Ms Mairead McGuinness
European Commissioner
Financial Stability, Financial Services and the Capital Markets Union

Ms Irene Tinagli
Chairperson, Economic and Monetary Affairs Committee
European Parliament

Mr Zbyněk Stanjura
Minister of Finance of the Czech Republic

3 November 2022

Securitisation can provide significant support to Europe's economy in the testing times ahead – targeted measures are needed to unlock its potential

Dear Commissioner McGuinness,
Dear Madam Chair Tinagli,
Dear Minister Stanjura,

The European Commission's report on the functioning of the Securitisation Regulation published on 11 October comes at a time of uncertainty for the European economy, where the fresh resources that securitisation can provide would be particularly valuable. Securitisation is the only financial instrument which enables financial institutions both to recycle capital and refinance lending to households and small businesses through risk transfer transactions and traditional securitisations respectively. Securitisation can be used to finance not just direct loans to SMEs, but also SMEs' working capital and leases of essential assets, such as low emission vehicles, solar panels, and energy efficient manufacturing equipment. These assets in turn drive Europe's digital and green transitions.

For this reason, it is particularly concerning that close to 80% of respondents to the Commission's consultation preceding the report disagree with the view that the Securitisation Regulation has been successful in improving access to credit for the real economy, in particular for SMEs.[1]

[1] Report from the Commission to the European Parliament and the Council on the functioning of the Securitisation Regulation. See Figure 1, page 6. We note that the remainder of respondents are mostly neutral on the question.

The European economy needs securitisation more than ever given its continued reliance on bank loans as a source of funding. Securitisation is vital to achieving the objectives of the Capital Markets Union and addressing the very significant financing needs today and in the coming years, including those arising from the green and digital transformations, as well as from the economic impacts of the Covid-19 pandemic and the war in Ukraine. Yet securitisation volumes in Europe have continued to decline in 2022,[2] in sharp contrast to the growth seen in other markets in recent years. Macroeconomic considerations and factors such as the pandemic and central bank interventions are not the main reasons for this decline. The United States, for example, recorded its highest ever issuance levels in 2020 and again in 2021[3].

The absence of a well-functioning securitisation market represents a strategic loss to the European financial system. It is undermining the competitiveness of European financial institutions and limiting their ability to recycle capital to support new financing. It has encouraged institutional investors to shift towards other products that do not offer the same advantages in terms of protection, transparency and liquidity.

At the heart of the problem is a disconnect between the Commission's vision for securitisation in Europe – a tool making a significant contribution to a well-functioning financial system that efficiently finances the real economy – and aspects of the regulatory framework which remain miscalibrated and, in practice, disincentivise issuance and investment in securitisations, thus holding back the tool's potential to support the economy.

We take note that the Commission does not intend to undertake a general review of the Securitisation Regulation Level 1 requirements within this mandate, which is undoubtedly needed to support investors' return to the product. We welcome, however, the Commission's invitation to ESMA to streamline disclosure requirements, which are widely seen as burdensome for issuers and unhelpful for investors. We look forward to engaging with ESMA to contribute to this important workstream.

The decision not to review the Securitisation Regulation at this stage, nevertheless, strengthens the case for and urgency of pursuing targeted measures in other aspects of the framework, notably the prudential requirements for banks and insurance companies, where we identify some of the most pressing challenges. EU legislators should use the opportunities provided by the current legislative discussions on the **CRR3/CRD6 and Solvency 2** to introduce immediate adjustments to securitisation-related calibrations in these legislations and concrete mandates for more risk sensitive revisions to be undertaken as a subsequent step.

[2] In Q2 2022, EUR 34.5bn of securitised product was issued in Europe, a decrease of 45.9% from Q1 2022 and a decrease of 5.1% from Q2 2021. Of the EUR 34.5bn issued, EUR 16.4bn was placed, representing 47.4% of the total, compared to the 51.2% of issuance in Q1 2022 and 71.7% of issuance in Q2 2021. Outstanding volumes (ex-CLOs) decreased to EUR 964.1bn outstanding at the end of Q2 2022, a decrease of 2.38% QoQ and a decrease of 0.85% YoY. Source: AFME Securitisation Data Report Q2 2022.

