

Securitisation in the EU

1. Addressing regulatory complexity and costs in European securitisation

1.1 Streamlining due diligence and disclosure requirements

The Chair observed that the targeted consultation launched by the European Commission in late 2024 aims to assess the functioning of the securitisation framework, which is targeted at supporting the capital markets union (CMU). The findings indicated a very strong demand for increased securitisation in Europe. Most market participants expressed that the securitisation framework was overly complex and costly, leading to undue burdens in terms of due diligence and disclosure, coupled with punitive prudential frameworks affecting banks and insurers.

An industry representative stated that their company is a long-term global investor in securitisation. Work has been done around the deltas between asset classes in the US and EU; there is around a €1 trillion opportunity for financing and securitisation in the EU by fixing some of the issues.

An industry representative explained that banks are supportive of the improvements relating to the simplification of due diligence, the streamlining of disclosure requirements, and changes to the prudential standards, but by themselves these will not be sufficient, and more needs to be done. There needs to be more urgency to move towards a pan-European market. A greater alignment of the securitisation framework with the broader regulation of financial instruments would be helpful. Insolvency law also needs to be reformed, with a move towards a common insolvency framework. The Savings and Investments Union (SIU) project could provide necessary impetus.

A regulator noted that the Commission's survey was timely, but there were challenges in garnering participation because of the burdensome transparency rules and excessive transaction costs involved in securitisation processes. Given the inaccessibility of securitisation in the region, Estonia turned to covered bonds, leading it to harmonise regulations across the Baltic states based on the EU directive. While the initiative has been a success, there is a necessity to review existing securitisation rules to lower administrative burdens and reassess prudential treatments, including due diligence and transparency standards.

A public representative added that there is also a need to resolve structural fragmentation within the EU's financial landscape, as Europe essentially functions with 27 separate capital markets. To prevent further fragmentation, targeted actions must be taken, not only on securitisation, but also in synchronising

broader market functions. Solvency laws and supervisory practices are focus areas. Reforms to the securitisation framework should extend beyond adjustments in prudential regulation. It is also important to increase transparency and improve due diligence.

The Chair stated that there is widespread agreement that more needs to be done in reducing red tape; the same can be done on reporting frameworks. However, it is difficult to think of an institution or person who has lost money on European securitised products during the last 30 years. All the money that has been lost has been on American instruments.

An industry representative highlighted that there is no difference in the due diligence that their company conducts when it invests in the US, Australia, Europe or the UK. EU securitisation changes how their company documents how that due diligence occurs. The company is already regulated in the EU by Undertakings for the Collective Investment in Transferable Securities (UCITS), the Alternative Investment Fund Managers Directive (AIFMD) and the Institutions for Occupational Retirement Provision (IORP) Directive. However, the current regulations often increase costs and crowd out smaller managers. Additional data acquisition does not inherently equate to more meaningful information, so a targeted approach to transparency is needed that does not overwhelm the market.

A regulator observed that the three key issues are prudential, transparency and due diligence. There needs to be a move away from punitive measures on securitisation, and towards a neutral stance. There also needs to be uniform treatment. There are doubts around non-simple, transparent and standardised (STS) securitisation, because it is more difficult for small companies to access. It is also important not to over-regulate public securitisation; EU law works, with the Markets in Financial Instruments Directive (MiFID), the Markets in Financial Instruments Regulation (MiFIR), prospectuses, and a transparency framework. The market needs to work on private securitisations.

1.2 Revisiting Prudential Frameworks for Banks and Insurers

An industry representative explained that banks issue securitisation for various reasons, but primarily to address increasing capital requirements mandated by European regulation. Current regulations impose multiple new buffers and ever inflated methods for calculating risk-weighted assets, with the completion of Basel III being the latest consideration. Inspections and model reviews from the Single Supervisory Mechanism (SSM) continuously introduce layers of conservatism, thereby raising capital requirements further. To tackle escalating capital demands, banks increase capital through retained earnings annually,

yet this is detrimental to the economy. Between 2014 and 2024, over 90% of retained earnings from all banks under SSM supervision were used to bolster capital ratios rather than to increase operational activity. Securitization is the only way to reduce risks hence risk weighted assets without curbing business.

A regulator stated that supervisors do not have the intent to punish with capital requirements. Supervisors do evidence-based, data-driven analysis. A 2022 assessment of insurance investments in securitisation concluded there was no rationale for lowering capital requirements based on the available data.

