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**COMMISSION STAFF WORKING DOCUMENT**

**IMPACT ASSESSMENT**

*Accompanying the document*

**Proposal for a**

**REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**

**laying down common rules on securitisation and creating a European framework for simple and transparent securitisation and amending Directives 2009/65/EC, 2009/138/EC, 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012**

**and**

**Proposal for a**

**REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**

**amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms**

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## Contents

1) INTRODUCTION .....	4
2) PROCEDURAL ISSUES AND CONSULTATION OF INTERESTED PARTIES ...	10
2.1) Procedural issues.....	10
2.2) External expertise and consultation of interested parties.....	10
3) PROBLEM DEFINITION .....	11
3.1) Problem drivers .....	11
3.1.1) Investor stigma.....	11
3.1.2) insufficient risk-sensitivity of the regulatory framework .....	13
3.1.3) Lack of consistency and standardisation.....	17
3.2) Problems 18	
3.2.1) Low demand for securitisation products.....	18
3.2.2) Simple and transparent securitisation products disadvantaged.....	18
3.2.3) High operational costs for investor and issuers .....	19
3.3) Consequences.....	21
4) OBJECTIVES .....	22
4.1) General, specific and operational objectives .....	22
4.2) Consistency of the objectives with other EU policies .....	22
4.3) Consistency of the objectives with fundamental rights .....	22
4.4) Subsidiarity and proportionality .....	23
5) POLICY OPTIONS .....	26
6) ANALYSIS OF IMPACTS .....	28
6.1) Section 1 - STS differentiation .....	28
6.1.1) Policy option 1.1: No further EU action (baseline scenario).....	28
6.1.2) Policy option 1.2: EU soft law .....	30
6.1.3) Policy option 1.3: EU legislative initiative to specify applicable STS criteria.....	31
6.1.4) Impact summary and conclusion .....	32
6.2) Section 2 - Scope of the STS definition.....	33
6.2.1) Policy option 2.1: Cover only term securitisation .....	34
6.2.2) Policy option 2.2: - cover term and ABCP securitisations .....	36
6.2.3) Policy option 2.3: cover term, ABCP and synthetic securitisations .....	38
6.2.4) Impact summary and conclusion .....	39
<b>6.3) Section 3 - Ensuring compliance with STS criteria and consistency in implementation .....</b>	<b>41</b>
6.4) Section 4 - Banking and insurance prudential treatment .....	49
6.4.1) Option 4.1: - no change to the existing securitisation framework as set out in the CRR .....	51

6.4.2) Option 4.2: - develop a preferential capital treatment for STS securitisations .....	52
6.4.3) Option 4.3 – baseline: no further action.....	55
6.4.4) Option 4.4 – modify treatment for senior tranches only .....	56
6.4.5) Option 4.5 – modify treatment for senior and non-senior tranches .....	57
6.4.6) Impact summary and conclusion .....	58
6.5) Section 5 - Standardisation and harmonisation.....	60
6.5.1) Option 5.1 – Baseline - No EU action .....	60
6.5.2) Option 5.2 – Establishing a single consistent EU securitisation framework and encouraging market participants to develop further standardisation .....	61
6.5.3) Option 5.3 – Adopting a comprehensive EU securitisation framework .....	63
6.5.4) Impact summary and conclusion .....	65
7) THE RETAINED POLICY OPTIONS AND INSTRUMENT .....	67
8) MONITORING AND EVALUATION .....	70
ANNEX 1 – GLOSSARY .....	71
ANNEX 2 – STYLISTED FACTS ON SECURITISATION MARKETS .....	73
ANNEX 3 – BCBS-IOSCO SURVEY ON "IMPEDIMENTS TO SUSTAINABLE SECURITISATION MARKETS" .....	74
ANNEX 4 – STS CRITERIA IN THE LCR AND SOLVENCY II DELEGATED ACTS	75
ANNEX 5 - SYNTHETIC SECURITISATION.....	81
ANNEX 6 - FINANCING SMES WITH THE SECURITISATION TOOL.....	85
ANNEX 7 – SUMMARY OF RESPONSES TO THE COMMISSION'S PUBLIC CONSULTATION ON SECURITISATION.....	87
ANNEX 8 – FINDINGS FROM THE COM QUESTIONNAIRE TO FSC MEMBERS ON SECURITISATION .....	122
ANNEX 9 – BIBLIOGRAPHICAL REFERENCES.....	130

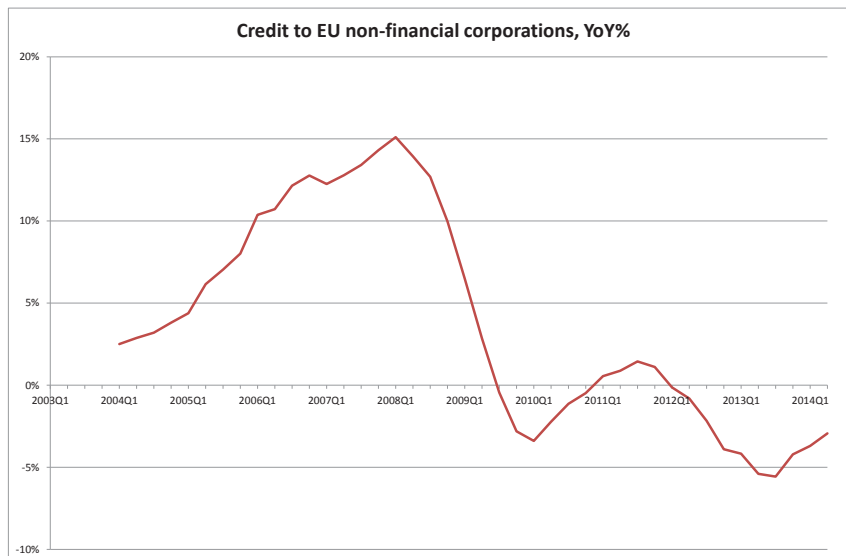
# 1) INTRODUCTION

## 1.1) Creditless recoveries and the need to repair financial market intermediation

In deep recessions such as the one triggered by the global financial crisis, credit to firms and households drops steeply. Without credit growth recovering, GDP and employment are also much less likely to recover (see ECB (2011) and Abiad et al. (2014)). Furthermore, even when such **creditless recoveries** do materialize, they **tend to be slower and weaker**. GDP growth is on average 30% lower in creditless recoveries than in "normal" ones (i.e. in those where credit growth goes back to pre-crisis rates quickly). Creditless recoveries tend to follow after credit booms and banking crises, to depress investment and to affect disproportionately those industries that are more dependent on external finance. All this suggests that impairment in financial intermediation contributes to the below-average GDP performance.

Europe's current situation is one of a creditless recovery: six years after the collapse of Lehman Brothers credit to the private sector and GDP growth are still subdued (see Chart 1) and so is investment. The percentage of unemployed workers is still higher than before the crisis. Moreover, all this follows a credit boom and banking crises in various jurisdictions.

*Chart 1 – credit to EU non-financial corporations, % year-on-year growth rate*



*Source: ECB*

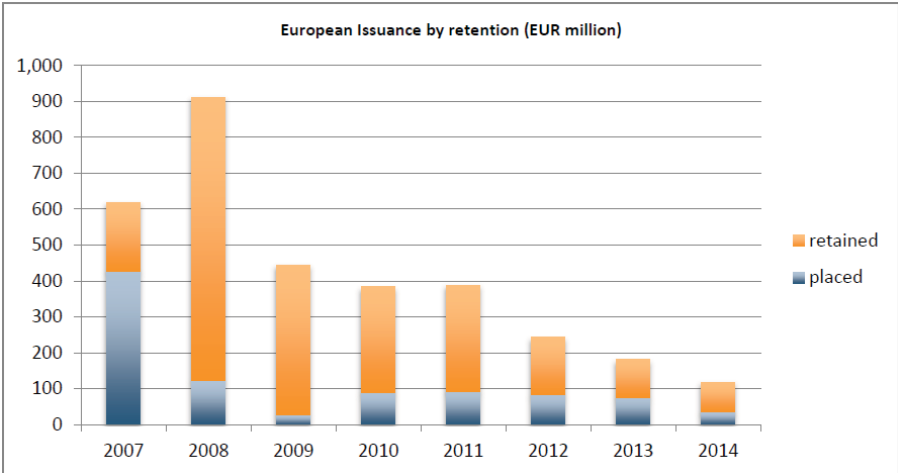
If employment and growth are to recover, it is thus pivotal to tackle the frictions still present in the financial system and restart the flow of credit to European firms and households on a sustainable basis. Much has already been done to strengthen the EU financial system and the recent improvement in credit dynamics are a testimony to this. Nonetheless, **European banks are still deleveraging and do so by reducing credit to the private sector**. With relatively small capital markets, bank deleveraging is thus slowing recovery in Europe.

While deleveraging and negative credit growth do not need to go together (credit to the private sector represents only 28% of EU banks assets), any mechanism helping banks to deleverage in a sustainable way without reducing credit provision would help substantially the recovery of credit, investment and job creation in Europe.

**1.2) The role of securitisation**

**Securitisation**, a mechanism by which credit institutions package loans they have granted into a security and sell this to investors, **can provide a useful tool to transfer risk to other institutions and raise cheaper funding.** By allowing banks to sell some of their assets to investors, securitisation provides them with a tool to deleverage (i.e. reduce their balance sheets) without cutting credit provision to the private sector. Since banks provide the overwhelming majority of credit to EU firms and households, securitisation could help break the link between deleveraging and credit decline in a material way. **Securitisation could thus support bank credit provision and allow for a faster recovery.**

*Chart 2 – Issuance of securitised products in the EU – placed and retained*

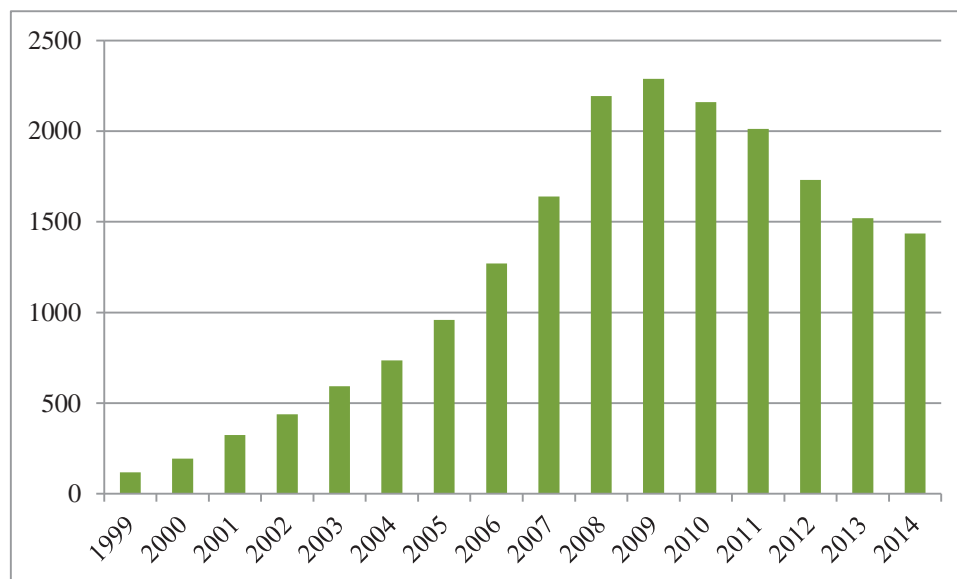


*Source: SIFMA/AFME quoted in EBA 2014*

Since 2008, the issuance of securitised product in Europe has fallen by 88% (see Fig.2). Outstanding amounts have declined accordingly (see Fig.3). This notwithstanding the fact that European securitised products have proven remarkably safe during the crisis, generating near-zero losses (Fig. 5 and 6, see also EBA 2014 and BoE-ECB 2014). It was the exposure to US securitised product that caused significant losses to European banks<sup>1</sup>. However, unrelated products such as securitisations based on EU SME loans and residential mortgages suffered significant declines in issuance.