[3] The US market is significantly larger than the European market, even with the exclusion of issuances from the US government sponsored entities.

In relation to the bank capital regime in the CRR3, **an immediate recalibration of the SEC-SA is particularly urgent to mitigate the severe negative impact of the incoming output floor**. We strongly support proposals by MEPs for a transitional arrangement providing that the “p” factor is divided by two for the purpose of the output floor calculation until a wider review of the framework is undertaken. This transitional measure is critical for the economic viability of synthetic on balance-sheet transactions, the main instrument used to share risk and redeploy capital into lending to SMEs, corporates and project finance, as they are the most severely impacted by the CRR3.

A recalibration of the **Solvency 2** capital charges on assets to levels that are proportionate to the commensurate risks is a condition for the return of the insurance sector as investors in securitisation. Without these changes, there is no economic rationale for this industry sector to invest, despite the many advantages that securitisations could offer.

The adoption of the above measures, together with an appropriate treatment for securitisation in the **EU Green Bond Standard**, would be important steps towards the restoration of an active securitisation market in Europe. We emphasise that securitisation can also provide a major contribution to the green transition by freeing up capital for banks to lend towards sustainable projects such as mortgage loans financing energy-efficient houses, rooftop solar energy loans or other sustainable loans.

It also very important that **critical technical standards under preparation** do not exacerbate the imbalances in the current prudential framework. As discussed in the annex below, we are very concerned by the potential introduction of further disproportionate requirements in certain Level 2/3 outputs or Delegated Acts, which would be at odds with established market practices and formulated without evidence of regulatory shortcomings.

We take the opportunity to outline in the annex below the main workstreams underway with a brief summary of our views. We believe our recommendations are consistent with the objective of maintaining strong levels of investor protection and a prudent regulatory environment for this product.

We thank you for your consideration and stand ready to engage with policymakers to provide technical evidence and analysis supporting our views.

Sincerely,

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CC:

Andrea Enria, Chair of the Supervisory Board of the ECB

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Jonás Fernández, Member of the European Parliament (CRR3 / CRD6 Rapporteur)

Markus Ferber, Member of the European Parliament (Solvency 2 Rapporteur)

Paul Tang, Member of the European Parliament (Securitisation Regulation Rapporteur)

Othmar Karas, Member of the European Parliament (CRR/CRD Securitisation Framework Rapporteur)

John Berrigan, Director General, Directorate-General for Financial Stability, Financial Services and Capital Markets Union, DG FISMA

Annex: Summary of Key Recommendations

Primary legislation / Current Level 1 workstreams

CRR3 / CRD6 Banking Package – Immediate lowering of the "p" factor in SEC-SA

We urge the co-legislators to take on board amendments tabled in the European Parliament to recognise the impact of the output floor on securitisation by supporting an immediate lowering of the p factor in the SEC-SA.[4] Reducing the risk weight floors on retained senior tranches will have no effect unless also accompanied by the reduction of the p factor. This is urgently needed to ensure the viability of securitisation transactions and solve the double counting effect resulting from supplemental capital charge already embedded in the SEC-SA formula; this change would also bring closer alignment between requirements in the EU and the simplified supervisory formula approach applied in the United States. In the longer term, a full review is needed, which should cover both the SEC-SA and SEC-IRBA as per other proposals tabled in the EP and Council discussions.

We believe a reconsideration of these aspects of the prudential framework is fully justified following the introduction of over 100 criteria to meet the Simple, Transparent and Standardised (STS) securitisation label and safeguards applying also to non-STS securitisations. The safeguards have significantly mitigated perceived agency and modelling risks that have underpinned the design of prudential calibrations. It is worth recalling that such risks exist in many other investments – such as in the purchase of whole loan portfolios (ie, when similar underlying assets are sold to investors in unsecuritised form) – yet other types of transactions do not carry comparable capital charges, transparency and due diligence requirements and other obligations for the parties involved.

