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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).

**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. ●