SECURITISATION IN EUROPE

DOMINIQUE LABOUREIX

Secretary General - Autorité de Contrôle Prudentiel et de Résolution (ACPR)

Do not miss the opportunity of the review

Securitisation creates a bridge between credit institutions and capital markets and accordingly is an effective product in the toolbox to foster the Capital Markets Union. Soundly structured securitisations enable banks to optimise their allocation of capital, increase their capacity to finance the economy and have access to new liquidity providers. Buying the different tranches of a securitisation with various risk-return profiles offer different opportunities for investors.

In view of its complexity, securitisation requires a robust and prudent framework that limits harmful practices. On the other hand, this framework should not contain undue obstacles to its use by originators and investors.

The implementation of the new European cross-sectoral securitisation regime in early 2019 was an important step forward from the previous situation. However, it has not yet produced all expected results and the development of the market has been limited since its inception. To some extent, this may be due to certain elements in the regulation that need an upgrade.
The current review of the European framework offers an opportunity to improve its efficiency. While maintaining the key principles that governed the reform, all relevant areas of the framework should be assessed without any bias, so that issues are correctly identified and addressed.

Ahead of the upcoming response of the Joint Committee to the Call for Advice issued by the European Commission in October 2021, I would like to underline that in our view some technical amendments to the prudential requirements would be highly welcome without prejudice to the risk-based sensitivity of the framework.

1. The so-called non-neutrality "p" factor in the RW securitisation function for banks has in fact three roles (allocation of capital between tranches, overall capital surcharge post-securitisation and steepness of the cliff-effect). Reaching these three goals in an optimal fashion with only one parameter may appear a difficult objective; the European Union could propose that the Basel Committee reviews this part of the international standard in the future. However, I believe that in the meantime a targeted reduction of the risk weight floors and of the "p" factor, at least for certain qualifying tranches retained by the originators, could be introduced in the CRR.
2. The assessment process of the significant risk transfer (SRT) should be framed through a strong and structured dialogue between the originators and their supervisors. In that regard, I welcome the delegated act that the European Commission intends to release soon in order to implement the recommendations of the EBA Report on SRT published in November 2020, subject to an appropriate calibration of the proposed tests.

3. A potential upgrading of certain STS securitisations to level 2A of the LCR (with adequate haircuts and subject to observed liquidity) would likely stop discouraging institutions subject to the LCR to invest in such securitisations. Then, the increasing demand on the "buy side" may produce positive effects on the offer from the "sell side", potentially creating a virtuous circle.

4. A clarification of the definition of private transactions would help to design proportionate disclosure templates, tailored for the investors' needs. On the other hand, it is sometimes difficult for supervisory authorities to become aware of the issuance of private securitisations without any notification. Making the information for private securitisations available by means of a securitisation repository would allow supervisory authorities to access and query the information in an easier and more structured way.

5. The role of insurance companies as investors is also critical. In this regard, the prudential framework for insurers could be made more risk-sensitive. Indeed, Solvency II capital charges encourage insurers to invest in senior STS categories only, putting aside other categories of securitisations. It may explain the limited appetite of insurers to invest in such financial instruments. Here again, we are in front of an egg and chicken dilemma. A first step towards improvement may be to include in Solvency II a segmentation of the non-STS securitisation tranches into two sub-categories at least (senior and non-senior) - as in the banking prudential framework. Such a segmentation would allow these products to benefit from a better risk-adjusted treatment without adding too much complexity to the framework.

As a preliminary conclusion, I would support that the outcome of the European Commission review triggers, along the lines mentioned above, some fine-tuning of the European securitisation regime that is overall fit for purpose.

I really hope that the appropriate amendments to the framework can be implemented as soon as possible in order to make securitisation more competitive with comparable products and to ease its liquidity while maintaining the necessary transparency.

