IACPM CONTINENTAL EUROPE ROUNDTABLE

REGULATORY SESSION:

GLOBAL LANDSCAPE AND KEY PERSPECTIVES

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I) Focus on the global regulatory environment: the Basel III transposition in the EU

II) Which perspectives for securitisation in the short, medium, and long run?

I) Focus on the global regulatory environment: the Basel III transposition in the EU

FINALISING THE EU BANKING PACKAGE CRR3/CRD6

- **7 December 2017:** agreement on the finalisation of the Basel III reform
- **European transposition:**
  - Commission legislative proposal (CRR3/CRD6) - 27 october 2021
  - Council of the EU's general position - 8 november 2022
  - European Parliament compromise - 24 january 2023
  - Political agreement reached in trilogue - 27 june 2023

➔ **Publication of final texts by COREPER (CRR3 and CRD6) - 6 december 2023**

  - Entry into force expected at S1 2024 (after adoption by the EP, legal-linguistic review, and publication in the OJEU)
  - **CRR3** : date of application of the **main provisions – January 2025**
  - **CRD6** : entry into application 18 months after entry into force – **end-2025**

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FINALISING THE EU BANKING PACKAGE: A KEY MILESTONE

- The transposition of the Basel 3 standards into EU law brings a final result to the set of reforms launched after the great financial crisis:
  - Increasing the risk sensitivity of standardised approaches (credit risk; market risk; CVA risk; operational risk)
  - More constraints on internal models (especially with the output floor)

- **The strengthening of the soundness of the EU banking system was at stake.** Its resilience was proven both through the COVID crisis and the bank failures of March 2023.
  - Recent events have stressed the importance of tight adherence and wide implementation of Basel standards.

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A WELL-BALANCED AND PRAGMATIC AGREEMENT (1/3)

The banking package strikes a **good balance between compliance with Basel standards, maintaining a level playing field** and **accounting for the specific features of the EU market**:

- ➔ **Compliance with Basel 3 innovations for the purposes of RWAs calculation** (restriction to the field of modelling for credit/market risk; removal of modelling for operational risk)
- ➔ **Arrangement of a first set of long European transitional arrangements,** only applicable to <u>internal model institutions</u> for the purposes of the <u>Output floor</u> calculation:
  - **Treatment of residential mortgages**: temporary reduction of risk weight depending on the exposure-to-value (ETV), subject to the satisfaction of both quantitative and qualitative stringent criteria

***Output floor* residential mortgages**	ETV <= 55%	55 % < ETV <= 80%	ETV > 80%
Until 31 December 2029	10% risk weight	45% risk weight	75% risk weight
Until 31 December 2030	10% risk weight	52,5% risk weight	75% risk weight
Until 31 December 2031	10% risk weight	60% risk weight	75% risk weight
Until 31 December 2032	10% risk weight	67,5% risk weight	75% risk weight
From 1st January 2033	20% risk weight	75% risk weight	75% risk weight

  - **Treatment of unrated corporates**: temporary reduction of risk weight depending on the credit quality of the counterparty

***Output floor* unrated corporates**	« investment grade » (PD<=0,5%)	« non-investment grade » (PD>0,5%)
Until 31 December 2032	65% risk weight	100% risk weight
From 1st January 2033	100% risk weight	100% risk weight

  - **Treatment of counterparty credit risk**: temporary reduction of the alpha factor in SA-CCR (alpha=1 instead of alpha=1.4 until 31 December 2029)

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A WELL-BALANCED AND PRAGMATIC AGREEMENT (2/3)

➔ **Arrangement of a second set of long European transitional arrangements**, applicable to SA institutions (as well as internal model institutions, depending on the cases):

- Treatment of **object finance**: temporary reduction of risk weight depending on the quality of the exposure (80% instead of 100%, until 31 December 2032)
- Treatment of **equity**: 5-year phase-in for the application of CRR3 risk weight (vs. CRR2) to speculative unlisted companies (400%) and other equity exposures (250%)
- Treatment of **unconditionally cancellable commitments (UCC)**: 8-year phase-in for the application of CRR3 conversion factor (vs. CRR2), from 0% to 10%
- Treatment of **mortgages on immovable property**: maximum 3-year exemption from CRR3 property revaluation requirements for existing exposures, without any cap or prudent valuation constraint
- Treatment of **public debt issued in the currency of another Member State**: 2-year extension of the Quick fix Covid temporary measure

