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Role of insurers in securitisations

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In the ongoing discussions aimed at reviving securitisation in Europe, it is worthwhile to highlight that the (re)insurance industry has the capacity to contribute significantly to the desired securitisation market growth and robustness in the EU.

(Re)insurance is the main "non-bank" financial industry which benefits from **prudential regulations** (Solvency II) and supervisory oversight. (Re)insurance affords a very specific focus as it can play **two complementary roles** in securitisation.

1. As the credit arm of multiline non-life insurers or reinsurers, (re)insurers can also sell **unfunded credit protection** from the liability side of their balance-sheet, and cover losses in specific tranches of securitisations. Contracts can take the form of credit insurance policies, non-payment insurance, risk participation agreements or guarantees.
    - From a bank' prudential perspective, such a credit risk mitigation technique is viewed as an unfunded credit protection (UFCP).
    - From an insurer' prudential perspective, these contracts are treated as "Non-life underwriting risk" in Solvency II regulation.
    - From an EU securitisation regulation (SecReg) perspective, transactions covered by (re)insurers cannot qualify as STS, as the regulation requires funded protection of all tranches.
    - In case of insurer' default, these protections are – by Solvency II - senior to bondholders and other non-insurance credit obligations of the insurer.

   Due to its non-eligibility in STS, insurers' unfunded protection on tranches of synthetic securitisations is limited to non-STS transactions, where their market share has been increasing mostly on mezzanine tranches. Annual surveys conducted by the IACPM since 2019 specifically on insurers' SRT activity show that the appetite of non-life (re)insurers is even higher than what banks can supply given bank's preference for issuance of STS transactions [*cf high-level survey results in attachment*].

   SRT and loan-by-loan credit insurance production remains however a marginal part of the underwriting book of multiline (re)insurers, enabling the insurer to benefit from the diversification advantage offered by Solvency II.

Banks are also interested to grow unfunded risk sharing with well capitalized, highly rated and prudentially regulated private credit insurers due to:

- Their appetite for the senior mezzanine risk, when thicker tranches have to be protected after Basel 3 implementation, which is increasing RWA on corporate credit assets and establishing an output floor, and
- The diversification of counterparty risk offered by insurers, thereby, increasing the robustness of the package of protection sellers (investors and insurers) on the tranches aiming at significant risk transfer (SRT).

Therefore, (re)insurers offer robust counterparty diversification and provide greater opportunities for banks to manage credit risk, counterparty limits and capital, and ultimately undertake further lending.

However, the STS framework for on balance-sheet synthetic securitisations requires either funded credit protection (by way of cash collateral or 0% risk-weighted debt securities) or unfunded credit protection provided by a limited number of potential counterparties (e.g., 0% risk-weighted multilateral development banks). To appeal to the widest range of appropriate investors, notably private credit insurers and re-insurers, the STS Requirements should be amended so as not to limit the availability of a key distribution channel that is currently available to banks in respect to on balance-sheet securitisations.

2. As **funded investors** on the asset side of their balance-sheet, (re)insurers can hold bonds issued by the SPVs in true sale securitisations, and credit linked notes issued by the SPVs or directly by the banks in synthetic on balance-sheet securitisations.
    - From a bank prudential perspective, such a credit risk mitigation technique is viewed as a funded credit protection (FCP).
    - From an insurer' prudential perspective, these investments are treated as "market risk" (Spread risk) in Solvency II regulation.
    - From a SecReg perspective, transactions can qualify as STS if they comply with the STS requirements for true sale or synthetic securitisations, and benefit from a favourable prudential treatment in both banks' and insurers' prudential regulations.
    - In case of an insurer' default, the issuing bank is protected by the cash received from the bondholders or posted as collateral of the credit linked notes.

Despite the preferential treatment for STS securitisations under Solvency II, insurers' appetite for securitisation investments remains low. Five years post the regulatory change, securitisations are an immaterial asset class for the average European insurer.

According to an analysis that the Joint Committee (JC) of the European Supervisory Authorities carried out in 2022, most insurers cite mismatched risk-return profiles and asset-liability management preferences as reasons for limited interest in traditional investment grade securitisations.

However, based on interviews conducted by the IACPM, more specifically on insurers' appetite for credit linked notes issued on first loss and mezzanine tranches of synthetic securitisations, it appears that the Solvency II framework is the most significant driver for insurers' lack of investment activity in CLNs on junior tranches of securitisations, because of the 100% weighting like private equity.

To release insurers’ investments and protections on EU securitisations, it is therefore critical for decision makers to consider

- For insurers as sellers of **unfunded credit protection**, to review the **STS regulation** to allow eligibility of unfunded credit insurance protection offered by Solvency II (or equivalent) regulated insurers, and

- For insurers as **funded investors**, to review **Solvency II** regulations “market risk” for a fair calibration of the junior and senior tranches of funded STS and non-STS securitisation invested by insurers.

Attachment – High level insurers' SRT survey results 2019-2023

The IACPM conducted volume surveys since 2019 to provide insight on private credit insurers' capacity to support real economy finance by selling unfunded protection on tranches of synthetic on balance-sheet securitisations.

These surveys covered the SRT protections executed by 13 insurers and highlighted that:

- Between 2019 and 2023, insurers participating in the survey entered into **153 risk participations**, executed on **127 synthetic securitisations**
    - After syndication, they protected about **€ 1 billion of SRT tranches in 2023**, bringing the total amount of active protections on SRT tranches since 2019 to **€ 3.8 billion**
    - **Seniority** of insurers' protections moved from senior to junior mezzanine (about half of the transactions in 2023), with more junior protections in mortgages transactions
    - The number of **syndicated transactions** is strongly increasing (89% in 2023), with each insurer protecting on average 35% of the syndicated amount. The average insured amount per insurer remains stable around **€ 25 million** on average since 2019
    - The dominant part of protected loan pools has been originated in **Europe** (55% EU, 30% UK)
    - The asset classes of underlying loan pools protected by insurers remain very diversified, with about half of business finance (SMEs, Corporates, Trade finance), 40% of residential mortgages, and 10% of specialized lending (project finance, commercial mortgages, object finance)

- As of 2024, insurers' **growth expectations** in SRT transactions remain strong, but their appetite varies per asset class:
    - Around 60% growth is expected in 2024 in transactions protecting pools of residential mortgages, which represent about 40% of the number of transactions in insurers' portfolios by end 2023, and 100% growth on pools of SMEs and asset-backed finance
    - More growth is expected in protection of securitizations of large corporate loans, with a doubling of expected volumes of protections on pools of project and trade finance transactions
    - The capacity of insurers to contribute further to banks' lending growth is therefore limited mostly – if not only – by the supply side, i.e., by the effectiveness of banks' capital release through unfunded insurance.