

PRIORITIES FOR RELAUNCHING SECURITISATION

1. The securitisation market is disappointing in the EU, despite repeated regulatory efforts and expressed ambitions

1.1 Policymakers have always expressed ambition regarding the securitisation project, which is however a complex financing tool. Finally, so far related regulatory evolutions have proven unable to relaunch the market

A supervisor stated that relaunching securitisation is a burning question. Amendments to the securitisation framework agreed in December have just been published. The proposal achieves a more risk-sensitive treatment for non-performing loan (NPL) securitisations and the expansion of the simple, transparent, and standardised (STS) label to embrace synthetic securitisation. Securitisation supports the objectives of the capital markets union (CMU). Because the EU financing market relies heavily on banks, securitisation provides a useful tool for diversifying funding sources and risks and providing a liquidity upgrade for banks. Securitisation remains a complex product and deserves a robust regulatory framework.

Though, current figures are somewhat disappointing. The primary public asset-backed security (ABS) issuances market fell by around 40% from 2019 to 2020. The low level of holdings by insurers is striking. Although the new securitisation framework entered into force in January 2019, the market is far from mature.

The COVID 19 crisis has also played a role. The securitisation framework has not fulfilled all its promises.

An industry representative agreed that the situation is not satisfactory. The aim was for securitisation to perform the funding and risk transfer function and enhance and deepen the CMU. Unfortunately, this has not happened. Both macro and micro aspects need to be considered. Securitisation volumes have been declining consistently since 2018. Historically, residential mortgage-backed securities (RMBS) have been the leading part of the securitisation market. That is no longer the case. In countries like Holland and the UK, mortgage covered bonds have taken over from securitisation from RMBS. RMBS is now less used by banks and more by finance companies.

An industry representative commented that public numbers are being compared, but the market is also a private market. Only a partial reflection of that market can be seen through the asset-backed commercial paper (ABCP) conduits. The public numbers ignore the activity on the private market, which is quite significant, especially for the banks. Yet, the bigger banking books are using less securitisation currently, doing less RMBS and more synthetic risk transfer activity. It is unlikely that the market will return to the state it was in before the global financial crisis.

1.2 The STS label was introduced in 2019 in the EU to combat the negative stigma related to securitisation

An industry representative stated that such a stigma is, and has been for years, undermining the securitisation market. Some politicians are still very hostile to securitisation.

A policymaker commented that securitisation was stigmatised in the context of the global financial crisis, although this was never entirely justified in the EU context. In 2015, the Commission identified the securitisation markets as one of the essential elements of the CMU. The framework now in place introduced the STS label and has been in force since 1 January 2019. It is too early to draw firm conclusions about whether this framework works. The Commission is committed to continuing to support the securitisation market.

An industry representative noted that the grand total issuance under the STS label is 186 billion so far. A large portion of that is legacy transactions that were relabelled after 1 January 2019 but issued prior to 1 January 2019. Most of those transactions are auto loans. There is a much smaller number of residential mortgages. The hoped-for extension and expansion of the issuer base through STS has not materialised yet. There has not been an expansion of the investor base.

1.3 Despite the adjustments in 2018 of the insurance regulatory framework regarding securitisation holding, the insurance sector related investments remain limited

A regulator commented that the stigma effect is uncertain, but the market is not where it should be. Work at the European Insurance and Occupational Pensions Authority (EIOPA) in this area started in 2013. EIOPA issued some advice to the Commission on a more favourable but still prudent treatment of securitisation. There is clear evidence that, from a fundamental credit risk perspective and in terms of spread volatility, many securitisation products perform very well. Therefore, specific treatment is needed when thinking about capital charge, Solvency II and insurance investment. The STS label has been introduced. The regulatory equipment is there and has been for some time. However, the proportion of investment of insurance undertaking has not significantly increased. It is still around 2% to 2.5% of investment.

An industry representative agreed with the numbers with regard to insurance. The Bank of America numbers suggest a 2.5% to 3% proportion of investment. For comparison, insurance companies in the US take between 10% and 30% of securitisation paper, depending on the particular sector.