Finally, a separate but important element of the bank prudential framework is improving the treatment of STS securitisations in the Liquidity Coverage Ratio (LCR), which is supported by evidence. This would enable bank treasuries to better access diversified liquidity through more equitable regulatory treatment of the asset class. The disproportionate LCR treatment for securitisation relative to other asset classes has disincentivised bank treasuries from considering the most senior and well rated tranches within their Liquid Asset Buffer.

Solvency 2 – Adjusting the risk weights for securitisation

In line with our comments on the bank capital treatment, the co-legislators should support proposals tabled in the European Parliament to re-calibrate the risk-weights associated with securitisation investments by insurance companies under Solvency 2.[5] As these proposals

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[4] Amendment 1388 by MEPs Gilles Boyer, Stéphanie Yon-Courtin, Billy Kelleher, Olivier Chastel. As the MEPs have correctly noted "The highly conservative calibration of the SEC-SA means the output floor would very significantly reduce the efficiency of securitisation transactions. While awaiting the delayed "securitisation comprehensive review", an essential element of the CMU Action Plan, and without prejudice to its outcome, a transitional arrangement providing that the "p" factor is divided by two for the purpose of the Output Floor calculation, in order to mitigate the unintended impact of the SEC-SA is justified."

[5] Amendment 794 by MEP Paul Tang.

correctly note, recent academic work suggests that the risks associated with investments in STS securitisation are lower than the risk weights accorded to such investments by insurers. The risk weights should therefore be adjusted to reflect the risk of securitisation investments.

EU Green Bond Standard (EuGBS) – Ensuring an appropriate treatment for securitisation

A well-designed EuGBS regime could be an important enabler to support the development of the green securitisation market.

The EBA's recommendation to establish the standard on a "future use of proceeds by the originator" approach with additional transparency requirements represents a sound and pragmatic solution. This approach correctly takes into account that the EU economy is in a transition phase and is moving therefore towards building deeper pools of Taxonomy-aligned green collateral to securitise.

Green securitisation should not be treated differently to other eligible instruments under the EuGBS. In substance, securitisation, as a secured funding instrument, is no different to a secured bond, covered bond or indeed an unsecured bond. That is to say that interest and principal of the bond is paid from the issuer's operating income, which for most companies, at this stage in the transition to a greener economy is not generated from green assets on balance sheet. Therefore, whilst it would be paradoxical to exclude from the standard any transactions currently backed by green collateral, we caution against introducing requirements on having green underlying collateral in securitisation structures at this stage. Such requirements would be more appropriate at a stage when there are deep pools of green assets in the economy. Securitisation should be positioned to play an important role in the current transitioning phase, in the same way as other financial instruments.

Technical standards / Current Level 2/3 workstreams

Significant Risk Transfer (SRT) – Concerns with proposed tests

We understand the Commission is considering the adoption of a delegated act on SRT based on the EBA's proposals in 2020 for new SRT tests. European banks report that many fundamentally sound transactions that have been subject to a positive assessment by the ECB on achieving SRT until now would fail to meet the tests proposed by the EBA in 2020 and new issuance could largely cease as a consequence of the implementation of these tests.

The SRT process is central to achieving capital relief on securitisation transactions and we are very concerned by the possibility of further adverse impacts to the European securitisation market and the financial capacity of European banks arising from new requirements in this area. We therefore call on the Commission to limit the delegated act to elements that would further improve the SRT process in line with practices that are functioning adequately, taking into account the feedback of market participants, the European Investment Fund, and the ECB.