<sup>1</sup> US issuance has instead restarted growing after a substantial drop in 2008. US 2014 issuance was still less than half than in 2007 but a positive trend is clearly visible. This is mostly ascribable to public guarantees from state agencies (Fannie Mae, Freddie Mac and Ginnie Mae), which cover the vast majority of the market.

Chart 3 – Outstanding amounts of securitised products in the EU



Source: SIFMA/AFME

Securitisation can also provide important **benefits to investors, giving them access to assets they could not otherwise access**. This is particularly beneficial for institutional investors such as pension funds and insurance companies that have long-term liabilities and are therefore natural buyers of long-term assets such as mortgages. The majority of institutional investors cannot underwrite mortgages directly but they could gain access to them buying securitised mortgages. Greater investment opportunities would be particularly beneficial in the EU context, where high GDP per capita and relatively small capital markets imply high demand but limited supply of long term assets.

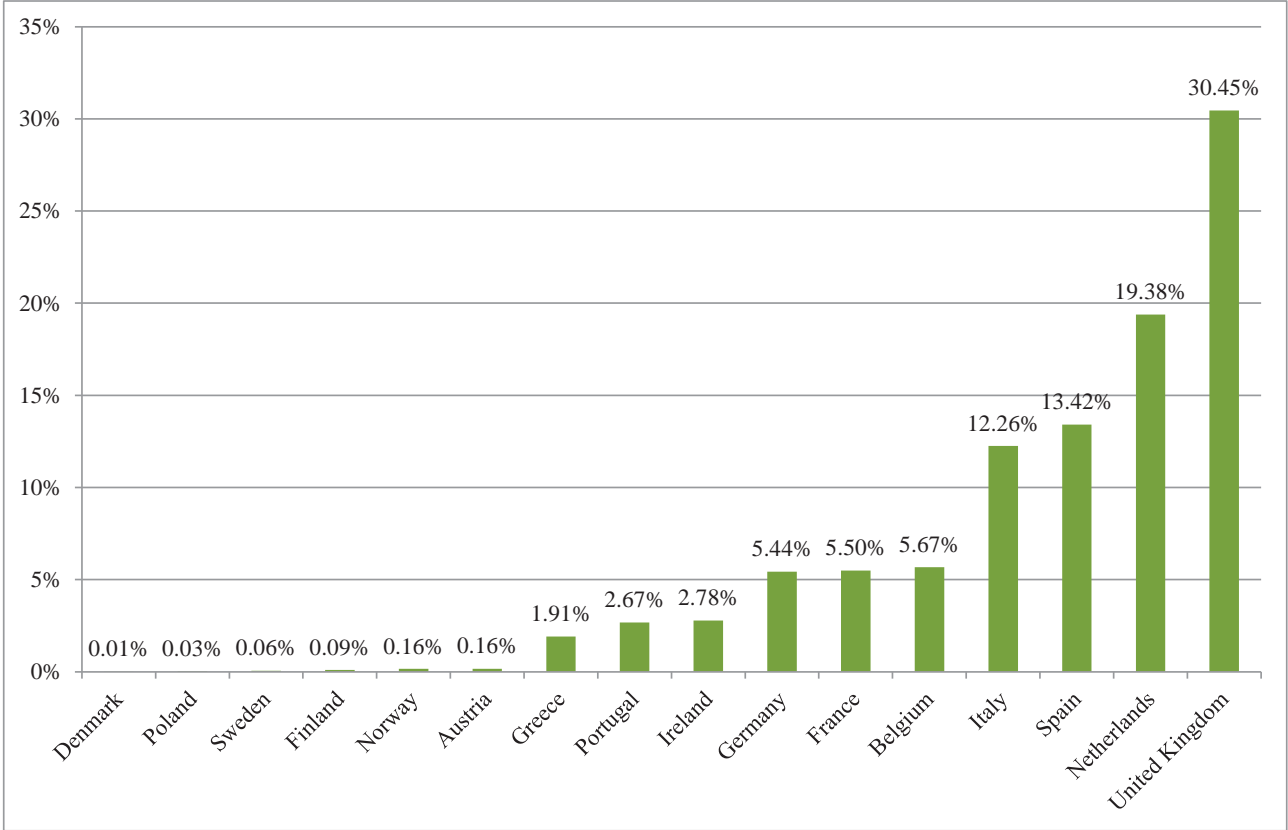
**It is not easy to provide a reliable estimate** on the additional provision of loans a revival of the securitisation market could provide. This depends indeed on a multitude of factors: a) monetary policy, b) demand for credit, c) developments in alternative funding channels (covered bonds, unsecured credit to name a few). All of these are likely to change through time, affecting the final outcome. With these caveats in mind, one can say however that, all things equal, if the securitisation market would go back to pre-crisis average issuance levels, banks would be able to provide an additional €157bn of credit to the private sector (see issuance data graphed in Figure 2). This would represent a **1.6% increase in credit to EU firms and households**. The latter is still 4.7% below its peak. Therefore, while one must be realistic and recognise a revival in the securitisation market would not by itself solve all problems in the EU financial markets, it could provide a material contribution in improving the banking sector ability to provide credit and help alleviating the negative effects of the credit less recovery on jobs and growth.

Additional to these short-term benefits, **restarting a safe securitisation market could have further long term benefits**. The macroeconomic scenario currently prevailing in the EU hinders securitisation activity in various ways: by reducing credit activity and thus the need to fund it; by delivering an environment of abundant and cheap central bank funding and finally by lowering the best credit rating achievable by securitisation deals in many EU jurisdictions because of sovereign rating caps (discussed in section 3.2.2). All these factors constitute powerful disincentives to

securitisation activities that will weigh on the sector until the situation normalises. Nonetheless, once the macro situation normalises and the above impediments subside, having a safe and thriving securitisation market already in place will allow it to reach its full potential. **This could lead to more balanced funding structure for the EU economy, with both banking and non-banking credit stably available for borrowers.** This is therefore both a short term and a long term project.

The revival of a safe securitisation market could have different effects across Member States. On the one hand, countries with more developed securitisation markets would be more likely to benefit from it. As the chart below shows<sup>2</sup>, the United Kingdom and the Netherlands are the biggest markets as of today, representing half of the outstanding securitisations. On the other hand, the countries where the funding of banks and the credit provision in general tends to be more problematic could also benefit from a revived funding channel. Italy, Spain, Ireland, Portugal and Greece would fall under this category. Also, a single and harmonised framework for EU securitisation could lay the foundations for developing securitisation markets where these are currently not developed, like for instance in Member States in Central and Eastern Europe.

*Chart 4 – Outstanding amounts of EU securitised products by country – end 2014*



*Source: SIFMA/AFME*

<sup>2</sup> The chart shows outstanding balances by country of collateral. This is a proxy for country of issuance. Precise and complete data on the latter are unfortunately not available.

### 1.3) The need to avoid past errors

The financial crisis showed also how, if not properly structured, securitisation can magnify financial instability and inflict serious damage to the wider economy. Unsoundly structured securitisation products were central in transforming a relatively local problem such as the slowdown in US housing prices into a near-meltdown of the global financial system in 2008 (see, among others, BCBS-IOSCO (2009), Gorton (2008), Shin (2009), Coval et al. (2009)). The box below provides a summary of what went wrong in securitisation markets during and before the global financial crisis (see next page).

In order to avoid the errors of the past, it is thus **paramount to foster only a well-functioning securitisation market whose features are conducive to financial stability, healthy intermediation and growth**. To do so, the Commission can rely also on the substantial amount of work that EU and international organisations have already invested in identifying the characteristics associated with safe and performing securitisations.

### 1.4) International dimension/relation with previous work

**A substantial amount of work has already been devoted to such a goal by a number of European and international institutions.** The European Commission has already introduced incentives for properly structured securitisation in the Delegated Regulations for Solvency II (2015/35) and the Liquidity Coverage Ratio (henceforth LCR - 2015/62), adopted in October 2014. The ECB and the BoE have carried out work on the topic. International standards to identify simple, transparent and comparable securitisations are being developed by a Task Force led by the BCBS and IOSCO, while the European Banking Association (EBA) has carried out a similar exercise for European banking standards.

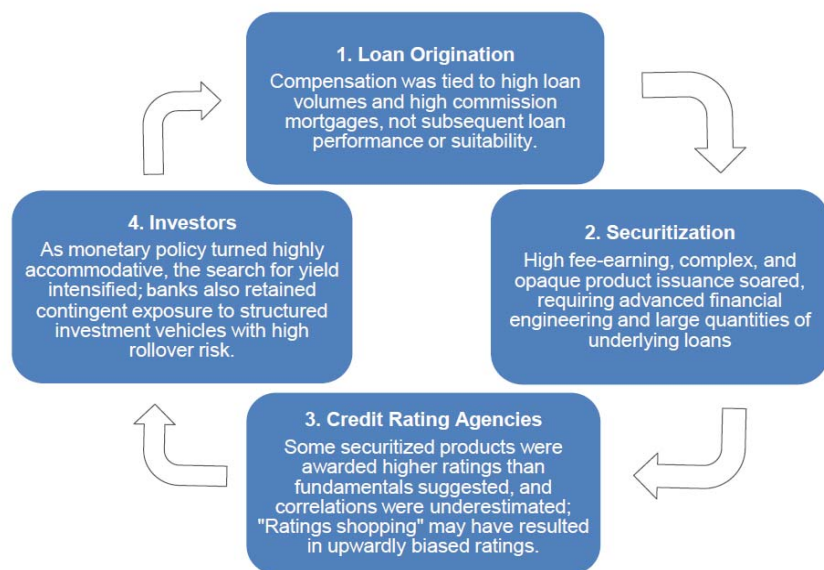
Fostering the market for simple, transparent and standardised securitisation is also a central **part of the wider effort launched by the Commission to support investment and growth in Europe**. As such it is a continuation of the work started with the Communication on long-term financing published in March 2014 and it is a central element of the Capital Markets Union project and the Investment Plan for Europe launched in November 2014. This impact assessment draws on this work and assesses the different options available to support the re-emergence of a securitisation market conducive to growth and stability.



## Role of Securitisation in the 2007-2008 financial crisis

Securitisation played a role in amplifying systemic risk by facilitating excessive leverage and risk concentration across the financial sector. The chart below presents a stylized model of the four key elements of the self-reinforcing securitisation chain:

- i) poor underlying loan origination practices;
- ii) unprecedented issuance of complex and opaque securitised products;
- iii) over-reliance on credit rating agencies,
- iv) leveraged and unleveraged investors.



