IACPM

September 21, 2023

Subject : FSB invitation for feedback on the effects of G20 financial regulatory reforms on securitisation

The IACPM is a global industry association established in 2001 to further the **management practice of credit exposures originated by banks**, by providing an active forum for its members and their regulators to exchange ideas on topics of common interest. The IACPM's institutional member firms comprise the **world's largest financial institutions**.
Our perspective is unique, however, in that 1) the IACPM represents the teams within those institutions who have responsibility for the economic, risk and prudential management of such institutions' credit portfolios, and 2) our members include not only banks, but credit investors, insurers and reinsurers, which participate in credit risk transfer transactions as sellers of credit protection.

The Association is recognized as a trusted advisor by global regulators, holds global conferences and regional meetings, collects data and conducts research to assist its members and their regulators to safely optimize the whole chain from loan origination by banks to protection sellers around the world. In this chain, **synthetic securitisation is the most favored tool used by banks for private risk sharing with specialized investors and insurers**, to manage credit risk and capital of their own lending book**.** Therefore, the IACPM is welcoming the FSB's invitation for feedback on the impact of post-GFC regulatory reforms on securitisation and will focus its input on this specific type of purpose of securitization, which is not aimed at long term funding like true sale transactions.
By transferring the genuine credit risk embedded in the first and mezzanine tranches on portfolios with high-risk weight density, these synthetic securitisations, executed with or without SPV, are critical to enable banks to release capital and further grow their lending to the real economy.

In this feedback, the IACPM wants to highlight

- The **growing need for risk sharing** by banks, evidenced in our attached paper "The case for risk sharing" (Att.1, June 2022),
- The **current growth in synthetic risk sharing securitisations**, becoming mainstream with different practices per region, after having been dominated by European institutions, as you can see from our yearly survey results 2016-2022 in our attached paper "Risk sharing is becoming mainstream" (att. 2, June 2023), and
- After a robust implementation in Europe of securitisation regulations, the **systemic risk that might arise from fragmented and ineffective regulatory treatment** of risk sharing transactions, as explained in our paper **before** the finalization of Basel 3 implementation in the EU "CRR impact assessment on banks" (att. 3, May 2023).

The IACPM considers that, as currently implemented or expected to be implemented **in the EU**, via

- **CRR3** prudential regulations, which are in the process of being completed to finalize the gradual implementation of Basel3, including **lower p factors in order to mitigate the negative impacts of the OF calculation** and maintain the current size of the EU market in a transitional phase (prior to a potential review of the prudential treatment based on a comprehensive EBA report and taking into account internationally agreed standards developed by the BCBS)
- **EU securitisation regulation** (including STS criteria), considering the differences between **public** true sale and **private risk sharing** transactions, and
- after **extensive data collection, consultations** and **discussions** between regulators, banks and investors, enabling to share concerns, objectives and build solid and workable solutions,

securitisation reforms applying to **synthetic on-balance sheet securitisations** have achieved their financial stability and economic objectives, by

- effectively preventing the build-up of any **systemic risk** associated to the use of these risk-sharing structures,
- creating a robust and safe **private market** between **banks, specialized investors** and **credit insurers**, enabling to further finance the real economy by on-going risk sharing representative portfolios from banks' core lending to corporates, to SMEs and in asset-based finance,
- designing and implementing **reforms specific to risk sharing securitisation** which had an impact on both originators and sellers of credit protection, while remaining economically viable and suited to their purpose.

However, given their prudential treatment for banks as originators, the **economics** of synthetic securitisations are only marginally favorable. Indeed, while synthetic on-balance sheet securitisations are comparatively the securitisation segment that has developed the most over the past few years, their volume in absolute terms remain subdued in the EU. Actions are thus necessary to improve their attractiveness for banks in order to further support lending growth through efficient capital management.

Also, as the market is now expanding to other regions, the IACPM wants to advocate that, to achieve its **financial stability** objectives, the FSB considers the below global actions:

- An urgent **review by BCBS of the regulatory treatment of securitisations** used by banks for capital relief, and more generally of unfunded risk sharing transactions, considering the lessons learned in the EU and the specificities of this market,
- The **broadening** of updated BCBS standards implementation to the main jurisdictions which did not implement them yet (i.e., outside EU, UK and Canada), and an **alignment** on the way jurisdictions apply these standards in order to avoid fragmentation and arbitrage,
- Creating, by collecting data in the jurisdictions where disclosure frameworks do not exist, **transparency on the flows of risk transfers** from banks to any type of investor/insurer, and on the growing market of **private credit**, as part of FSB NBFI agenda - in order to monitor the

potential build-up of vulnerabilities in some areas not subject to the securitisation framework, and

- Taking the necessary supervisory actions to maintain or restore a **robust network of protection providers across all sectors** (pre-trade due diligence, monitoring, etc).

Financial stability could also be affected by **greenwashing**, as the concept of “green” or “sustainable” securitisation becomes more and more used, while not clearly defined in countries outside the EU and UK. To avoid a sudden loss of investors’ confidence in this growing part of the market, investors and sellers of credit protection should be properly informed about the ESG features of the underlying loans (or use of proceeds), in order to make their own judgment on the impact of the transactions, as currently introduced by the EU amongst the set of prescribed STS securitization **disclosure requirements**.

We therefore recommend that – while updating the BCBS current **STC guidelines** based on lessons learned in the jurisdictions that implemented them (EU, UK and Canada) – regulators consider incorporating a minimum set of standard sustainability indicators to be disclosed, taking into account for instance the indicators used in ISSB standards and in the European framework for ESG disclosures (e.g., ESRS reporting templates, EU Green Bonds disclosure standard, etc).

Finally, because of banks’ increased funding cost, they are considering issuing **credit linked notes** on the (currently mostly retained) **senior tranches of synthetic securitisations**, to reduce their cost of long-term funding. To mitigate the systemic risk arising from unintended growth in non-bank finance, it will be important that – as advocated by other stakeholders for AAA bonds from true sale transactions – these senior notes receive a fair prudential treatment for regulated investors like banks (in the assets eligible in the Liquidity Coverage Ratio) and insurers (in the regulatory capital associated with their investments).

The IACPM would be honored to respond to any further questions from the FSB before the consultation planned for next year, and will also participate in this consultation.

Sincerely,

Som-Lok Leung
Executive Director, IACPM

Att 1 - The case for risk sharing
Att 2 - Risk sharing is becoming mainstream
Att 3 - Systemic risk from ineffective regulatory treatment of risk sharing transactions