FAUSTO PARENTE
Executive Director - European Insurance and Occupational Pensions Authority (EIOPA)

Trends in securitisation investments by insurers

The Solvency II Directive came into effect in Europe on 1 January 2016 and was a true milestone, resulting in real progress in terms of risk management and the harmonisation of prudential standards in the European Economic Area (EEA). The insurance industry now uses a risk based approach to assess and mitigate risks. It also has better aligned capital to the risks it runs for all asset classes held by insurers including those of securitisation.

As far as the treatment towards securitisation is concerned the current calibration on securitisation is based on Art 178 of the delegated act which was updated in 2019 by the European Commission. This is an amendment of the previous article 178 of the delegated act from 2015 used initially in Solvency II. The amendment of 2019 introduced the treatment for the new Simple, Transparent and Standardised (STS) securitisations which increased the number of the categories treated within the framework of Solvency II for this asset class.

Stress factors were adjusted by replacing the previous categorisation according to type 1, type 2 and re-securitisations with a new classification of senior STS, non-senior STS, Non-STS and re-securitisations. Exposures to STS securitisations receive a more favourable capital treatment under certain conditions are met (STS eligibility criteria).

The aim of this revision was to boost investments in securitisation by insurers in a prudent way. Three years after the new delegated regulation has come into effect, investments in securitisation have been overall stable to approximately 12.5 billion euro for the solo standard formula users which operate in the EEA. According to data from EIOPA's quantitative reporting templates, in 2021, when looking within the STS and the Non-STS segments, in relative terms, one can observe small increases to both categories since 2019 by approximately 3%. Within the STS segment this increase is observed mainly in respect to the senior STS category.

Demand for securitisation investments across the majority of insurers in the EEA seems to be stable.

In addition to the above it has to be mentioned that the distribution of securitisation investments within the EEA is concentrated in a small number of undertakings (255 out of 2086 solo undertakings according to data from EIOPA's quantitative reporting templates in 2021) located only in a few countries (in eight countries in 2021 – Belgium, Denmark, France, Germany, Ireland, Italy and Spain). The vast majority of European insurers have not been investing in securitisations since the introduction of Solvency II. Of those who invest, 85% do so for an amount of less than 5% of their total investment assets. Only a small number of insurers seem to be active players in the securitisation market.

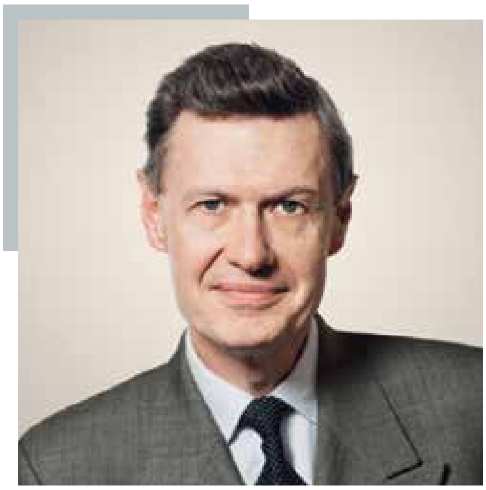
In order to better understand the investment behaviour against this asset class, EIOPA launched a survey to the insurance industry which indicated that the appetite of insurance undertakings with regards to investments in securitisation is very diverse. This can be partly explained by the individual insurers Asset and Liability Management (ALM). In this regard, each undertaking has a different liability structure and adjusts its investments accordingly. While a few undertakings seem to use securitisation for this purpose, the vast majority seem not to do so.

A few insurers mentioned that the high capital charges are one of the reasons that is holding them back from investing in this asset class. In addition, some other insurers highlighted that if an undertaking's solvency position is very robust, the significant driver for investment activity is primarily risk and expected return rather than capital requirements. Some of the additional reasons were reported to be:

(i) Other asset classes show better risk-return profiles;
(ii) Portfolio consists of "hold-to-maturity" bonds. Securitisation investments do not fit into this portfolio;
(iii) Given the profile and nature of the liabilities, insurers tend to invest in longer duration fixed rate investments.