## **2) PROCEDURAL ISSUES AND CONSULTATION OF INTERESTED PARTIES**

### **2.1) Procedural issues**

The first meeting of the impact assessment steering group took place on 10 April 2015. The second meeting took place on 19 May 2015 and the third one on 8 June 2015. DGs involved in the steering group were ECFIN, GROW, SG, LS, JUST and COMP. The meeting of the Regulatory Scrutiny Board (RSB) took place on 15 July 2015.

The RSB gave a positive opinion and recommended the following changes:

- The report should go beyond the EU level to also explain the situation in the Member States. In particular, it should provide an overview of the situation of loan and securitisation markets across Member States and their likely evolution in the absence of EU intervention. Moreover, it should show the differentiated impact of the policy options in Member States.
- The report should clearly link the objectives of the initiative with the identified problems. To this end, the report should describe the larger macroeconomic context and indicate the relative importance of a revival of the securitisation market as one of the instruments to improve the situation of the banking sector, increase the provision of bank credit and prop-up economic activity.
- The analysis of the impacts should provide a balanced overview of the pros and cons of each policy option and discuss possible risks that may prevent the attainment of the objectives. It should also describe existing and future risk mitigation instruments.

These comments have been addressed and incorporated in this final version.

### **2.2) External expertise and consultation of interested parties**

#### *Stakeholder consultation*

A public consultation on a possible EU framework for simple, transparent and standardised securitisation was carried out between 18 February and 13 May 2015. 121 replies were received. On the whole, the consultation indicated that the priority should be to develop an EU-wide framework for simple, transparent and standardised securitisation (see summary of replies in Annex 7).

Respondents generally agreed that the much stronger performance of EU securitisations during the crisis compared to US ones needs to be recognised and that the current regulatory framework, needs modification. This would help the recovery of the European securitisation market in a sustainable way providing an additional channel of financing for the EU economy while ensuring financial stability.

#### *External expertise*

The Commission has gained valuable insights through its participation in the discussions and exchange of views informing the BCBS-IOSCO joint task force on securitisation markets. The

Commission has also attentively followed the work relating to key aspects of securitisation carried out by the Joint Committee of the European Supervisory Authorities (ESAs) as well as by its members separately (EBA, ESMA, EIOPA). Three public consultations, carried out in 2014 by ECB-Bank of England (BoE), Basel Committee for Banking Supervision (BCBS) - International Organisation of Securities Commissions (IOSCO) and EBA respectively, have gathered valuable information on stakeholders' views on securitisation markets. In its own consultation, the Commission has built on these, focusing on gathering further details on key issues. Fruitful meetings and exchange of ideas with European central banks and the IMF have enriched the debate and understanding of the issues at stake. On the whole, these international level consultations confirm the views expressed in the Commission's own consultation, and provide some additional feedback on the relative merits of some of the proposed policy options.

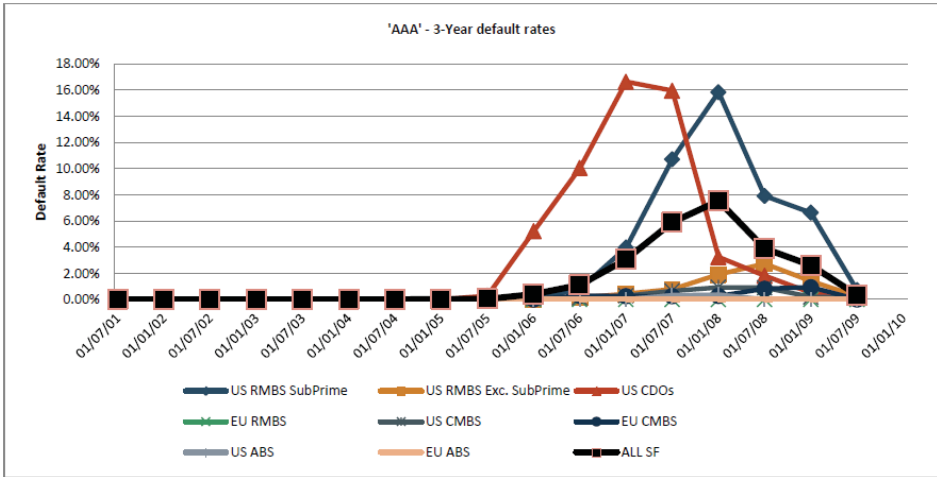
### 3) PROBLEM DEFINITION

#### 3.1) Problem drivers

##### 3.1.1) Investor stigma

A comparison between default rates in securitised products issued in the US and in the EU shows immediately the different performance of the two asset classes during the crisis. Looking at AAA-rated securities, US products backed by residential mortgages (RMBS) reached default rates of 16% (subprime) and 3% (prime). By contrast, default rates of EU RMBS never rose above 0.1% (see chart 5).

Chart 5 – Default rates of AAA-rated securitised products, EU vs. US<sup>3</sup>



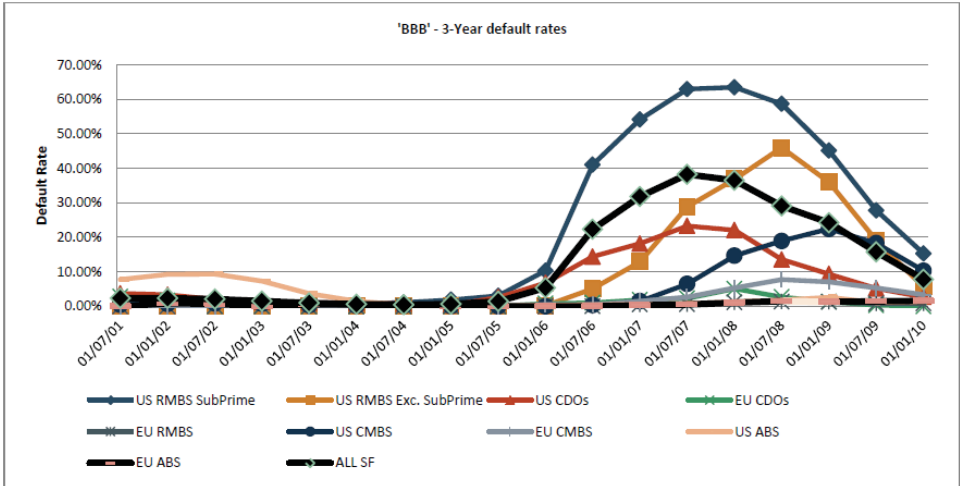
Source: EBA – See glossary annex for acronyms explanation

<sup>3</sup> The chart shows all data provided in the EBA study, which covers the 2001-2010 period. Throughout the impact assessment the full time-span of data available has been shown.

The divergence is even bigger for BBB-rated products where US RMBS' default rates peaked at 62% and 46% (subprime and prime, respectively) while EU products' default rates peaked at 0.2% (see Chart 6). Consequently, as noted in the introduction, losses generated by US products are a multiple of those generated by EU securitisations (see Chart 7).

Notwithstanding their strong performance during the crisis, EU securitisation markets have suffered a significant reduction in issuance since 2008 and have not recovered yet. Furthermore, a much higher part of this issuance is still not being placed to investors, but retained by issuers instead. There is a strong consensus among European and international supervisors, regulators, central banks and market participants that the post-crisis reputation of securitised products issued in Europe was severely tarnished by practices and events taking place in the US. In the summer of 2014, the BCBS-IOSCO task force in charge of reviewing developments in securitisation markets conducted a survey among market participants. The survey asked contributors which were, in their views, the factors determining market developments since the crisis. The most common factor mentioned was investor perception (see Annex 3). This led BCBS-IOSCO to conclude: *"investors' confidence in securitisation has eroded. From the onset of the crisis, securitisations were perceived as too complex and subject to too many conflicts of interest and asymmetry of information among securitisers, originators and investors"*.

Chart 6 - Default rates of BBB-rated securitised products, EU vs. US



Source: EBA – See glossary annex for acronyms explanation

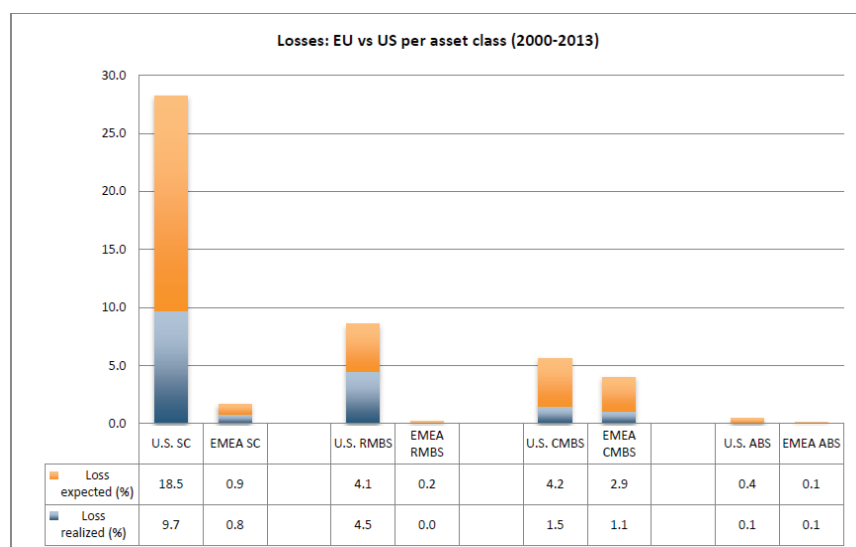
In a similar fashion, the first impediment to EU securitisation markets listed by EBA is "post-crisis stigma" (see EBA 2014). The regulatory authority points out that high level of defaults and losses in US markets have contributed *"to the spreading of the stigma attached to bad performing asset classes also on those instruments that passed the test of the crisis with relatively good performances"*

The same issues are highlighted by the ECB and the Bank of England: *"Potential impediments to its [the securitisation market's] revival include a mix of temporary factors, such as the current interest rate environment and the stigma attached to securitisation, and more structural factors"* (see ECB-BoE 2014). The two central banks also notice how the EU securitisations' reputation has been tarnished by practices mostly prevalent in the US (poor underwriting standards, complex structures).

### 3.1.2) insufficient risk-sensitivity of the regulatory framework

Set in the wake of the US securitisation markets crash, capital requirements for exposures to securitisation have been calibrated on such markets' performance. These have however been the worst performers in terms of default and losses generation. Indeed, as shown by Chart 7, the vast majority of losses in securitisation markets *globally* arose in US subprime mortgage-backed securities and collateralised debt obligations (CDOs).