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A WELL-BALANCED AND PRAGMATIC AGREEMENT (3/3)

➡ **European specificities are permanently taken into account, such as:**

- the preservation of **SME and infrastructure supporting factors**;
- the **assimilation of residential loans guaranteed by a protection provider** as loans secured by mortgages;
- the freeze of the risk weight applicable to all **intra-group or intra-IPS** (institutional protection schemes) **equity exposures** (100%), as well as the **grandfathering of strategic long-term equity investments** with control or significant influence;
- the introduction of a **dynamic cap to the property value** for mortgages on immovable property (6-year and 8-year averages for residential and commercial mortgages, respectively)
- **Treatment of trade finance** : preservation of CRR2 conversion factor (20%) for certain transaction-related contingent items

- <u>Level playing field is a major concern</u>: possibility of a delegated act enabling the European Commission to fine-tune market risk treatment in the event of a discrepancy with third jurisdictions

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THE BANKING PACKAGE ENTAILS MANY ACHIEVEMENTS

- **Co-legislators could address several topical issues:**
  - Transitional provision for banks' crypto-assets exposures
  - Climate-related financial risks: requirement for transition plans, new powers for the supervisor to adjust targets and actions, further work on Pillar 1
  - Securitisation regulatory framework: *touched upon in a few slides.*
- **Compromise on the level of application of the output floor:**
  - Application of the output floor at every level, with a national option for application to the highest level of "domestic" consolidation;
  - Commitment from the Commission to carry out by 2028 a comprehensive review of the state of the EU banking system, taking into account the situation of the Banking Union and the implementation of the output floor.

MONITORING BASEL III IMPLEMENTATION IN OTHER MAIN JURISDICTIONS

- **In the US, a « Basel 3 endgame » proposal faithful to its core, although with uncertain adoption**
  - No more internal models for credit and counterparty credit risk; still allowed for market risk
  - Sometimes goldplating the Basel standards: mortgage and retail calibration under credit risk, minimum threshold x1 for recognizing historical losses under operational risk
  - But deviations on competitive market activities: possible waiver of the 'look-through' approach requirement for investment funds exposures in the market risk internal approach, decrease of the alpha factor (1,4->1) for non-financial counterparties under the SA-CCR approach;
  - Most importantly, uncertain implementation: strong push back by the industry, clashes with presidential campaign … Implementation already delayed to July 2025.

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MONITORING BASEL III IMPLEMENTATION IN OTHER MAIN JURISDICTIONS

- **In the UK, an equivalent package**
  - Faithful in the big picture although coming with targeted and permanent deviations (eg. SA-CCR)
  - Entry into application pushed back to July 2025
  - Beware of the « strong and simple » proportionality framework that would relax requirements for medium-sized banks

- **Key messages:**
  - **Basel 3 implementation should be the main focus of the BCBS in the coming years. We must collectively strive for a timely and faithful implementation.**
  - **In the EU, regulatory efforts are not over: around 130 technical standards yet to be adopted in the coming years.**
  - **ACPR will pay particular attention to the progress in the implementation of Basel 3 by all jurisdictions, which is key to preserve level playing field across international banks and the credibility of international standards.**

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II) Which perspectives for securitisation in the short, medium, and long run?

SECURITISATION'S REGULATORY FRAMEWORK

BIS

The Basel regulatory landscape:

- Weaknesses in the Basel II securitisation framework highlighted by the GFC.
  - These included a number of shortcomings, such as:
    - Concerns of insufficient capital for certain exposures
    - Excessive and mechanistic reliance on external ratings
    - Excessively low (high) risk weights for highly (low) – rated securitisation exposures
    - Cliff effects
    - Insufficient risk sensitivity of the framework

- Release of a **new BCBS standard in 2014**, **completed (STC) in 2016 & 2018**

A BRIEF REMINDER
SECURITISATION'S REGULATORY FRAMEWORK

The European playground:

- **Securitisation regulation (SECR : UE2017/2402)**
  - General framework for securitisation: harmonization of definition, specification of common rules for all financial sectors (due diligence, transparency, risk retention requirements);
  - Specification of criteria for identifying securitisation transactions benefiting from the "STS" (simplicity, transparency, standardisation) label

- **Amendment to the Capital Requirements Regulation (CRR: UE2017/2401)**
  - Implementation of the new Basel prudential framework in the EU;
  - Specification of the favorable prudential treatment for investments in STS securitisations

WHICH PERSPECTIVES IN THE SHORT, MEDIUM, LONG RUN?
A SHORT TERM EUROPEAN LEVER

Through the Banking Package:

- **Transitional reduction of the non-neutrality p-factor**
  - Aim is to mitigate the impact of the output floor introduction for banks using internal model approaches (i.e. modifications **only** for the purpose of calculating the OF counterfactual -> no direct consequences on own funds requirements for banks not using the internal model approaches (or banks not bound by the OF)
  - May be applied until 31 December 2032
  - Following modifications:
    - P-factor can be set to 0,25 (instead of 0,5) for STS securitisations;
    - P-factor can be set to 0,5 (instead of 1) for non-STS securitisations.

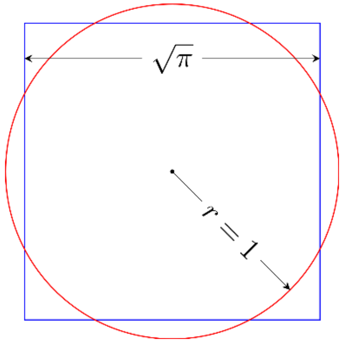
- **EBA mandate for a report on the prudential treatment of securitisation transactions**
  - Due by 31 December 2026, with a possibility of a Commission's legislative proposal by 31 December 2027
  - Focus on the impact of output floor introduction
  - Broader scope: prudential treatment of securitisation (including appropriateness of non-neutrality factors)

IN THE MEDIUM RUN, A NEED FOR A COMPREHENSIVE BASEL REVIEW

- **Implementation work conducted at European level has highlighted the limitations of the current Basel framework, which does not allow the simultaneous optimization of the different underlying regulatory objectives.**

- Several objectives indeed compete under the formulaic approaches of the current framework:
  - The reduction of cliff effects;
  - Preserving a capital deduction at least as conservative as pre-securitisation;
  - Preserving a reasonable capital non-neutrality.

- Impossible to optimise all three aspects simultaneously.



Squaring the circle: intractable problem

BIS

- **Active involvement of the ACPR in reopening the Basel framework.**

A GLANCE AT OTHER INTERNATIONAL DEVELOPMENTS

- **US Agencies proposed rule** (July 27th 2023):
  - Proposal to transpose the Basel framework with a couple of exceptions:
    - No introduction of the STC framework;
    - Differences in the approaches for capital requirements calculations (modelling approaches not allowed);
  - Proposed rule under consultation until January 16th 2024 (extended from the initial deadline by November 30th)

A GLANCE AT OTHER INTERNATIONAL DEVELOPMENTS

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

- **UK's PRA Discussion Paper on capital requirements**
  - Published on October 31st : consultation open until January 31st;
  - Different sections:
    - Basel Output floor and capital requirements for securitisation exposures;
    - Hierarchy of methods;
    - Scope of the framework for STS securitisations;
    - Use of credit risk mitigation techniques in synthetic SRT securitisations

- "The PRA would, in any event, support a wider review by the BCBS of Basel standards relating to the Pillar 1 securitisation capital requirements"

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WHICH PERSPECTIVES IN THE SHORT, MEDIUM, LONG RUN?
A GLANCE AT OTHER INTERNATIONAL DEVELOPMENTS

FSB FINANCIAL STABILITY BOARD

- **Financial Stability Board's Evaluation on Effects of G20 Reforms on Securitisation**
  - Work in progress; started last summer; set to be finalised during summer 2024;
  - Evaluation objectives are twofold:
    - assess the extent to which the G20 reforms on securitisation implemented to date have achieved their financial stability objectives;
    - examine broader effects of the reforms on the functioning and structure of the securitisation markets and the implications for financing to the real economy
  - First outreach on the Terms of Reference closed on September 22nd;
  - Expected public consultation on interim findings (Q1/Q2 2024)

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Questions