the core of our economic activity.

European securitization is and must continue being transparent and understandable for issuers and investors alike. But it is time that we acknowledge their critical role to build the capital markets, especially for a banking-based economy like ours, and we make sure that our legislative framework incentivizes the right usage of this financial instrument.

> *European securitization is and must continue being transparent and understandable for issuers and investors alike.*

There are several areas of the prudential and supervisory treatment of securitizations that should be improved, both for STS and non-STS. Priority should be given to improve the LCR treatment of securitizations and to remove the risk weight floors for originator positions. It is also key that STS with preferential capital treatment should be granted to qualifying synthetics.

The various regulations introduced since the last crisis, such as the banning of re-securitizations, the retention rules, the investor due diligence rules, and the STS criteria, have made securitizations significantly safer, even though European securitizations have a history of very low defaults even during the last crisis. ●