1.4 Monetary policy and market conditions also contribute to reducing securitisation issuance

An industry representative commented that the current monetary policy has an effect. When the European Central

Bank (ECB) introduced the pool of additional credit claims eligibility in April 2020, there was a significant decline in the use of securitisation and covered bonds for the purposes of the access to the ECB.

A policymaker noted that there are currently many cheapways of refinancing and risk sharing in the market. This should be borne in mind when considering potential remedies or next steps.

1.5 In the current complex regulatory context securitisation is an expensive financing tool for both issuers and investors, compared with other financing techniques

An industry representative stated that securitisation remains relatively expensive for an issuer, although margins are slightly higher than comparable instruments. Securitisation is also expensive in terms of operational resources, particularly dealing with compliance and monitoring. As such, some small issuers and fund originators are not very well equipped for securitisation. It is also expensive or onerous for investors because due diligence processes are relatively heavy for securitisation. There are alternative solutions, for example transactions such as loan sales. Instead of securitisation, investors and sellers are using simpler structures that have less protection but do not fall under the securitisation regulation.

1.6 The recent evolutions regarding the securitisation of NPL are rather positive, though further clarification is needed

An industry representative noted that there are certain positive changes around retention, the calculation of the retention and the retaining entity regarding NPL. Regarding risk capital, there are no changes in capital for Solvency II. How these details will operate in practice is not yet known, but overall, it is positive. Whether it will be a massive boost for securitisation is uncertain.

An industry representative commented that the issue concerning disclosure for synthetic and NPL was not mentioned in the recent initiative, so clarification is still needed.

2. A review of the regulation of securitisation has started

2.1 The EU commission is first focusing on outlining a clear diagnosis of the features of the legislation that require adjustments

A policymaker stated that the Commission first needs to clarify which legal issues must be addressed. The Commission is working on a report, as obligated in the STS regulation and the capital requirements regulation (CRR) securitisation part. The report is planned for the end of the year. The Commission will need input from EIOPA and the European Banking Authority (EBA). Next steps will be considered after the report. A holistic overview of the various elements is needed. The Commission is aware of the concerns around the prudential treatment.

2.2 Whatever the regulatory evolution envisaged, the regulatory frameworks should remain risk sensitive and the prudential treatment should rely on evidence

A regulator agreed with the suggested approach of the Commission first carrying out a global analysis and then

considering possible legal or regulatory changes. Changes regarding securitisation in the insurance framework have only recently been introduced. There has not been an increase in investment or a significant impact, but the period from 1 January 2019 to the present has been particularly challenging. As a supervisor and regulator, excessive changing of regulations is a problem as there might be undesirable or unexpected effects.

EIOPA did not address securitisation in the opinion on Solvency II because additional requirements or specific treatment are not needed for securitisation. Regarding the prudential treatment, EIOPA has not advised the Commission to take hold of the issue. Other changes in the Solvency II framework simplification proposal will amend the way in which some risky mitigation impacts are calculated and may have an indirect effect in facilitating and easing investment in such instruments. EIOPA will continue with its risk based approach. Prudential treatment is defined depending on the riskiness of the product.

EIOPA does not perceive a penalisation effect for securitisations. There is currently not enough evidence of the need to adjust the treatment from a prudential perspective. However, EIOPA is willing to discuss the matter further. The suggestion of not penalising some instruments may end up being the usual different views from a prudential supervisor and a market player. EIOPA's approach is evidence based.

2.3 Many aspects of existing securitisation-related regulations require adjustments

An industry representative commented that the two initiatives that came into force in the previous week, with regard to synthetic securitisation and NPL, reflect the industry's proposals to some extent, but not 100%. The changes made to the synthetic framework for STS for on-balance-sheet synthetic securitisation are generally positive, but application is uncertain.

An industry representative stated that the significant risk transfer (SRT) process needs improvement. The processes should be similar in all jurisdictions and be managed consistently. There are still some anomalies in Solvency II. STS has been improved, but non-STS is still penalised. In the past, insurers were relatively present in buying the investment-grade mezzanine tranches, so single A or triple B, but are not anymore. These are not appropriately treated under Solvency II. The liquidity coverage ratio (LCR) does not treat STS, or even non-STS although triple A investments manage very well. This should be made consistent with the treatment of covered bonds.

