SESSION SUMMARY - BERLIN SEPTEMBER 2020

How to relaunch securitisation in the EU

1. The recent measures were not supportive enough of the securitisation market

An industry representative indicated that there is now general recognition that recent measures were not supportive enough to truly relaunch the securitisation market. It has been said for years that the measures are too complicated, not transparent and not simple. The subject being revisited in the context of the relaunching of the capital markets union (CMU) is welcome. The industry has to be listened to because they are practitioners and know what is working.

An official explained that last year the level of issuances diminished. Europe is only issuing 140 billion compared to 800 billion in the US. The extension of the Simple, Transparent and Standardised (STS) label to synthetic securitisation is welcome in this regard.

2. The development of the low interest rate and zero interest rate environment, and the amount of liquidity coming through, have also weighed on the securitisation market in Europe

An official noted that central bank liquidity is one of the issues. There was a significant amount of liquidity coming into the system over the last several years, particularly with the COVID-19 packages. It is a good way to move forward and boost the STS. The expansion of the synthetic to all types of asset classes underlying loans would be an important amendment to bring forward, particularly for SME loans because they need a quick and efficient way to bring securitisations. The package has to get through Council and Parliament, ideally before the end of the year, to maximise its benefit.

3. Other geographies teach that a well-functioning securitisation market is necessary to help banks to reduce risk-weighted assets in order to contribute further to the financing of economic growth needs

An industry representative noted that the urgency is growing, because having a well-functioning securitisation market and helping banks to reduce their risk-weighted assets by selling out their risks is a prerequisite for Basel IV. In the US, everything which is low risk is securitised and sold out. Mortgages are sold to the Government Sponsored Enterprises (GSE). The prime or near-prime consumer loans are securitised and sold out to investors. That is not possible in Europe, where everything is kept on balance sheets. As a result, the balance sheets are bigger in Europe, but the density of risk is lower. As soon as Basel IV comes in and puts in floors, erasing the difference between highly risky assets and less risky assets, the less risky assets need to be sold in order not to be penalised.

An official noted that green securitisation is also a priority for France. There is room for more ambition, and that is why there should be more than a quick fix. A green STS label could be worked on first to have enough harmonised collateral.

4. The STS framework contributed to addressing the political stigma provoked by the US subprime market

The Chair noted that there is an argument that there is a stigma for securitisation and that the STS framework is needed. It appears that the market would develop much more quickly if not for the cheap money from the ECB.

An official agreed that there have been many positives with what has been achieved with the STS regulation. With the framework and its due diligence, transparency and confidence have increased. Unfortunately, volumes have decreased.

An industry representative noted that securitisation is instrumental for building the bridge between the Banking Union and the CMU. Securitising or SRT-ing RWAs from the balance sheet creates new landing capacities for the real economy.

Since the financial crisis there have been a number of helpful developments on regulations, given that there is a ban on re-securitisation, which contributed to stability in the securitisation market, and the implementation of the retention rule and of STS. There is also the obligation for setting up mandatory due diligence meetings for the investors.

5. EU investors feel that securitisation is reliable but complex and unaffordable

An industry representative stated that European securitisation has always been reasonably safe. Even in the US, the crisis occurred because sub-prime mortgage loans started to be securitised, which was a very specific segment of the market. That does not exist in Europe and never has. The market is ready to buy good securitised products.

The issue is less the stigma than the prudential treatment because the target is to be able to unload assets from the banks' balance sheets. A prudential treatment is needed which relieves the risk-weighted assets calculations from the banks that are securitising, so it is a framework that is not too severely penalising banks or investors.

If the load is securitised and different tranches are sold to different banks, the addition of these different parts should not be much higher than the risk-weighted assets of the initial loan. The current situation is that by securitising there is roughly a doubling of the risk-weighted assets associated with the same loan.

The benefits, in terms of risk-weighted asset transfers, should be measurable and reliable. The current rules, which are not working, have not taken the issue in the right direction. There has been insistence on the processes, complexities and rules instead of the creation of avenues for a market of risk-weighted assets.

