# SECURITISATION RELAUNCHING IN THE EU

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## Europe must revive securitization

The need to relaunch securitization in Europe has been discussed for quite some time, without significant progress, although there is consensus among experts about what is needed to unlock the market:

- Recalibrate capital charges applied to senior tranches, in line with their risk profile
- Improve the Significant Risk Transfer Assessment process to make it swift and flexible
- Upgrade eligibility of senior STS tranches in the LCR ratio
- Simplify disclosure requirements for private transactions.

However, policy makers and regulators seem to be still unsure about why the long-awaited reform of securitization should be a top priority in the CMU agenda, and how to accelerate securitization while avoiding to create the financial stability risks that led to the Global Financial crisis. STS reforms have made the market safer and smaller...

Providing a concrete, evidence-based, and non-politicized answer to two questions is essential to unlock the process and reach as promptly as possible an effective "comprehensive review" promised by the Commission.

**Have earlier reforms addressed financial stability risks linked to securitization?**

Yes. A lot has been done in the post-crisis regulation on this front: retention rules, supervision of rating agencies, systematic assessment of Significant Risk Transfer by the competent authority, etc... It is now time 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.

**Making progress is key to avoid that current regulation and supervision keep slowing down the necessary transformation of the European economy.**

Should the Commission be convinced that securitization opponents in the Council and the Parliament are too numerous and too durably shocked by the sub-prime crisis to change their mind, then let's focus on non-mortgage loans. Implementing the few initiatives hereabove to all the other loans (corporate loans, auto loans, consumer loans, etc ...) would already unlock a significant additional financing power without raising controversies: including during the financial crisis, the track record of such securitized non-mortgage products has always been flawless.

**Why securitization is urgent now?**

The European Commission estimates the additional investment needs in the relation to the green and digital transition at nearly EUR 650 billion per year until 2030. As banks finance 80% of the EU economy, this would require an amount of prudential capital which is well beyond EU banks' capacity to grow their capital base over the period (and anyway above supervisors' appetite for banks' balance sheet growth!). Even if banks can get abundant funding from ECB and have access to deep and efficient funding instruments such as covered bonds, it does not solve the capital issue, all the more given the impact of CRR3 to be absorbed over the same horizon.

At the same time, banks are best placed to originate these financings, given their proximity to clients, across all Member States, their expertise in credit analysis and structuring, and their capacity to offer clients a full range of financing solutions beyond lending. The EU banking sector has demonstrated its capacity of mobilization during the COVID crisis and is a natural leader in the financing of the green and digital transition. Indeed, capital markets, even if developed under the CMU initiatives, will not have the breadth of access that banks have through their local presence across all Member States.

How to square the circle? Banks should continue to do what they do best, ie provide tailored financing solutions to their clients. But they should have the option to transfer risk to investors, to alleviate their capital charges, in a cost-efficient way. If well originated and structured, securitization is a win-win-win transaction: win for the issuer, who reduces its residual risk and associated capital requirement, win for the investor, who accesses a portfolio of assets, with some credit protection depending on the tranche, and win for the borrower which can benefit from bigger risk appetite from banks and more competitive pricing.

Making progress is key to avoid that current regulation and supervision keep slowing down the necessary transformation of the European economy. This technical subject requires pooling the expertise across the various authorities involved: Commission, ECB, EBA, ESMA, EIOPA, ESRB, EIF, etc... Indeed, only a coordinated effort to rebuff conservatism and rebuild the securitization ecosystem can deliver results, after 15 years of anemic markets.

Let us not miss this step, as 2022 is probably our last chance to deliver on a policy goal endorsed... in 2013!

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## Weak EU securitisation will slow down the greening of the EU economy

More than a decade after GFC, the EU securitisation market falls short of full recovery in size and reputation. Placed volume has crept up to reach just €90bn in 2021, which is a far cry from the €270bn+ volumes issued annually before the GFC and the current EU capital market needs. Post crisis, covered bonds unabashedly cannibalised RMBS, the mainstay of securitisation. Reputational recovery is slow despite the decade-long PCS and industry efforts. The EU-only introduction of STS brought on average €26bn supply per annum since its adoption in 2019, mostly from long-established auto ABS issuers. Broad negative statements about securitisation abound, disregarding positive EU securitisation market track record over many years. Proven credit resilience under multiple market trials is considered a weakness of EU securitisation, while the lack of real-life test and favourable regulation are considered a strength of covered bonds.

The slow EU securitisation market recovery is in stark contrast with its post-GFC rebound and growth in other geographies. Excluding agency product, 2021 securitisation issuance exceeded €740bn in the US, €420bn in China and €38bn in Australia; on a GDP-weighted basis, it was five-to-six times higher than that of the EU. Yet, the EU boasts the most detailed securitisation regulation, the only (bar the UK's transposed one) STS regime in the world with detailed criteria and external verification, the most stringent transparency requirements and a central data repository. The conclusions are self-evident: EU has the most prescriptive rules and the weakest securitisation market among comparable economies. Consequently, EU securitisation cannot deliver for the EU economy, including in the transition to sustainable finance and ESG capital markets.

In the aftermath of the GFC, clarity in regulation is needed, but so is proportionality; supervision is necessary, but so is flexibility. It is unclear to us what data and assumptions were used to calibrate capital and liquidity for securitisation, what cost-benefit analysis was performed, what consideration to a level-playing field across capital market instruments was given. A decade after the GFC, the available performance data for EU securitisation does not justify the high capital charges, unless they were calibrated on extreme outliers in EU context or on data from other markets. Academic research does not support the discrepancies in the liquidity treatment of securitisation and covered bonds, the massive differences between the capital charges for STS and non-STS securitisations especially under Solvency II, and the capital charge differences (the quantum of non-neutrality) between securitised and non-securitised exposure.

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The data used then does not reflect the enforcements embedded in EU securitisation regulation post-GFC now - retention, disclosure, third-party involvement, regulatory supervision, etc. We find support for our views in the EU securitisation default and impairment studies by the rating agencies (close to zero and affecting mostly non-investment grade tranches of securitisation), in the rating transition comparisons between RMBS and covered bonds, in the recent recalibration of regulatory capital for securitisation for US insurers, in the performance of the securitisation purchase programmes of the Australian government, etc. We believe that the alleged risk of steep rise of the current annual RMBS issuance of €25-€35bn is immaterial when compared to the annual half-a-trillion issuance of covered bonds, unless EU banks' bail-out and bank-sovereign nexus are as good as guaranteed.

EU securitisation markets have been tested under heavy duress and without external support for several decades now. And they have performed broadly in line with expectations. Meanwhile, the EU securitisation framework is constantly evolving adding new layers of rules and costs, occasionally opting for new tools, which negate proven practices and threaten to unravel the EU securitisation fragile recovery. Such lack of stability, not observed in any other comparable securitisation jurisdiction, is unsettling and costly to the EU securitisation markets.

The review of securitisation regulation by the EU Commission is a chance to take a comprehensive look at all regulations affecting securitisation introduced in the last decade and pending now, and at the ensuing level-playing field distortions. The principles of retention, transparency, due diligence, STS, risk-based capital are, without doubt, necessary and widely accepted. It is how they are implemented in daily practices in line with historical performance, proportionality, optimal cost-benefit balance, efficient securitisation execution and so on, that will make the difference between a middling and a thriving, financially and environmentally beneficial to the EU economy, securitisation markets. Europe needs a thriving securitisation market now.