On transparency and disclosure, there is a problem for private reporting. It is not normal to be obliged to develop reporting alongside the standards of the European Securities and Markets Authority (ESMA). If a firm is dealing with a very sophisticated investor that requires its own reporting with different features, the firm needs to report twice, so its clients need to report twice.

Some regulations are passed without considering what the impact on securitisation could be, for example additional requirements on disclosure or more regulation on credit services for NPL.

2.4 The review recently initiated should encompass a holistic approach to provide a macro view of markets and contribute to defining regulatory evolutions consistent with the regulations regarding similar instruments across the board

An industry representative commented that strong ambition and political will are needed. Otherwise, the market may stay at its current level or even contract further. Having a critical mass in this market is quite onerous, since resources, experts and knowledge are needed. A contraction may mean that resources or knowhow will not be available in the market in the future.

An industry representative commented that it is surprising that a holistic approach and one not needing to change prudential requirements is being discussed simultaneously. It is often noted that securitisation presents systemic risk and care is needed as to how regulations are put in place. RMBS outstanding is about 400 billion, or 10% of the eurozone mortgage market, whereas covered bonds are 2.7 trillion outstanding and fund more than 55% of the eurozone mortgage market. It is difficult to discuss the systemic risk of RMBS when it is such a small portion of the market.

There is a discrepancy in regulatory capital in relation to underlying loans, which, when securitised, attract higher capital. In Solvency II, that is obvious in the context of the so-called non-STs. Even STs mezzanine tranches are heavily penalised. There are many examples that demonstrate that a holistic approach is necessary. For example, it does not make sense that a special-purpose vehicle (SPV) from Australia is subject to reporting to a tax authority when it is issuing RMBS, but it is not subject to reporting when it is issuing covered bonds. It does not make sense that RMBS or ABS use HTML templates for reporting loan by loan, and other asset classes just use a simple Excel spreadsheet. Treatment of similar instruments should be realigned across the board.

2.5 Short term improvements should also be envisaged since the EU legislative process takes time

A policymaker noted that, even if legal proposals were presented today, they would need their time to go through the political process in the EU. The priority should be to see whether the system can work better within the current framework, at the same time evaluating what can be improved going forward.

3. Top priorities for improving securitisation in the EU

3.1 Take the time to assess the current framework

A policymaker emphasised the importance of obtaining a holistic overview before assessing potential legislative changes.

A policymaker stated that there is no one measure that will magically revive the European securitisation market. Time should be taken to assess the current framework, after which next steps can be decided upon. The a priori not negative assessment from industry colleagues is helpful. The Commission is aiming for a very thorough report. Several measures may be necessary.

A regulator agreed with the approach of the Commission.

An industry representative stated that the complexity of the market should be considered holistically across sectors and regulations. There is nothing that will help immediately.

An industry representative commented that the market must be understood, not considering simply public issuance numbers but also private activity. The Commission's report could include a comparison with other markets, for example China, Australia, Korea, the US and Canada.

3.2 Assessing the prudential issue is important

A policymaker commented that, in the context of prudential treatment, the global Basel framework must also be considered.

A regulator stated that the priority is to check the penalisation effects that were mentioned. EIOPA is in the process of adjusting the framework on Solvency II, so it is important to hear the stakeholder view and analyse if there is a need to adjust. EIOPA aims for a stable insurance market with, as much as possible, the possibility of investing, especially in this period of low return.

An industry representative reiterated that a much smaller proportion of European securitisation is taken up by insurance companies than is the case in the US. It is concerning that Australia, which is a much smaller economy, is issuing more RMBS than the entire eurozone. The Chinese securitisation market is now about four to five times bigger than the European securitisation market.

3.3 Proportionality of regulatory measures is also necessary

An industry representative stated that the proportionality principle should be borne in mind when considering adjustments, measures, or clarifications. Disclosure is an obvious example.

3.4 Political will and ambition around securitisation is needed

An industry representative commented that securitisation can achieve positive things, such as a contribution to sustainable finance and the green transition and rebalancing the balance sheets for the banks. Securitisation is a vital instrument for the future solidity of the European banking system. NPLs should increase in the future. Basel "IV" will come into play.