6. Benefitting from a securitisation market to relaunch the EU economy demands not delaying the regulatory evolutions outlined by the High-Level Forum

A policymaker noted that the European Commission listens carefully to what the industry has to say. Securitisation can be a very useful refinancing tool for banks, allowing them to create capacity on their balance sheets. The Commission agreed that, following the adoption of the STS framework, securitisation is not picking up sufficiently. This has to be addressed, especially in light of the COVID-19 crisis, which should lead to doing whatever can be done to facilitate lending to the economy.

An official stated that with Europe's banks there is a zero-interest rate environment and decreasing comparability. There has to be consideration of what measures can free up capital to provide lending into the economy. It comes back to synthetic structures and giving beneficial treatment to the senior tranches. That is essential for bringing the lending through to the real economy and for leveraging what member states have done. All member states have brought forward guarantee schemes to support companies in the move into the post-COVID-19 and recovery stages.

An official explained that during shutdown periods many businesses saw a collapse of revenues. Support mechanisms were being brought in everywhere. SMEs' ability to generate capital organically has been impacted, and it was already under pressure prior to the crisis. Banks have to be able to patiently use their capital, to ensure that there is funding available for the real economy.

Changes are being made to Prospectus and MiFID, but SMEs need to be able to access capital markets and securitisation. The ability of banks to securitise those exposures is one of the quickest approaches.

An industry representative noted that there has now been a High-Level Forum to address the issue, and five main game changers have been identified. The High-Level Forum has done a very good job and their recommendations should be implemented promptly.

For practical reasons, the Commission is isolating a number of measures, but this is very selective, covering perhaps a quarter of the proposals underlined by the High-Level Forum. For the full result, all of the measures have to be implemented as quickly as possible, so work on them has to start rapidly. Even if the work is split into two packages for legal or regulatory reasons, the urgency of the second package is as great as that of the first.

An industry representative stated that numerous adjustments remain necessary. One concerns the punitive treatment of securitisation in the liquidity coverage ratio (LCR), which hinders the market from becoming more liquid. This needs to be improved. Another is extending the STS to synthetic transactions, which is underway. There are smaller items, such as relief from ESMA templates and private securitisation requirements. The requirements from the ESMA templates are so great that many originator issuers will not be able to facilitate private securitisation.

An official noted that the High-Level Forum report shows that Europe can do much better, and should seize the opportunity to introduce more changes, especially regarding the clarification of the significant risk transfer (SRT) test. When it comes to non-performing loan securitisation, the EBA report must be built on.

An official added that there are always comparisons with the US, but there there are government-sponsored entities. The STS will have to evolve going forwards. What happened with UCITS can be considered. There were numerous iterations of UCITS but it is now a globally recognised brand.

The package needs to be targeted and to go through both Council and Parliament quickly. There will be the amendments on Prospectus and MiFID, and what matters is the combination of those changes, as no one part stands alone.

There could be greater ambition than what the Commission has brought forward. However, the Commission has been good with the expert groups it has facilitated, resulting in a well-developed package for the Council and Parliament. Nonetheless, there are other things that can be considered, some of which are in relation to transparency on private deals and cashflows on synthetic structures.

A policymaker pointed out that the Commission has identified two issues it considers sufficiently mature to move forward with. First is the securitisation of non-performing exposures (NPE), which is particularly relevant in the present context because there will be a rise in the number of NPEs. It is important to ensure that the securitisation of non-performing exposures becomes a more viable alternative for banks. The Commission hears the industry saying that it and the Basel Committee have not gone far enough, so the subject matter is currently being discussed.

Following work from the supervisors in the EBA, so-called synthetic on-balance-sheet securitisation has been identified as having a strong case for a review of prudential treatment. It is hoped that adoption can take place very soon so that the new rules can come into force towards the end of the year.

In a few days the Commission will provide its official reaction to the High-Level Forum report in the form of an action plan. Securitisation will be an important element. However, there is a need to do things properly. A fundamental review of the securitisation framework is planned for next year. It will be a fairly fundamental examination of what is in place and what can be done. There are markets where securitisation functions well, and the drivers behind that have to be understood.

The Commission will issue its CMU paper soon. There will be no surprises therein, insofar as what comes from the High-Level Forum should be adhered to. A root and branch review is planned for early the following year.