Chart 7 – Losses generated in 2000-2013 by securitised products, by geographical area



Source: Fitch quoted by EBA – See glossary annex for acronyms explanation

The implications of this regulatory approach are stated clearly by EBA in its latest assessment of the capital treatment of securitised products in Europe: "*Calibrating capital requirements following a one-size-fits-all approach led to a focus on the crisis performance of the worst segments of the market (US Subprime and CDOs). The consequence is an unduly conservative treatment of relatively less risky securitisations, showing a very good historical performance during the crisis years, in terms of both observed defaults and losses. [...] the substantially different performance across jurisdictions and asset classes has led the current framework to be less risk sensitive*". (EBA 2015)

The limited risk sensitivity of the current regulatory capital framework (i.e. the detachment between the risk profile of a securitisation deal and the capital charges imposed on it) comes from the fact that the framework differentiates among securitised products almost exclusively on their credit rating<sup>4</sup>. In other words, two AAA-rated securitisation deals will generate the same capital requirements irrespective of key characteristics such as the homogeneity of the assets underlying

<sup>4</sup> One of the weaknesses of the securitisation framework revealed during the global financial crisis is the fact that the capital requirements framework for securitisation places undue mechanistic reliance on external ratings. The G20 Leaders called on jurisdictions to address adverse incentives arising from the use of credit rating agency (CRA) ratings in the regulatory capital framework (communiqué available at [www.g20.utoronto.ca/2010/to-communique.html](http://www.g20.utoronto.ca/2010/to-communique.html))

the deal, the transparency and completeness of the underlying assets' credit history and the simplicity of the deal's structure<sup>5</sup>.

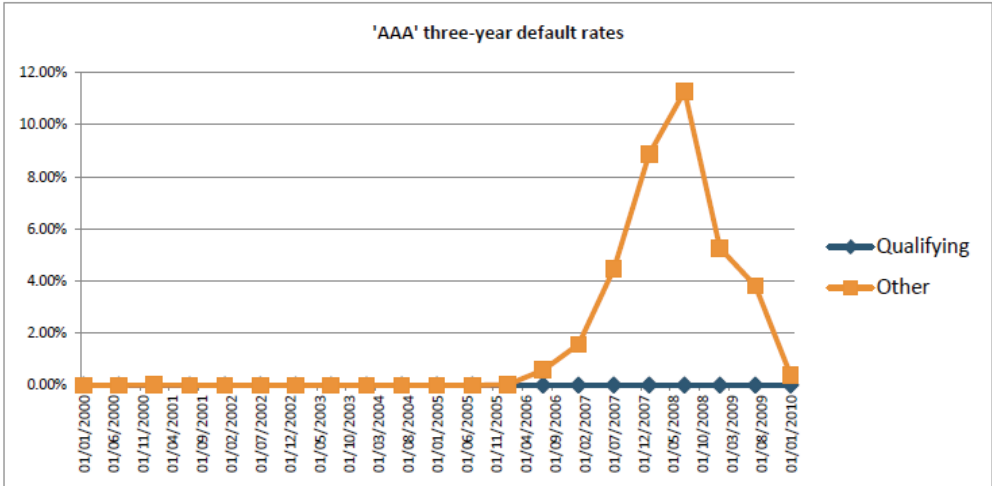
These characteristics have however determined the performance of securitisation deals during the crisis, with simpler and more transparent products generating losses substantially smaller than more complex and opaque products. The difference is shown neatly in a recent study of the EBA, who split the securitisation universe in two (see EBA 2014). On one side the products that applied principles of alignment of interest between originators of the loans and investors (i.e. risk retention), simple structures (no re-securitisation such as CDO-squared) and no maturity transformation (i.e. EU RMBS or auto loans ABS); on the other side the rest. EBA has then compared the default rate of securitisations with the same credit rating but belonging to the two groups.

Looking at AAA-rated deals, while those applying the above principles of simplicity and transparency never showed on average a default rate higher than 0.1%, the others' default rate peaked at 11.8%. The difference was even bigger among BBB-rated deals, where "principled" securitisations' default rates peaked at around 1% while the others peaked at 42% (see charts 8-9).

The very different default performance of these securitisation groups is reflected in the losses they generated. Asset classes following the principles above (EU RMBS and ABS) generated respectively 0.2% and 0.1% losses in 2000-2013. In the same period, the other assets such as US RMBS and CMBS<sup>6</sup> generated losses in the 6-10% range. More complex, structured credit products such as US CDOs and CDO-squared<sup>7</sup> generated 28.2% losses (see structured credit "SC category" in Chart 7 above).

Even leaving out the most complex structures (such as CDOs) and focusing on some of the most common mortgages backed securities (e.g. RMBS), requiring the same capital charges for investing in an RMBS respecting the principles of simplicity and transparency and another not fulfilling them would be an insufficiently risk sensitive approach.

Chart 8 – Default rates of AAA-rated securitised products, qualifying vs. non-qualifying



Source: EBA

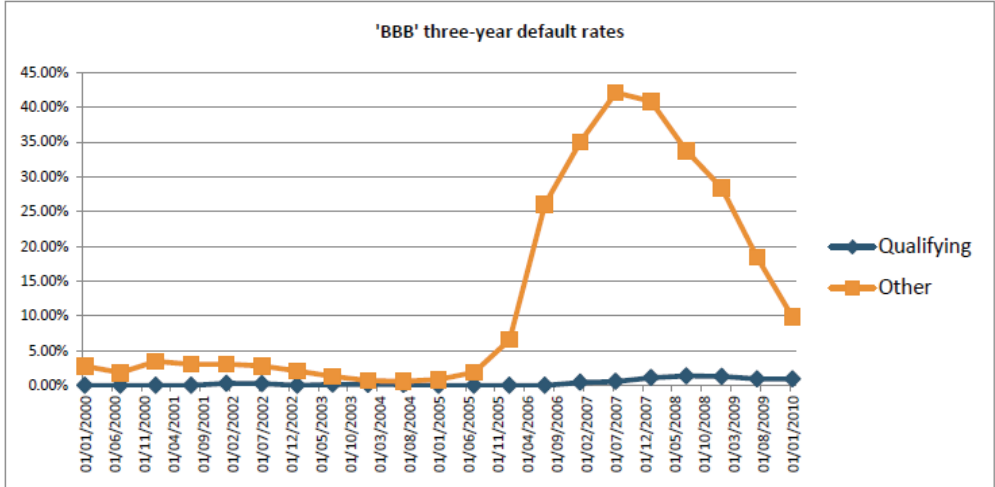
<sup>5</sup> The only key exception being re-securitised products (such as CDOs, CDO-squares), which have higher capital requirements due to their more complex structure.

<sup>6</sup> Commercial Mortgage-Backed Securities (ABS backed by commercial mortgages)

<sup>7</sup> CDO stands for Collateral Debt Obligations; "CDO-squared" are CDOs of CDOs

The current capital prudential framework is however mostly based on the securitisation rating. Investing in an AAA-rated RMBS will require today a capital allocation of 0.56% to 1.7%, depending on the approach followed in the Capital Requirement Regulation (CRR) (575/2013) used by the issuing bank (standardised and internal-rating based) and the seniority of the tranche bought. These charges are a multiple of the losses generated by EU RMBS throughout the crisis, whatever their rating. Similar arguments can be applied on BBB-rated deals, where the same capital charges are currently imposed on EU products with an historical 1% default rate and US products with a default rate 42 times higher. The "one-size-fits-all" approach to capital requirements implies that charges are quite disconnected from the risk profile of the products they are imposed on.

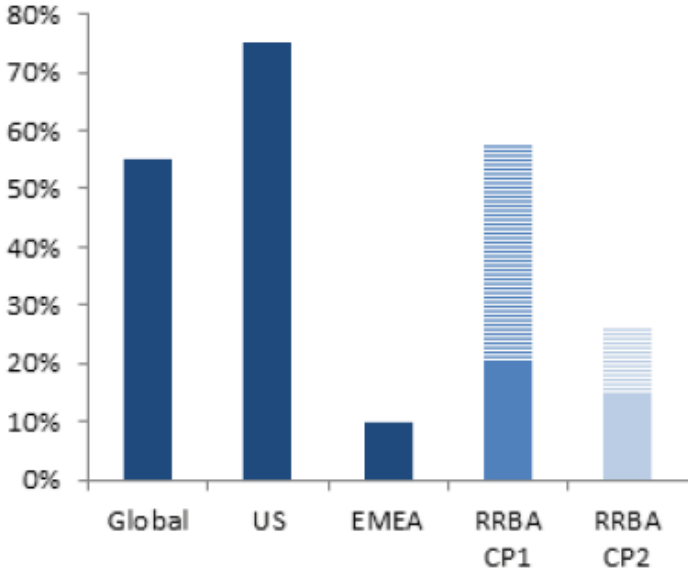
Chart 9 – Default rates of BBB-rated securitised products, qualifying vs. non-qualifying



Source: EBA

Supporting this statement, the ECB and BoE have run an exercise similar to EBA's with a different procedure and reached the same conclusions. The central banks have compared the risk weights proposed in the new (Basel III) framework for senior tranches of securitisations (light blue columns in Fig. 9) with the weights that would have covered the losses generated during the crisis securitisations (dark blue columns in Fig. 9). They found that the proposed weights are a multiple of those sufficient to cover losses generated by EU products but are still considerably lower than the weights needed to cover US-generated losses.

Chart 10 – Risk weights covering losses and risk weights proposed by Basel Committee



Source: ECB-BoE

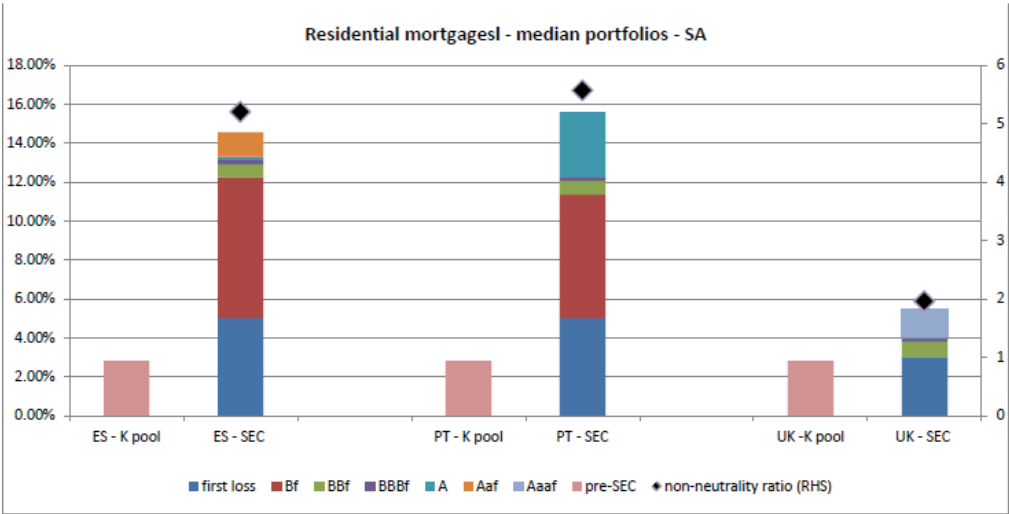
Low risk sensitivity appears also in other aspects of the capital regulatory framework. Comparing the charges imposed on a securitisation deal with those imposed on the assets underlying such product, if held directly, shows that the former is a multiple of the latter. In other words, the prudential capital a bank will be required to hold for a portfolio of its loans is a fraction of the capital that will be required to investors in a securitisation of the same portfolio of loans. This is termed "non-neutrality" of the capital treatment.

As securitisation adds a layer of risk in the form of complexity and model uncertainty, the capital charges for a securitised product should be higher than for its underlying assets (i.e. neutrality is not justified). Nevertheless, the degree of non-neutrality (i.e. the additional capital requirements imposed on the securitisation deal) does not appear fully proportionate by the increase in risk introduced by the securitisation process. EBA calculates, for example, that the capital imposed on a representative EU RMBS is between 1.7 and 2.4 times higher than the capital required to hold the same portfolio of mortgages unsecuritised (see EBA 2014).