In conclusion, the demand for securitisation investments across the majority of insurers in the European Economic Area seems to be stable since the introduction of Solvency II. The Simple, Transparent and Standardised label is in place only since 2019 and at the moment there are small indications that investments may increase.

As part of its ongoing work, EIOPA will continue to follow closely trends in securitisation.



PHILIPPE BORDENAVE

Senior Executive Advisor to General Management and the Chair of the Board - BNP Paribas

Securitization : quick fixes or complete overhaul ?

I have been advocating for a holistic review of the securitization framework for many Eurofi conferences now.

While some quick fixes have been implemented, such as the extension of the STS eligibility to on-balance sheet securitization, most of the obstacles that had been identified by the High Level Forum on the CMU back in 2020 are still unsolved:

- Inefficiency of the Significant Risk Transfer assessment by the ECB/SSM
- Excessively penalizing capital charges for banks and insurance companies
- Unfairly penalizing liquidity treatment, notably compared to covered bonds
- Excessively burdensome reporting requirements, that do not meet investors' need.

2022 was supposed to be the year of this "holistic review", however:

- The European Commission seems to have decided not to reopen the Securitization Regulation to address the simplification of reporting
- The Joint ESAs are still to issue a response to a September 2021 Call for Advice from the European Commission, and preliminary industry outreach has been disappointing, as to the level of ambition of this report.

As co-legislators are currently negotiating the CRR3-CRD6 package, as well as the revision of Solvency 2, Europe cannot afford to leave this subject unaddressed.

Indeed, Europe is facing multiple challenges, which will require massive investments in the coming years. Estimated in 2020 by the Commission to 650 bn€ additional investments per year to finance the green and digital transition, this amount is likely to grow toward 1 trn€ per year, considering the responses to the consequences of the Ukrainian war as regards reindustrialization, defense, and strategic autonomy at large.

Public funds can only finance a limited part of these investments, given high levels of public debt and rising interest rates. So the main share will have to be financed by the private sector, where banks currently represent about 75% of this financing.

Although banks have currently high level of capital, the amounts at stake are well beyond their capacity to increase risk-taking, given ever increasing regulatory and supervisory pressure: "finalization" of Basel III, reinstalment of buffers, supervisory pressure on lending to corporates with "high" leverage, continued goldplating of MREL...

Missing the opportunity to unlock this market would mean that Europe will have to slow down its investment programs, and will not achieve its Green, Digital and Strategic autonomy ambitions.

While Capital Markets can develop, from the low base that they currently represent, they cannot become a substitute to banks' long-term relationship with clients, notably in the SME sector. The only solution to square this circle is to allow banks to originate those investments, and to package them for investors in the form of securitization. This combines the safety and soundness of banks' regulated lending practices, and the capacity to share risks with the very deep European saving markets, offering them profitable, robust, and purposeful exposure to the real economy.

The Joint ESAs report should not miss the opportunity to provide well-known and effective solutions to well-recognized issues today preventing the European securitization market to take off. The Commission and co-legislators should ensure that such answers find their way in the current revisions of CRR and Solvency 2.

The potential is huge: securitized assets represent only 8% of GDP in the Eurozone, compared with 47% in the US. Missing the opportunity to unlock this market would mean that Europe will have to slow down its investment programs, and will not achieve its Green, Digital and Strategic autonomy ambitions.

ALEXANDER BATCHVAROV
Structured Finance Expert - Bank of America

EU securitisation has large potential, but needs a re-launch

The Global Financial Crisis was a watershed for the EU and US securitisation markets. It tripped both markets, but while the US market got up, brushed the dust off and moved on, the EU market is still struggling, we think, to regain its footing. The best summary of the contrast between the two markets' evolution is the ESM Blog statement: in 2008 the size of the European securitisation market, including the UK, was 75% that of the US, and in 2020, it was just 6%. The EU share is even smaller given that the UK market is about a quarter of the European market.