The issue of significant risk transfers is very important for improving the framework, and there is a desire to look very closely at the feasibility of a framework for green securitisation. The points on the liquidity coverage requirement are understood. The preference is to remain close to the Basel standards. However, there is work within Basel Committee to make progress on the Commission's priorities. It is then up to the legislator whether alignment with Basel is confirmed or not.

An official noted that there was little data available in 2016 when working on the STS regulation, because the market collapsed. A policymaker remarked that since STS the supervisors have been looking at the issue more closely, so it is hoped the position will be better, but they should be checked with to ensure they are able to feed policy-makers with sufficient data.

An industry representative stated that the US securitisation market can be looked to for inspiration on how it works, and the way banks are using securitised products, which may be more effective than just going through the Basel Committee. It would be better for this to happen at the beginning of next year rather than at the end. As long as the five game changers identified by the High-Level Forum are not all completely solved the market will not take off. Insurance companies are needed as investors, and one item is related to Solvency II. The banks are needed as investors for the senior tranches, so the LCR is key as well. The private issue is needed.

An industry representative agreed that all five were needed. The market has to be kept liquid. To have a sustainable recovery from the ongoing crisis, it is vital to have liquid markets, and hindering liquidity anywhere in the entire value chain cannot be afforded.

An industry representative agreed that all of the ingredients are needed at the same time; they interact with each other and then the market is created.

An official noted that there are many aspects to the five points raised at the High-Level Forum, such as the LCR and the transparency side, especially with private deals. Regarding how many of the five should be adopted, there is a need for realism. There needs to be ambitiousness in the review of STS next year and quick adoption.

Much was done in the previous version of the CMU. Calls for a reform of the European long-term investment funds (ELTIF) structure are very important, particularly for the SME side. For non-listed debt equity in that sector, ELTIF has an important role to play. The retail aspect needs to be boosted, as there are pools of cash there.

There will be aspects of the CMU that are multiple Commissions, so prioritisation on that basis should be in the action plan. The work from the High-Level Forum is heading in the right direction, some of which is in relation to investor education and more money going into funding pensions. These different changes will all help to develop out capital markets, without which Europe will be put at a disadvantage.

Some changes in the quick fixes are important for supporting what has been done at a state level. The next stage is to see what is possible more quickly and what can be addressed in the timeline of this Commission. Insolvency and other issues will not be dealt with in one Commission, but there is a need to be ambitious and to ultimately deliver on the objectives in the coming years.

An industry representative indicated that corporate loan securitisation and consumer lending securitisation are being addressed currently, but together only represent about 20% of the market. 80% of the market is about mortgage lending securitisation. Those are the proportions in the US market. To fully align with the US market structure the issue of creating conditions for mortgage securitisation will have to be considered, which implies a setup including government-sponsored entities like those in the US.

An industry representative added that the US has a big advantage over Europe in terms of its agency structure. In the financial crisis, almost from one day to the next, the American banks were reset. It is unclear to which extent Europe can implement that, but ideas like it are very welcome. Before a crisis comes, Europe needs to be prepared and that can only be done if every condition is carried out.

A policymaker stated that there will likely be further legislative negotiations on securitisation. The ground needs to be well prepared. Member states, the Council and the Parliament should have objective and unemotional discussions about securitisation, because on the previous occasion there was still a stigma attached, given what happened in the 2008 crisis. In order to achieve things, that has to be left behind, while still ensuring there is a robust framework, given what happened in the past.

7. Success factors for a green securitisation

The Chair asked what is expected from green securitisation. Sustainable finance is still in development. The taxonomy has just come out and benchmarks are needed.

An official replied that the key issue regarding sustainable finance is the quality of data, without which the green products on the market cannot be relied on. There is therefore a great deal of work needed to help make the green STS label mean something real. It must be possible to trust whether a green product will be very green or greener, but that it is not greenwashing. There is a need to have some common standards at the EU level.

The Chair suggested that there are not many truly green products out there, at least not verified by the taxonomy, and queried whether securitisation can help.

An official indicated that it is important to start the work on green securitization as soon as possible, without necessarily waiting for the publication of the delegated acts on taxonomy. However, it will be very important in the long run to ensure full consistency between the stabilized taxonomy and the new framework for green securitization. European common certificates, such as European energy performance certificates, can be relied on. There has to be a wide pool of assets and a common harmonisation of those assets so the market can be very liquid. ■