The multiple becomes even higher for RMBS or SME loans-backed securitisations issued in countries with low sovereign credit ratings. The EBA has calculated that holding the representative Spanish and Portuguese RMBS requires more than 5 times the capital required to hold the underlying portfolios directly (see Fig. 10 below – pink columns represent capital requirements for holding the mortgages directly, the multi-coloured columns represent capital requirements for holding the same mortgages securitised; the square represent the ratio between the two). Similarly, holding the representative Spanish and Italian securitisation backed by SME loans requires more than 3 times the capital required to hold the underlying SME loans directly. Additional risks introduced by securitisation's complexity and model uncertainty are unlikely to multiply potential losses by a factor of 3 or even 5. While the presence of non-neutrality is justified, it is thus the degree of it that does not seems so. The consequence is, again, a lack of proportionality in the relationship between the riskiness of the securitisation bought and the capital charges required to do so.



Chart 11 – Capital charges on residential mortgages pools – securitised vs. underlying



Source: EBA

One last consideration to be made is on the consistency of capital charges required for different types of investors being exposed to the same product. Substantial differences (between the capital treatment of banks and insurance companies investing in the same product) have been documented. In a comparative study of the current Basel 2.5 and Solvency II frameworks for banks and insurance prudential capital regulations, the authors conclude that there exists "considerable differences in required capital for the same type and amount of asset risk, burdening insurers with almost twice as high capital requirements than banks." (see Laas and Siegle, 2014).

3.1.3) Lack of consistency and standardisation

In recent months the Joint Committee of the European Supervisory Authorities carried out an assessment of the existing EU framework regarding the requirements relating to disclosure, due diligence, supervisory reporting and risk retention. The Committee's objective was to assess whether the existing framework has been set up in a consistent manner across the many pieces of legislation regarding securitisation introduced after the crisis. The Committee's work highlighted how current due diligence requirements show substantial differences depending on the investors involved (banks, insurers, alternative investment funds, etc.) while common requirements can be justified for some investor types (see JC 2015). It also highlighted the importance of accompanying due diligence requirements with disclosure requirements that render the due diligence feasible and not too onerous for investors. The importance of giving investors access to standardised loan-by-loan data is another area where further work is necessary. Finally, on top of differences and inconsistencies in the EU regulatory framework, there are national differences in a variety of key aspects affecting securitisation.

Limited standardisation of information is particularly detrimental to the securitisation of SME loans. It makes it harder for prospective investors to conduct risk assessments, compare the risk-return characteristics between comparable products, making them less attractive. In addition, credit rating agencies typically require 3-5 years of financial performance and credit history when rating a securitised product. This includes information on outstanding balances, collections, collateral, delinquencies, write-offs, recoveries, to estimate the probability distribution of losses that may be generated by the pool. If information is missing or inadequate, as is often the case for small and new companies, this probability distribution cannot be reliably estimated and credit rating agencies may

refrain from providing a rating. This immediately excludes potential investors constrained by mandates to only invest in rated products.

## 3.2) Problems

### 3.2.1) *Low demand for securitisation products*

As noticed above, issuance of securitised products in the EU has dropped 88% since the crisis began. While in 2007 70% of the issuance volume was publicly placed to investors, only a year later that percentage had dropped to 13% (see AFME 2014). The subprime crisis had changed drastically investor perception of securitised products and issuers were unable to place most of it, being thus forced to retain it. While some improvement has taken place since, the situation is still far from normalisation. Notwithstanding the reduction in issuance seen since 2008, its vast majority (67% in 2014) is still retained by issuers and used for central bank refinancing operations. Demand for EU securitisation products is thus a fraction of what it used to be before the crisis. Yet this has little to do with the performance of EU securitisation itself. The events in the US (and their damaging effects on EU investors) have altered the perception of the latter with regard to all securitisation products, without geographical or asset class distinctions. This is in line with the BCBS-IOSCO questionnaire ranking investor perception as the most important factor contributing to the decline of securitisation markets since the crisis.

### 3.2.2) *Simple and transparent securitisation products disadvantaged*

EBA, BoE and ECB work shows that the capital charges in the current regulatory framework are multiples of those that would have covered the losses generated by EU securitised products during the global financial crisis. It is clear that these products are being disadvantaged by the regulatory framework. This is one of the key reasons behind the persistent subdued state of EU securitisation issuance. As EBA put it, the consequence of the capital regulation's scarce differentiation among securitised products is "*an unduly conservative treatment of relatively less risky securitisations, showing a very good historical performance during the crisis years, in terms of both observed defaults and losses.*"

The negative effects of the scarce risk-sensitivity in the regulatory treatment are exacerbated by its interaction with sovereign caps employed by some credit rating agencies. The conservative regulatory framework, combined with its mechanistic reliance on credit ratings, interacts with sovereign rating caps and renders the regulatory treatment of securitised products issued in low-rated countries punitive and sometimes disconnected from the product's risk profile. This is because securitisation products can have higher credit rating than that of the country the issuer resides in. The difference is however "capped" (i.e. it cannot be more than a certain number of steps). It follows that securitisation products issued in countries with low sovereign ratings are bound to have low ratings and punitive capital charges, no matter how safe, simple and transparent these products may be (see Chart 12). This puts all securitisations issued in the periphery at huge disadvantage, irrespective of their risk profile, as discussed in section 3.1.2.

Chart 12 – Country sovereign ratings and maximum achievable securitisation ratings

	SF rating cap			Country rating		
	Moody's	S&P	Fitch	Moody's	S&P	Fitch
Greece	Ba3	BBB/BB	BB	Caa3	B	B
Ireland	Aa3	AAA/AA	AAA	Baa3	A-	A-
Italy	A2	AA/A	AA+	Baa2	BBB	BBB+
Portugal	A3	A/BBB	A+	Ba3	BB	BB+
Spain	A1	AA/A	AA+	Baa2	BBB	BBB+
UK	Aaa	AAA	AAA	Aa1	AAA	AA+
Netherlands	Aaa	AAA	AAA	Aaa	AA+	AAA

Source: Barclays – See glossary annex for acronyms explanation

Credit rating reliance also introduces "cliff edge" risks as downgrades may translate into substantial harshening of the regulatory treatment of a securitisation deal. This results from the overreliance on external credit ratings in the capital treatment of securitisations, leading to fire-sales and such instruments by financial market participants to pre-empt higher capital charges in the case of a downgrade. Again, this is particularly damaging when a securitisation deal has its rating capped by a sovereign rating. In this case, a downgrade of the sovereign translates in a securitisation downgrade and thus a substantial tightening of the regulatory treatment. Furthermore, credit rating agencies link the securitisation rating with that of the many agents present in the securitisation deal (the so-called "ancillary services", for example providers of interest rate swaps or guaranteed investment accounts). This implies that the tightening of the regulatory treatment can be triggered by a downgrade of an ancillary service as well.

3.2.3) High operational costs for investor and issuers

The availability of data on underlying assets and monitoring metrics varies considerably between securitisation deals. This lack of standardisation is also reflected in different structures, availability and form of legal documentation, reporting practices and types of assets. The lack of standardisation increases the costs of implementing due diligence and credit analysis for investors. These costs may also be unnecessarily increased by the implementation mechanism currently envisaged for risk retention rules. These risk retention rules hold investors responsible for ensuring the issuer complies with the rules but do not ensure the data necessary to prove compliance are disclosed to the investor in a standardised and consistent way.

On top of this, not always justified differences in disclosure and due diligence requirements have been identified across different parts of the EU legislation on securitisation (as discussed in section 3.1.3 above). The situation is further complicated by the specific European context, where substantial differences across jurisdictions exist on all these aspects and on others such as the tax and accounting treatment of securitised products, as well as the legal frameworks. This lack of standardisation increases the costs of due diligence for investors. These in turn reduce the attractiveness of cross-border investment in securitisation, limiting the scope for EU market integration and economies of scale. Issuers face additional set-up and disclosure costs because of the need to adapt these differences. This argument is put forward by the ECB and the BoE in their joint paper quoted above (see ECB-BoE 2014).

All these considerations are even more important in the context of SME loans securitisation. This is generally more expensive than securitising other more standard types of loans such as mortgages. In order to be pooled, a portfolio of loans must indeed satisfy some key conditions such as a credit history, clarity on collateral and its availability, and sectoral diversification. From a bank's perspective, building a portfolio with such characteristics is more difficult with SME loans than with residential mortgages, where there is more uniformity of loans, longer maturity tenors, and regularity of payment streams due to amortisation (see IMF 2014b). Once a suitable portfolio of SME loans is built, the bank faces also higher than average costs of setting up and operating the securitisation structure. For example, the granular information and variety of collateral related to SME loan portfolios require the creation of expensive IT systems and these are then used for portfolios that tend to be smaller in SME than in other securitisations. The same is true for legal costs and documentation.

While these characteristics are intrinsic to SME loans securitisation and thus unavoidable, their negative effect is exacerbated by limited standardisation or outright lack of data on SME loans. As the IMF notes: "*operational constraints, such as a lack of uniform reporting standards and credit scoring, make securitization of SME-related claims more costly than, for example, mortgages*" (see IMF 2014b). From an investor point of view, the lack of data and the heterogeneity of the underlying loans make it at best time-consuming and costly and at worst impossible to carry out own credit analysis and due diligence. This view is shared by the ECB and BoE who affirm in their joint paper: "*facilitating investors' access to credit data could be especially beneficial for securitisations of asset classes such as SME loans where the level of historical performance information available between incumbents and new entrants is most obviously uneven and generally lacking*" (see ECB-BoE 2014).

With set-up and operational costs higher than for other types of securitisations and generally lower returns on the underlying assets<sup>8</sup>, structuring an SME securitisation that is profitable for the issuer and at the same time guarantees a satisfactory return to the investor is often unfeasible. This is shown by an IMF study estimating the return an investor (bank or insurance company) would obtain at different market return rates by investing in a securitised SME deal or holding the portfolio of SME loans directly. The Fund finds that "*investment in highly rated senior [SME ABS] bonds would result in a Return on equity (RoE) of about 11.5 percent for banks and 4.5 percent for insurers. This is well below the RoE that banks and insurers would earn by simply holding the SME loan on their books (14.5 percent and 7.5 percent, respectively)*". In jurisdictions where the sovereign rating cap binds securitised product into low credit ratings, the disadvantage in investing in SME securitisation is even bigger, rendering SME securitisation even more uneconomical.

The specificity of SME loans has been dealt with by market participants developing dedicated instruments (such as ABCP – asset-backed commercial papers) and structuring techniques (so called "synthetic" securitisations). While these instruments or techniques may be better suited to certain types of SME loans securitisation, their specificities do not fit in the current regulatory framework, impacting on operational costs and limiting the products' attractiveness (please see Annex 5 for a detailed analysis of synthetic securitisation. Annex 6 provides a detailed analysis of the problems affecting SME loans' securitisations and the solutions proposed within this initiative.

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<sup>8</sup> SME loans tend to have lower returns than, for example, credit card receivables.