The difference in the US and EU securitisation market's sizes is often attributed to the Agency MBS market in the US. In fact, US Agency MBS does not meet the EU securitisation definition; its MBS credentials are as close to EU securitisation-law-abiding MBS as are EU covered bonds. The differences between US Agency MBS and EU mortgage covered bond include: sovereign guarantee explicitness and format, degree of collateral pool disclosure and sheer issuance volume (about $3trn and about €0.5trn p.a. in recent years); they represent 38% of US and 17% of EU GDP. Yet, $8trn outstanding US Agency RMBS means that the US banks do not hold that amount on their books. In contrast, the entire amount of mortgage loans backing the nearly €3trn outstanding covered bonds is on EU banks' balance sheets, locking in capital and credit lines.

Away from US Agency MBS, the US saw about $850bn of securitisations in 2021, while the EU volume (placed with investors) was c. €96bn, with additional volume of c. €94bn retained by banks to access ECB liquidity facilities. This is a far cry from the €270bn+ volumes p.a. placed with investors before the GFC. In recent years, (non-agency) securitisation issuance was c. 4% of GDP in the US and c. 2.5% in Australia.

By comparison, EU placed issuance was barely 0.5% of EU GDP. In 2Q21 EU securitisations (both placed with investors and retained by issuing banks) represented only 2% of the total assets in the EU banking system; in the USA (excluding US agency RMBS) it was about 9%. To reach the Australian securitisation share of GDP, EU securitisation can easily provide an extra €350bn of funding p.a. to the EU economy. What more evidence is needed about the contribution of securitisation to both the GDP and the banking system of a given country? Note that SSM identified one of the reasons for the lower, than their US rivals, EU banks competitiveness as the much weaker EU securitisation market relative to the US.

EU securitisation can easily provide an extra €350bn of funding to the EU economy p.a.

In the GFC's aftermath, EU corporate finance was largely disintermediated and the credit markets doubled their size as a share of Eurozone GDP (c. 23% in 2022), with the help of the ECB. Since the Eurozone crisis, the ECB has regularly propped up the Euro covered bond markets, too. The resulting sovereign-bank-corporate nexus is unprecedented; the need for funding diversification and limiting the systemic implications of the above nexus requires a much bigger role for securitisation in the EU. Last but not least, EU green securitisation market lags those of the US and China by a wide margin. A green securitisation market, able to support fully the sustainability transition of the EU economy, is predicated, in our view, on an already well-functioning securitisation market, not vice versa.

The question of why the EU securitisation is not contributing to its full potential to the growth and sustainability transition of the EU economy has many answers, of course. We believe that the key one is EU regulations: both in their wording and implementation they create high barriers to entry for both issuers and investors, and distort incentives across capital market instruments and players.

There is little, if any, historical proof of agency and model risk in EU securitisation; US data justifies capital neutrality of c. 0.15%-0.25%. Capital non-neutrality is a regulatory barrier to bank investors: a p-factor of 0.5-to-1 cannot be justified in the EU. Solvency II charges incorporate 'capital non-neutrality' in a different way: the absence of EU insurers among securitisation investors, in contrast to the US, is a case in point. There is no historical evidence that the agency risk in securitisation is higher than that in whole loan portfolios or covered bonds; EU consumer lending laws largely equalise those risks.

We see no justification for disclosure gap for securitisation vs. covered bonds and whole-loan pools: all are asset-based instruments, the dual recourse fall-back has not been proven in real life and covered bonds are not homogeneous across EU, despite being subject to a uniform light-touch regulation. The EU-only launch of STS securitisation is yet to bring new issuers and investors to the EU securitisation market.

The EU securitisation market is delivering below potential. The High Level Forum on CMU detailed how to unleash its power for the benefit of the EU economy and transition. We think these proposals should be acted upon.