An industry representative noted that standards are trying to be levelled out, not weakened. Europe is missing a senior lender from the insurance space; it is therefore much more expensive to form securitisation capital, which is impairing the demand side. Internal models are masking that. Some of the insurance companies that have them are not advocating for that, as the internal models are very expensive, hard to maintain and hard to. It is therefore reducing what should otherwise be a larger demand. There is a lack of alignment between natural partners in the industry as a result of internal models.

A regulator added that the main regulatory challenge facing EU securitisation is its high operational costs, compounded by overly punitive and poorly calibrated prudential rules for banks and insurers. The EU's transparency and due diligence requirements are often viewed as costly and overly burdensome, with frequent overlaps and duplications that further increase the costs. There are also concerns regarding the risk-sensitivity of the prudential rules for banks and insurers.

An industry representative stated that there is a desire for banks to increase their securitisation activity, noting their capacity based on existing underlying assets. However, they are constrained by the excessively punitive capital treatment applied to retained tranches, complicating their decision to issue more. Banks weigh the revenue losses against risk-weighted asset savings during securitisation opportunities. The current capital treatment impedes potential transactions.

A regulator observed that unfunded guarantees from monoline insurers were a significant part of the problem in the previous crisis, which goes back to the context of funded versus unfunded guarantees. In particular unfunded synthetic securitisations, if allowed, will lead to an increase in systemic risk, counterparty default risk as well as policy holder risk. The latter because insurance supervisors can not identify the actual risks in the portfolio's when these products are there.

1.3 Combining transparency and reduced operational costs

An industry representative stated that the provision of loan-level data through the European Central Bank (ECB) and other European Securities and Markets Authority (ESMA) templates has brought a significant amount of standardisation in terms of the quality and the quantity of data, which their company has used in

order to appraise the risk factors, understand the credit risk drivers, and obtain insights around the comparatives between markets.

The European securitisation market has performed extremely well, particularly on the investment-grade side, when compared to corporate bonds since 2008. It is a good opportunity to think about the calibration that is currently in place, and whether it is appropriate when looking across other sectors around whether that is to do with the due diligence/disclosure side or the prudential side.

An industry representative highlighted that the market view is that there is €140 billion of issuance. If collateralised loan obligations (CLOs) are removed, which are non-STS, as well as UK securitisation, the EU placed securitisation total is between €40 billion and €45 billion. That is the size of the Australian securitisation market, which is about 10% of EU GDP. Despite the encouraging signs of a pick-up in issuance, the market is very far from anything that was seen before the global financial crisis (GFC). For the economies of Japan, the US and Australia, the market is going back to GFC levels, with a much better credit quality, and much better structured and more enhanced rated tranches. A great amount is desired from the European securitisation market.

2. Comparative analysis and market evolution

2.1 Lessons from global markets: US, Japan, and Australia

The Chair stated that the EU can be compared to Japan, as both jurisdictions have imposed stringent regulations after the post-global financial crisis. However, unlike the EU, Japan has lifted such burdens, which has led to significant growth in its securitisation market. The question is whether the EU can adopt similar modifications to enhance its own landscape.

An industry representative noted that the CLOs market is of special importance, and this market has seen growth in the US, but in Europe the market has lagged, with only a around \$50 billion in issuance last year. In contrast, total CLO issuance in the US market reached around \$200 billion.

2.2 Current state and evolution of the European securitisation market

The Chair stated that securitisation is a key instrument, not only for bank capital management, but also for risk sharing across the financial system. Given the current circumstances, it has a critical role in providing funding for transformations in Europe, but it remains underused in the EU compared to jurisdictions such as the US, Canada, Japan and Australia.

Insurance is an important sector. The issue with covered bonds is that it is purely a refinancing instrument and does not provide any money for risk sharing, trenching and rotation of banks' balance

sheets, so it will probably not solve anything in terms of additional capacity or financing investments.

An industry representative highlighted that the European securitisation market has gradually recovered after the pandemic, yet issuance levels have not significantly increased compared to pre pandemic figures. There is often a discrepancy in the reported size of the European securitisation market, which is frequently cited around €400 billion annually. However, it is difficult to reconcile this figure with actual market conditions. Public placements of European true sale securitisation is estimated at about €140 billion to €150 billion annually, but around €60 billion to €80 billion of that is retained and never enters the market, thus does not represent active market participation. The effective outstanding market size might therefore only be around €200 billion.

An industry representative added that it is essential to appreciate the underlying factors contributing to the underdevelopment of the market in Europe, and to reliance on more traditional funding mechanisms. There are historical, cultural and structural reasons for Europe's lower securitisation activity, including a prolonged low interest-rate environment where securitisation was less essential for funding. There is a successful covered bond market in Europe, although it has limitations compared to securitisation in terms of the range of financing opportunities it offers. An emphasis needs to be placed on the fragmented nature of the European markets, as securitisation is generally confined to six or seven member states.