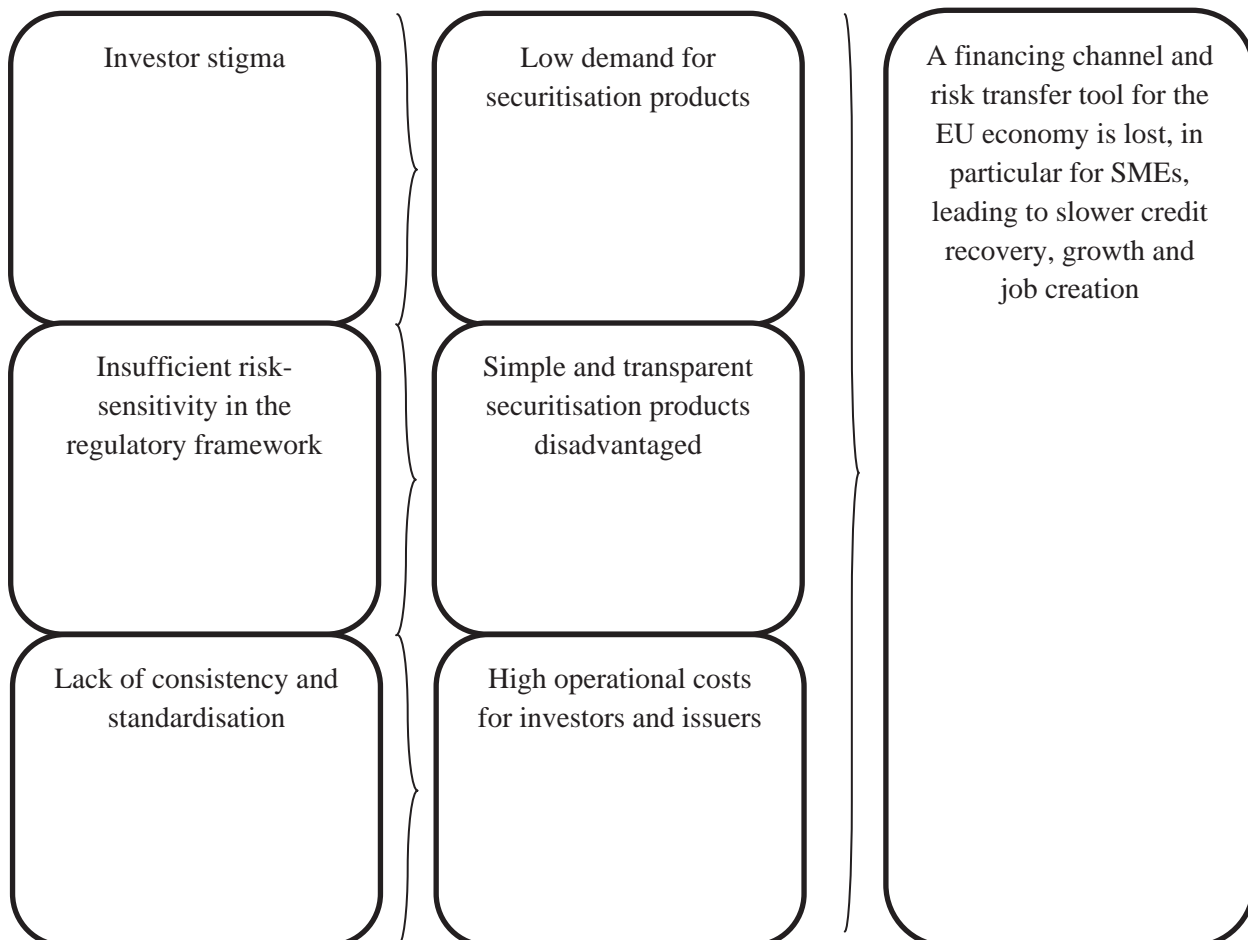
### 3.3) Consequences

Before the crisis the securitisation market was a growing channel of alternative funding to banks and the European economy. In addition its loss performance during the crisis showed good resilience. As a consequence of the problems highlighted in this chapter, as well as the subdued macroeconomic environment described in the introduction, this market is now moribund. A financing channel for the EU economy is impaired, with substantial detriment to potential contribution to growth and employment. Without securitisation, banks' ability to reduce their balance sheet by selling assets is indeed constrained. As a consequence, the current need for deleveraging imposes banks to shrink their balance sheets by reducing credit provision. In the European context, where 80% of financial intermediation takes place through banks, the implications for growth are relevant.

From a long term perspective, the moribund state of the securitisation market deprives the EU economy of a capital market that could provide additional funding when the banking channel cannot because of its own dynamics.

These dynamics are less relevant in the US where issuance has restarted growing after a substantial drop in 2008. US 2014 issuance was still less than half than in 2007 but a positive trend is clearly visible. This is however mostly ascribable to public guarantees from state agencies (Fannie Mae, Freddie Mac and Ginnie Mae), which cover the vast majority of the market. Such guarantees are however not feasible in Europe where an EU-level shared guarantee fund many times the size of currently existing supranational guarantors would be needed. It would also not be advisable as such schemes transfer risk from mortgage markets to the public sector, as recently highlighted by the IMF (see IMF 2014).

*Chart 13 - Drivers, problems and consequences chart*



## **4) OBJECTIVES**

### **4.1) General, specific and operational objectives**

In light of the analysis of the problems above, the general objective is to revive a safer securitisation market that will improve the financing of the EU economy, weakening the link between banks deleveraging needs and credit tightening in the short run, and creating a more balanced and stable funding structure of the EU economy in the long run. This should in turn benefit end users of credit intermediation: households, SMEs and larger corporations.

Reaching these general objectives requires the achievement of the following more specific policy objectives:

Remove stigma from investors and regulatory disadvantages for simple and transparent securitisation products (tackling problems 1 and 2 described in sections 3.1.1 and 3.1.2)

Reduce/eliminate unduly high operational costs for issuers and investors (tackling problem 3 described in section 3.1.3)

These in turn require the attainment of the following operational objectives:

Differentiate simple, transparent and standardised securitisation ('STS' henceforth) products from more opaque and complex ones. This objective will be measured against the difference in price of STS versus non-STS products. If this objective is achieved, this difference should increase. This should also trigger an increase in the supply of STS products, reason for which the achievement of this objective will also be measured with the growth in issuance of STS products versus non-STS ones.

Support the standardisation of processes and practises in securitisation markets and tackle regulatory inconsistencies. This objective will be measured against: 1) STS products' price and issuance, 2) The degree of standardisation of marketing and reporting material and 3) feedback from market practitioners on operational costs' evolution.

### **4.2) Consistency of the objectives with other EU policies**

The identified objectives are coherent with the EU's fundamental goals of promoting a harmonised and sustainable development of economic activities, a high degree of competitiveness, and a high level of consumer protection, which includes safety and economic interests of citizens (Article 169 TFEU).

### **4.3) Consistency of the objectives with fundamental rights**

Future legislative measures on securitisation, including appropriate sanctions, need to be in compliance with relevant fundamental rights embodied in the EU Charter of Fundamental Rights ("EU CFR"), and particular attention should be given to the necessity and proportionality of the legislative measures. Only the protection of personal data (Article 8), the freedom to conduct a

business (Art. 16) and consumer protection (Art. 38) of the EU Charter of Fundamental Rights are to some extent relevant. Limitations on these rights and freedoms are allowed under Article 52 of the Charter. The objectives as defined above are consistent with the EU's obligations to respect fundamental rights. However, any limitation on the exercise of these rights and freedoms must be provided for by the law and respect the essence of these rights and freedoms. Subject to the principle of proportionality, limitations may be made only if they are necessary and genuinely meet the objectives of general interest recognised by the Union or the need to protect the rights and freedoms of others.

In the case of the securitisation legislation, the general interest objective which justifies certain limitations of fundamental rights is the objective of ensuring the market integrity and financial stability. The freedom to conduct a business may be impacted by the necessity to follow certain risk retention and due diligence requirements in order to ensure an alignment of interest in the investment chain and to ensure that potential investors act in a prudent manner. As regards protection of personal data the disclosure of certain loan level information may be necessary to ensure that investors are able to conduct their due diligence. It is however noted that these provisions are currently already in place in EU law. As regards the new securitisation legislation it should not impact on consumers, since the instrument are not intended for consumers. However, for all classes of investors STS securitisation would enable better analyse the risks for the products which contributes to investor protection. We have focused our assessment on the options which might limit these rights and freedoms

#### **4.4) Subsidiarity and proportionality**

According to the principle of subsidiarity (Article 5 (3) of the TEU), action on EU level should be taken only when the objectives of the proposed action cannot be achieved sufficiently by Member States alone and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the EU. The objective of the initiative is to revive a safe securitisation market that will improve the financing of the EU economy and ensures financial stability and investor protection.

Securitisation products are part of EU financial markets which are open and integrated. Securitisation links different financial institutions from different Member States and non-Member States: often banks originate the loans that are securitised, while financial institutions such as insurers and investment funds invest in these products and they do so across European borders, but also across the Atlantic. The securitisation market is therefore European/international in nature.

Individual Member State action will not be able to remove the stigma. The EU has advocated at international level for standards to identify simple, transparent and standardised (STS) securitisation that performed well during the financial crisis. Such standards will help investors to identify categories of securitisations that have performed well during the financial crisis and which allow them to analyse the risks involved.

Although implementation of these international standards could be done by Member States, it could lead to divergent approaches in Member States, which would hamper the removal of the stigma and would create a de facto barrier for investors which would have to enter into the details of the each Member State's framework. As regards the insufficient risk-sensitivity of the regulatory framework, the relevant framework is currently laid down in EU law, in particular the Capital Requirements

Regulation for banks and in the Solvency II Directive for insurers<sup>9</sup>. Making the regulatory framework more risk-sensitive can thus only be achieved by amending these EU legal acts and thus only by EU action. It should also be noted that to be able to define a more risk-sensitive regulatory treatment for STS securitisation requires the EU to define what STS securitisation is, since otherwise the more beneficial regulatory treatment would in different Member States be available for different types of securitisations. This would lead to an un-level playing field, to regulatory arbitrage which in the end could work against the objective to remove the stigma attached to securitisation. As regards the lack of consistency and standardization EU law has already harmonised a number of elements on securitisation, in particular rules on disclosure, due diligence, supervisory reporting and risk retention. Those provisions have been developed in the framework of different legal acts (CRR, Solvency II, UCITS, CRA Regulation, and AIFMD) which has led to certain discrepancies in the requirements that apply to different investors. Increasing their consistency and further standardisation of these provisions can only be done by EU action.

The action proposed would give a clear and consistent signal throughout the EU that certain securitisations performed well even during the financial crisis, that they can be useful investments for different types of professional investors for which regulatory barriers (lack of an appropriate prudential treatment, inconsistent treatment across financial sectors) will be taken away.

Therefore, the objectives of the proposed action cannot be achieved by action of the Member States and can be better achieved by action by the Union.

The options analysed below will take full account of the principle of proportionality, being adequate to reach the objectives and not going beyond what is necessary in doing. The retained policy options are compatible with the proportionality principle, taking into account the right balance of public interest at stake and the cost-efficiency of the measure. The proposed action will create a simple, clear and consistent framework for investments in securitisation based on uniform definitions, including of simple, transparent and standardised securitisation. The prudential treatment will be carefully calibrated on the basis of extensive historical data, so to ensure that the treatment is proportionate to the risks involved and neither over- nor underestimates the risks of securitisation.