MASCHA CANIO

Head of Credit & Insurance Linked Investments - PGGM

The Pension Fund Standard for Credit Risk Sharing Transactions

The European economy is facing two main challenges today: recovery following the COVID-19 pandemic, which is being threatened by high inflation and potential lack of sufficient gas supply, and simultaneous transition towards a sustainable economy. Securitisation is perfectly designed to address these challenges as through its ability to transfer part of the risk from the banking system to capital market investors, it facilitates continued bank lending to the real economy. This is crucial in times of economic stress, like today.

Since 2006, PGGM invests in balance sheet synthetic securitisations, which we call 'Credit Risk Sharing' (CRS) transactions, on behalf of PFZW, the € 229 billion Dutch pension fund. We have been a vocal supporter of establishing the Simple Transparent and Standardised (STS) Securitisation Framework, which now also applies to the CRS market and we applaud Europe's leading role in this field. The benefits of the STS label are already showing. Yet, to realise the full potential of securitisation, more can be done.

Echoes of the Global Financial Crisis (GFC)

Alas, securitisation still has a stigma dating back to the GFC, where misalignment, overconfidence and insufficient risk awareness in the US securitisation market contributed to a financial breakdown. The misuse of securitisation before 2008 has tainted the full spectrum of securitisations and has driven regulatory caution for well over a decade. This is reflected, amongst others, in the non-neutrality of securitisation capital risk-weights and overly detailed ESMA disclosure templates which stack layers of conservatism on the securitisation products. This conservatism persists, despite the fact that several analyses of the EU CRS market since 2008, such as the comprehensive EBA Report (May 2020), show very low loss rates in CRS securitisations. Introduction of the aggregate output floor under Basel III, while not specific to securitisation, will exacerbate this due to the conservative treatment of securitisation under the Standardised Approach and is a key issue to address.

Standards always matter

That said, we recognise ourselves in the cautious approach and we have experienced low losses in over 60 CRS transaction we have invested in so far. As a prudent long-term pension fund investor, we always aim to thoroughly understand the risks involved and mitigate where appropriate to gain comfort prior to investing. As such we have always applied our own 'pension fund standards'. The STS criteria for CRS, which have been an excellent first step, partially encompass these standards, yet, further finetuning is needed to truly capture the risks involved. Our pension fund standards both work for an investor and simultaneously address regulatory concerns regarding these transactions.

Securitisation rules, if set properly, can truly support the financial system in economic stress.

The Pension Fund Standard

Our CRS transactions, which all concern blind portfolios (i.e. bank clients' names secret),are based on the principle of understanding the underlying and genuine sharing of credit risk between the bank and the investor. This leads to three key principles that are not yet fully captured by the current STS rules:

- Adequate risk alignment of 20% to avoid the originate-to-distribute model. CRS transactions, unlike the typical true sale securitisation, are focused on covering the first losses on a loan portfolio. As such, for CRS the regulatory minimum of 5% risk alignment is insufficient as that is quickly compensated through origination fees and a few coupon payments.
- Mitigation of counterparty credit risk to the bank by collateralising the funded notional. Not including this for CRS transactions has led to a lower STS standard for CRS compared to true sale, which by its nature is collateralised. In addition, it runs counter to a key lesson from the GFC and the regulatory trend.
- Having the right data to evaluate the credit risks of the loan portfolio and estimate expected losses throughout the economic cycle. This includes reporting data that is fit-for-purpose, reflecting the bank's modelled PD and LGD data, as well as significantly more than 5 years of historical data to understand the performance of the portfolio through economic cycles.

Setting these high standards will contribute to ensuring a robust CRS market through coming downturns. Capturing these adequately, for example in the STS framework, provides a rationale to reduce some conservatism in the regulatory framework.

Conclusion

So far, 2022 has been very active for the CRS market and we see this trend continuing this year. The CRS market is growing, yet how it develops into a mature market over the coming years largely depends on regulatory standards. If these are set properly, they will stimulate more direct participation by long-term institutional investors like ourselves, adding further stability in capital deployed. The result will be a healthy and sustainable CRS market that can continue to support European banks in lending to their clients and as such contributing to the real economy throughout time.