An industry representative stated that securitisation is a key aspect of growing the European economy. Growth requires credit formation. Europe is heavily reliant on banks, which is unique to other economies. More credit formation is needed to create growth; securitisation is a part of that. Banks want securitisation to transfer risk and manage their risk-weighted asset (RWA) calculation.

2.3 Diversification and performance of securitisation assets

An industry representative noted that there is a structural diversification in securitisation in the current market. There is an expanding asset-backed securities (ABS) market in the US, which virtually covers the real economy. In the US, data centres, solar, fibre and digital infrastructure have doubled since 2020. Stronger structures and improved performance have been seen since the GFC, as well as risk mitigation and significant amounts of regulatory reform that have eliminated the products that contributed to the GFC. There has also been performance of investment-grade tranches relative to other asset classes through every cycle.

An industry representative stated that residential mortgage-backed securities (RMBS) make up nearly half of all outstanding securitisation, predominantly situated in the UK. Furthermore, the collateralised debt obligation (CDO) and CLO markets represent around 20% of outstanding securitisation, but other variations like consumer and auto asset-backed securities remain relatively minor. Attention needs to

be drawn to the small scale and severe fragmentation in the markets, mainly due to the accessibility of underlying collateral along national borders.

An industry representative explained that securitisation provides vital diversification and is another tool in credit portfolio construction. The predominance of fixed income is either sovereign or corporate risk. Securitisation provides banks with an ability to invest in the real economy, whether it is consumer, commercial, digital assets or the energy transition. During liquidity crises such as the recent gilt crisis, securitisation assets were readily convertible into cash, thereby demonstrating their value as liquidity tools. There is a significance of securitisation for economic growth and the ability to diversify funding sources beyond traditional bank dependence, which, in turn, creates financial system stability.

3. Strategic initiatives and policy recommendations

3.1 Pan-European market integration and harmonisation

An industry representative proposed a collaborative approach similar to the success of the Eurobond market, suggesting that establishing a pan-European securitisation platform could enhance the overall functionality and appeal of the securitisation market.

The Chair noted that if securitisation eventually occurs throughout the whole EU, then the idea of an agency needs to be rediscussed. That agency has already been developed in the US, Japan, Canada and Australia, and seems to work.

3.2 Innovative solutions and technological advancements

An industry representative highlighted the various repository systems such as the European DataWarehouse. Their company now has access to a wealth of data that has benefitted from standardisation. In the past, some countries had provided default and recovery data, and others had just provided loss data. However, not all data is used for appraisal of risk factors. Their company uses loan-by-loan data from commercial and residential mortgages, as well as from SMEs. For most of the consumer sectors it uses portfolio stratification. Now is an ideal time to scale back on resource expenditure tied to unnecessary data demands, while ensuring the focus remains on valid and essential information.

3.3 Building consensus and stakeholder engagement

A regulator reiterated the importance of creating a regulatory framework that is clear, predictable, and proportionate to risk. It would bolster efforts to rebuild the securitisation landscape in the EU as stakeholders are more likely to support a regime they understand and that reflects the actual complexity and risk profile of their activities.

A public representative highlighted the necessity for all stakeholders to express their views openly and engage in thorough dialogues surrounding necessary regulatory adjustments, emphasising the path forward beyond merely reducing administrative burdens resulting from the EU legislation. Most of the problems in the financial markets are related to the low level of consolidation of the single market and the national barriers imposed by Member States.

An industry representative stated that the stigma associated with securitisation must be removed, as it is primarily a political construct instead of an operational flaw. Sweeping, holistic reforms are needed for meaningful progress, based on a comprehensive understanding of the risks involved.

4. Future outlook and key measures for growth

Measures to advocate for securitisation growth

An industry representative reiterated the emphasis on acknowledging that the nature of the assets involved in securitisation has evolved markedly since the crisis, signalling the need for corresponding adjustments of disclosure requirements in the sector.

A regulator encouraged participants to engage beyond the general discussions of supply and demand and advocated for direct dialogues between the supply side and the broader insurance industry to identify genuine market demand parameters required for a successful uptake of securitisation opportunities.

An industry representative advocated for a simultaneous comprehensive reform approach to securitisation rather than incremental changes, cautioning against potential setbacks from failed attempts in prior years. There is an urgent need to avoid a repeat of past difficulties.