The options retained will be implemented by as closely as possible alignment with the existing EU definitions and provisions on disclosure, due diligence, risk retention and definition of STS securitisation in the LCR and Solvency 2 delegated acts. This will ensure that the market can continue to function as much as possible on the basis of the existing legal framework, so to not unnecessarily increase costs and create regulatory disruption, thereby also continuing to ensure investor protection, financial stability, while contributing to the maximum extent possible to the financing of the EU economy.

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<sup>9</sup> [Regulation \(EU\) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation \(EU\) No 648/2012 \(1\): OJ L 176, 27.6.2013 and Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance \(Solvency II\) \(1\): OJ L 335,17.12.2009](#)





## 5) POLICY OPTIONS

In order to meet the first operational objective, this impact assessment analyses 14 different policy options. For ease of reference, these options have been grouped into different headings, such as options on product differentiation, scope of the differentiation, compliance mechanism and the prudential treatment (see table below).

	<b>Option</b>	<b>Description</b>
<b>Simple Transparent and Standardised criteria</b>		
1.1	No action on differentiation	Take no further action at EU level to introduce STS criteria
1.2	Soft law by EU	Codes of conduct, guidelines or recommendations to encourage Member States to set up specific provisions for STS products and/or endorsement or support to private initiatives
1.3	EU legislative initiative to specify STS criteria	Introduction of a legal instrument specifying a set of criteria for STS securitisation products
<b>Scope of differentiation</b>		
2.1	Same scope as LCR and S2	The scope of STS securitisations would only cover 'term' securitisation (ABS with medium to long term maturity)
2.2	2.1 + ABCP	Additional criteria for identifying STS types of short term securitisations
2.3	2.2 + synthetics	Introduce criteria for both ABCP and synthetic securitisations
<b>Compliance mechanism</b>		
3.1	Introduce a self-attestation mechanism	Responsibility for compliance with the criteria will lie with the originator of the securitisation
3.2	3.1 + 3rd party assessment	Self-attestation by the originator complemented by assessment provided by an independent third-party
3.3	3.1 + ex-ante supervisory approval	Self-attestation by the originator complemented by ex-ante supervisory approval.
<b>Prudential treatment</b>		
<b>Banking prudential treatment</b>		
4.1	No change to the existing securitisation framework	All securitisations (both STS and non-STS) continue to be subject to the same prudential treatment set out in CRR
4.2	Develop a preferential capital treatment for STS securitisations	Amend the existing requirements in the CRR with a new framework that would differentiate between STS and non-STS securitisations with a preferential treatment for the former

<b>Insurance prudential treatment</b>		
4.3	No further action on Insurance prudential treatment	Solvency 2 standard formula for capital charges unchanged
4.4	Modify treatment for senior tranches of STS products	Refine existing approach - without changing the scope of the differentiated approach (i.e. improve the risk-sensitivity of the calibrations for senior tranches only).
4.5	Modify treatment for all tranches of STS products	Extend the differentiated approach to insurers' investments in non-senior tranches of STS securitisation deals and refine the existing approach

In order to meet the second operational objective, a total of three different policy options has been analysed in this impact assessment (see table below). Notice that, while options aiming at the achievement of the first objective refer to the regulation of STS products, options aiming at the achievement of the second objective aim at setting the optimal provisions that will apply onto all securitisation products, STS and non-STS alike.

<b>B) Options aiming at fostering the standardisation of processes and practises and tackling regulatory inconsistencies</b>		
5.1	No further action at EU level	Finalise implementation of agreed reforms and address some remaining issues
5.2	Establish a single EU securitisation framework and encourage market participants to develop standardisation	Establish a single EU securitisation legislative framework defining securitisation, transparency, disclosure, due diligence and risk retention rules.
5.3	Adopt a comprehensive EU securitisation framework	Complementing option 5.2 with an EU securitisation framework harmonising Member States' legal frameworks for securitisation vehicles

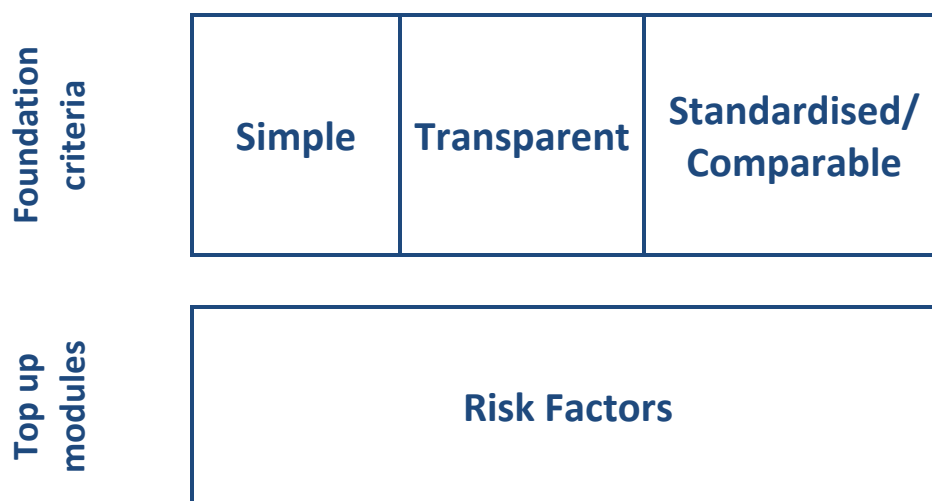
## 6) ANALYSIS OF IMPACTS

This section assesses the impacts of each of the policy options, measured against the criteria of their effectiveness in achieving the specific objectives (differentiating STS deals from more opaque and complex ones; fostering standardisation of processes and practises and tackling regulatory inconsistencies) and their efficiency in terms of achieving these objectives for a given level of resources or at lowest cost. Impacts on relevant stakeholders and the coherence of the options with EU policies are also considered. The retained policy options should be those scoring the highest for the relevant specific objective while imposing the smallest costs and impacts on stakeholders. At the end of each section of options assessment and before the impact summary the views of respondents to the public consultation are presented in the "Stakeholder View" boxes.

### 6.1) Section 1 - STS differentiation

#### Box 1: What is simple, transparent and standardised securitisation?

The discussions on setting criteria to distinguish between different types of securitisation start with the principles of simplicity, transparency and standardisation. These features are relevant across the whole financial system and form the foundation criteria (see footnote 9, page 30 for links to the criteria list of BCBS-IOSCO and EBA). As a second step, these features can be supplemented with additional criteria based on specific risks and for specific prudential requirements in a given sector. By taking a 'modular approach', this allows for increased consistency across the system and, at the same time, can help address sector specific risks.



#### 6.1.1) Policy option 1.1: No further EU action (baseline scenario)

This option would imply no further EU action aimed at defining criteria to identify STS products and distinguish them from other securitisation products. A distinction between the two is however already included in the provisions of the LCR and the Solvency 2 EU delegated acts.

## **Box 2: The current differentiation between STS and non-STS securitisation**

The LCR delegated act requires all EU banks to hold at any point in time liquid assets enough to cover the cash outflows the bank can suffer in a stressed situation lasting 30 days. "Liquid assets" are defined as assets that can be sold on private markets with no or little loss of value even in stressed conditions.

The LCR delegated act specifies what types of assets can be considered "highly liquid" and be included on the banks liquidity buffer. To be eligible in the buffer (as "Level 2B" instruments), these instruments have to meet certain criteria (cf. annex 4). All securitisation products not satisfying the criteria are instead excluded and cannot be accounted as cover for the LCR. Similar criteria identify securitisations that enjoy lower prudential requirements under Solvency 2 delegated acts for insurance companies' exposures. Notably, these lower prudential requirements are achievable only by the most senior tranche of a qualifying securitisation deal.

Furthermore, some EU jurisdictions have national legislative frameworks dedicated to securitisation and some of these frameworks include provisions aimed indirectly at promoting the development of simple and transparent instruments.

Finally, the market has started to independently develop differentiation mechanisms. The Prime Collateralised Securities (PCS), for example, aims at defining standards of transparency, simplicity and liquidity in the securitisation market. It does so with the PCS Label, which can be awarded to securitisation deals meeting certain criteria. These criteria have similarities to those identifying STS securitisation in the LCR and Solvency 2 delegated acts. The PCS Label is designed to assist investors and market participants in understanding key aspects of the labelled securities that make them simple, transparent and standardised: the simplicity of the structure, the homogeneity of the assets packaged in the security, the rules incentivising proper underwriting standards and so on. A similar initiative, True Sale International, has developed in Germany.

### **(a) Effectiveness - ensuring differentiation of STS deals from more opaque and complex ones**

Recognising the specific features of STS securitisation instruments and adjusting accordingly the prudential treatment these instruments are subject to, the two delegated acts introduce an important differentiation in the market. However, beyond banks' liquidity and insurance companies' capital charges, STS and non-STS securitisations are indistinct. Therefore, the current differentiation is a preferential treatment granted to some qualifying products in some limited and specific aspects, rather than the existence of a product immediately recognisable by all types of investors (banks, insurance companies, pension funds, UCITS, AIFs). It follows that the problem of stigma would not be efficiently tackled.

On top of this, the regulatory disincentives currently hindering securitisation (see introduction and section 6.4) would not be removed.

Market-developed differentiating mechanisms such as PCS and TSI are unlikely to fight stigma as they would rely on market associations' opinions that have not been tested by events (i.e. PCS-labelled securitisation were never tested in a stressed scenario). More importantly, even if these differentiating mechanisms between securitisation products would be successful in achieving differentiation and fighting stigma, they could not adjust the prudential treatment attached to

securitisations and thus improve the economics of EU deals. Furthermore, the current inconsistencies in EU legislation would continue to affect these markets.

In absence of any EU intervention, deals are thus likely to remain uneconomical and the current state of the securitisation market would be unlikely to be reversed: low issuance and fragmentation would persist.

The absence of macroeconomic factors currently hindering securitisation (see introduction) may be a necessary condition for the full development of the securitisation markets potential but it hardly is a sufficient condition. When the macroeconomic environment will improve, without a more risk sensitive prudential framework banks will cover their increasing funding needs with other sources/channels such as covered bonds or subordinated debt that will remain cheaper than securitisation. Also, non-bank investors such as insurance companies will not find attractive to invest in securitisation markets as current capital charges for them, compared with other available investments, are very onerous. As a consequence, a funding and investment diversification opportunity will not be exploited.

#### **(b) Efficiency and impact on stakeholders**

A recognisable product, guaranteeing a high level of simplicity, transparency and standardisation of the securitisation structure and its underlying assets, and allowing for a clear understanding of the risks intrinsic in the transaction, is however what is needed to overcome stigma and inspire investor confidence. Such a product must be recognisable and relevant for all investors beyond banks and insurance companies (e.g. UCITS, AIFM...) and across the European Union, reason for which the limited and differing differentiation incorporated in some national legislative frameworks are unlikely to be an efficient means to the end of rebuilding trust and fighting stigma.