On-balance-sheet securitisations – Concerns with proposals for the calculation of exposure value of synthetic excess spread (SES)

Market participants have received with great consternation the proposals in the EBA's recent Consultation Paper on Draft Regulatory Technical Standards specifying the determination by originator institutions of the exposure value of synthetic excess spread (SES). We fully appreciate that technical standards must adhere to the Level 1 mandate. We believe an appropriate implementation of the legislative intent should take into account how provisions fit into the broader prudential framework of the CRR, the overall purpose of the legislation and the impact on what is currently a well-functioning market.

If implemented in their present form, the draft RTS will likely render the use of SES uneconomic in virtually all synthetic (on-balance-sheet) securitisations. These securitisations have been fundamental to supporting bank lending to small businesses across the EU for many years, including in smaller jurisdictions with limited access to the market. We are not aware of any market or regulatory failure affecting this product.

The introduction of on-balance-sheet securitisation in the STS framework in 2021 was rightly intended as a measure to support credit provision to European SMEs in the recovery from the pandemic. The current proposals seem to be at odds with this objective and are likely to have the opposite effect – ie, that of supressing this essential capital and financing tool. It may be useful to note in this context that by far the largest section of the market using SES is synthetic securitisations where the protection provider is the European Investment Fund, deploying funds made available for that very purpose by the European Commission and Member States.

We believe the approach currently applied by the ECB – whereby the originator is required to capitalise the 1-year SES net of realised losses and specific credit risk adjustments on a rolling 1-year basis – is sensible and prudent, benefiting from a robust track record. Indeed, we are of the view that this is the *only* way the exposure value for SES for future periods can be calculated in a way which is both consistent with the broader capital framework and avoids producing an exposure value which is so large as to render the use of SES unviable in virtually all transactions.

Homogeneity of the underlying exposures in STS securitisation – Concerns in specific areas

We have concerns in relation to the proposed RTS, in terms of both (i) the substantive homogeneity requirements envisaged for corporate exposure securitisations, and (ii) the time-limited grandfathering envisaged for existing on-balance-sheet securitisations. Imposition of any regulatory definition distinguishing between "large corporates" and other corporate exposures (as proposed in the RTS) will lead to the arbitrary sub-division of homogeneous portfolios structured in line with internal underwriting policies. Such regulatory distinction will also create significant issues for the corporate securitisation market in terms of transaction granularity/concentration, as it will lead to smaller, less granular portfolios, many of which may not be viable at all given the granularity expectations of ECB Joint Supervisory Teams (JSTs) (and, indeed, of originators as prudent investors in senior tranches). Consequently, the technical standards under preparation by the EBA should permit corporate exposures (like consumer lending and trade finance exposures) to qualify as homogeneous based on asset class and the application of homogeneous principles of underwriting and risk management to the entire portfolio, without the imposition of further homogeneity factors.

Temporary/time-limited grandfathering for on-balance-sheet securitisations is unworkable as it is impossible to reverse-engineer compliance of the exposure portfolio of a securitisation following closing. The proposal would effectively result in declassification of most, if not all, existing on-balance-sheet STS securitisations, we therefore believe that permanent grandfathering for existing on-balance-sheet securitisations is the most appropriate solution. If the EBA feels that it can provide only for a time-limited period before the provisions of the proposed RTS enter into force for on-balance-sheet securitisations, that period must be sufficiently long to ensure that transactions in the market are not impacted.

Disclosure templates – Revisions should lead to significant simplifications in line with investor needs

We strongly welcome the Commission's invitation to ESMA to conduct a much-needed review of transaction reporting templates, noting the need to significantly simplify requirements for private transactions – in relation to ABS, ABCP[6] and on-balance-sheet securitisations – to make the framework relevant and proportionate. ESMA should in particular remove unnecessary fields in the templates, aligning them more closely with investors' needs. As noted by the Commission, ESMA should consider whether information on a loan-by-loan basis is useful and proportionate to investors' needs for all types of securitisations.

[6] Asset Backed Securities (ABS) and Asset Backed Commercial Paper (ABCP).