Similar considerations hold for market-led initiatives. While beneficial in rebuilding trust and fighting stigma, they are unlikely to be sufficient because, without the involvement of supervision, investors are unlikely to trust privately-awarded labels. Alone, the LCR and Solvency 2 delegated acts, national frameworks and private initiatives are thus unlikely to lead to the emergence of a clearly identifiable STS product for EU investors and issuers, able to overcome the stigma against securitisations.

##### *6.1.2) Policy option 1.2: EU soft law*

The Commission could use soft-law instruments such as codes of conduct, guidelines or recommendations to Member States in order to build on the existing delegated acts, national frameworks and market initiatives (PCS, TSI, DSA). These soft law instruments could encourage Member States to set up specific provisions or to encourage STS within their securitisation frameworks. They could also be used to foster further differentiation via endorsement or support to private initiatives such as the PCS and TSI labels and other initiatives to raise awareness of STS products.

#### **(a) Effectiveness - ensuring differentiation of STS deals from more opaque and complex ones**

An advantage of this option is that it could be implemented quickly so that the international consensus on STS criteria could be swiftly promoted among Member States and market participants. In a creditless recovery, such as the one currently experienced by the EU, where there

is urgency to restart credit flows to firms and households, this would certainly be an important advantage.

Offsetting the advantage of speed there is, however, a major drawback: limited coordination. It would be up to Member States and market organisations to decide whether and how to implement the recommendation/guidelines. Without a coordinated effort, national initiatives are more likely to develop in different ways, potentially creating a set of different provisions and STS standards across the EU. This would change little from the current situation, falling short of introducing the recognisable STS product needed. Timing would also potentially be an issue. Until the number of countries with a differentiating securitisation framework has reached a critical mass, the effect on the market will be negligible. This could take years. Choosing this option would then most likely lead to the creation of different STS products, implemented at different times or not even implemented. The same stands true for market-led initiatives, which could create a set of similar and overlapping STS labels. Finally, the limitations of market-led initiatives highlighted in the previous section are equally valid under this option.

#### **(b) Efficiency and impact on stakeholders**

Soft law would entail small costs in terms of administrative burden for EU authorities and market participants alike. However, low costs would be accompanied by low effectiveness in achieving the differentiation objective, thereby suggesting this option would be scarcely efficient. Even if Member States were to react quickly and introduce national legislation identifying STS deals, a soft law action would limit considerably the scope and depth of the initiative. This would impact market participants depriving them of a recognisable STS product, thus changing little from the current situation. The change would be even more negligible in the event of slow and non-harmonised implementation of STS product introduction by Member States.

#### *6.1.3) Policy option 1.3: EU legislative initiative to specify applicable STS criteria*

Under this option, a harmonised legal framework specifying a set of criteria for STS products generally applicable across financial sectors would be established. Extensive work to identify what features render a securitisation and the risks it entails clearly understandable and, furthermore, what features have empirically been associated with smaller losses during the crisis has been carried out by a host of authorities and organisations (EBA, BCBS-IOSCO). An international consensus has been reached and a set of agreed key criteria has been identified<sup>10</sup>. The STS definition would therefore be based on this set.

#### **(a) Effectiveness - ensuring differentiation of STS deals from more opaque and complex ones**

With the introduction of a single legal instrument defining STS products, two important goals would be achieved that would otherwise not be not achievable by the status quo or via soft law. First, it would provide a STS product that, accompanied by an appropriate level of supervision, could be relevant and trusted for all categories of investors, thereby overcoming stigma and fostering a finer distinction among securitised products than the one currently prevalent in the

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<sup>10</sup> BCBS-IOSCO criteria are available at <http://www.bis.org/bcbs/publ/d304.pdf>; EBA criteria at <https://www.eba.europa.eu/documents/10180/950548/EBA+report+on+qualifying+securitisation.pdf>

market. Investors would not, however, be relieved from their responsibility to conduct due diligence and credit risk analysis for STS products (cf. chapter 4). Secondly, it would provide a harmonised definition of STS products applicable across all EU jurisdictions and financial sectors, thereby fostering cross-border harmonisation without conflicting with national frameworks, which would not be impaired/hindered.

#### **(b) Efficiency and impact for stakeholders**

The single legal instrument envisaged in this option would have limited costs. These consist of a longer EU legislative procedure (compared to a soft law initiative) and the need to revisit various pieces of legislation and technical standards, some only recently adopted. Market participants would also incur administrative costs in adapting to the new legislation. These would, however, be more than offset by the advantages of creating a more transparent and sustainable market for securitised products, giving market participants another source of funding and investment and, in so doing, creating another safe channel of financing for the European economy.

**Stakeholders' view** - Respondents to the Commission's public consultation support strongly the introduction of a differentiation instrument based on the modular approach. Criteria developed by EBA/BCBS/IOSCO were seen as a natural and authoritative base for the criteria. Respondents support a differentiation not including credit risk elements and applying to all tranches of a deal, since differentiation is about the originating and structuring procedure. The importance of avoiding a proliferation of criteria/definitions/regimes in EU legislation (CRR, Solvency II, LCR) was highlighted as a key reason for introducing a unified instrument for the definition of STS criteria. These views were equally held across all categories of respondents (e.g. industry associations, market participants, supervisors as well as think tanks). Please see Annex 7 for an extensive summary of responses to the public consultation.

#### *6.1.4) Impact summary and conclusion*

Options 1.1 and 1.2 fall short of the need to introduce a recognisable product. Differentiation would be limited to that existing in current EU legislation or, in the case of option 1.2 being chosen, to that eventually introduced by Member States and/or market participants. No guarantee of a standardised EU product setting unified criteria for simple, transparent and comparable criteria that are relevant and recognised by all types of investors would be there. As such, the incentive to issue and invest in STS products would remain limited to certain banks and insurance companies.

By contrast, introducing an STS product that is relevant and, with effective supervision, trusted by all categories of investors is achievable under option 1.3. The STS products should create a harmonised definition of securitisation products whose intrinsic risks can be appropriately analysed, understood and priced by investors. Such a definition would be applicable across all EU jurisdictions and financial sectors. In this way, investors should be able to recognise simple, transparent and standardised products and the indiscriminate stigma against all securitisations should be reduced. Fostering the development of simpler, more transparent and standardised structures, option 1.3 would allow investors, credit rating agencies and supervisors to assess with more precision the risk involved in the assets contained in a securitisations, thereby reducing mechanistic reliance on credit rating to evaluate a deal's riskiness.



In the comparison table below, each option is rated between "--" (very negative), ≈ (neutral) and "++" (very positive) based on the analysis in the previous sections. The benefits are, however, very difficult to quantify in monetary terms. The costs should be understood in a broad sense, not only as compliance costs but also against all the other negative impacts on stakeholders and on the market of alternative options. This is why we have assessed the options based on the respective costs and benefits in relative terms.

In view of the above analysis and the opinion of stakeholders in the public consultation, option 3 (an EU legislative initiative to specify applicable STS criteria), is the preferred option.

	<b>Option</b>	<b>Effectiveness</b>	<b>Efficiency</b>	<b>Impact on Stakeholders</b>
1.1	No action on differentiation	(=) Differentiation limited to existing EU legislation.	(=) Market participants remain deprived of a recognisable STS product, thus changing little from the current situation	(=)
1.2	Soft law by EU	(-) Limited coordination potentially creating a set of different provisions and STS standards across the EU.	(=) Market participants remain deprived of a recognisable STS product, thus changing little from the current situation  (+) Fast implementation procedure	(=) Small costs in terms of administrative burden for EU authorities and market participants, but limited effectiveness
1.3	EU legislative initiative to specify STS criteria	(++) Introduction of an STS product that is relevant and trusted for all categories of investors  (++) Creation of a harmonised STS definition applicable across all EU jurisdictions and financial sectors	(++) Creation a more transparent and sustainable market for securitised products more than offsets limited costs	(-) Longer EU legislative procedure and the need to revisit various pieces of legislation and technical standards, some only recently adopted.  (-) Administrative costs for market participant in adapting to the new legislation.

**6.2) Section 2 - Scope of the STS definition**

During the financial crisis different asset types within the global securitisation market performed very differently. This raises a question about the scope of securitisations that should be eligible for

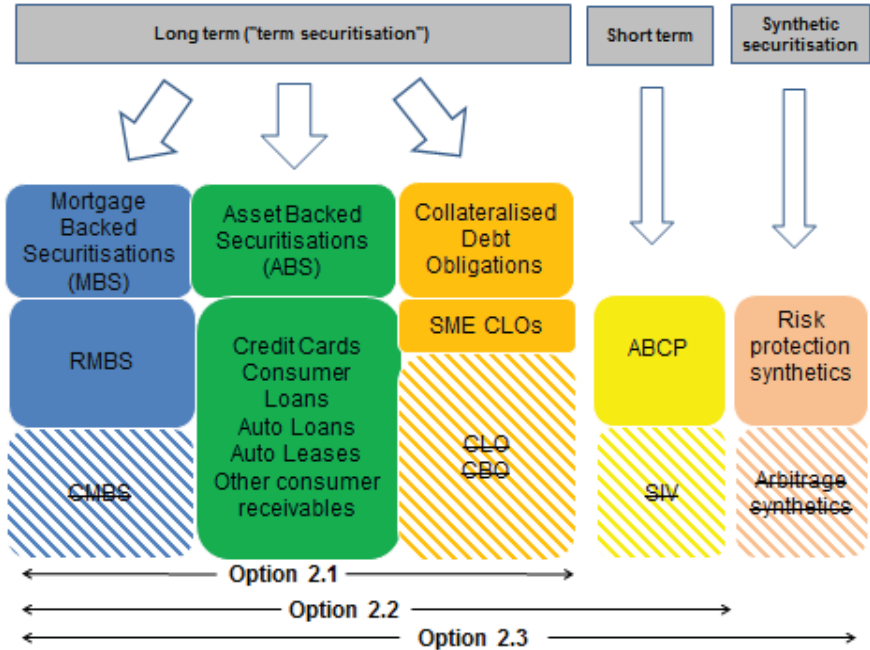
the STS category. This section considers three main policy options for the scope of STS securitisation. The first option is to limit the scope of STS criteria to 'term' securitisations (asset backed securities with maturities longer than one year) currently included in the LCR and Solvency 2 criteria. The second option would extend this also to ABCP securitisations. The third option would allow term, ABCP and synthetic securitisations to be included in the scope.

6.2.1) Policy option 2.1: Cover only term securitisation

This option is the baseline and builds on the existing differentiation approaches developed by the BCBS-IOSCO working group as well as in the Solvency II and LCR Delegated Acts. The scope of STS securitisations would only be open to 'term' securitisation. Furthermore, to be considered as STS, securitisations would require an effective transfer of ownership of the underlying assets from the originator of such assets to a dedicated and legally separate Special Purpose Vehicle that issues the securitisation. In other words, only "true sale" or "cash securitisations" will be eligible, according to BCBS-IOSCO and EBA criteria, thus keeping synthetic securitisations out of the scope of the criteria. This option would also be consistent with the ECB framework for refinancing operations, where synthetics are not accepted as collateral by the central bank.

The non-inclusion of ABCP would be in line with the developments of the BCBS-IOSCO task force as specific criteria are still under development. However, EBA has already prepared a set of specific criteria which adjust the term criteria for specificities of short-term products<sup>11</sup>.

Chart 14: overview of options



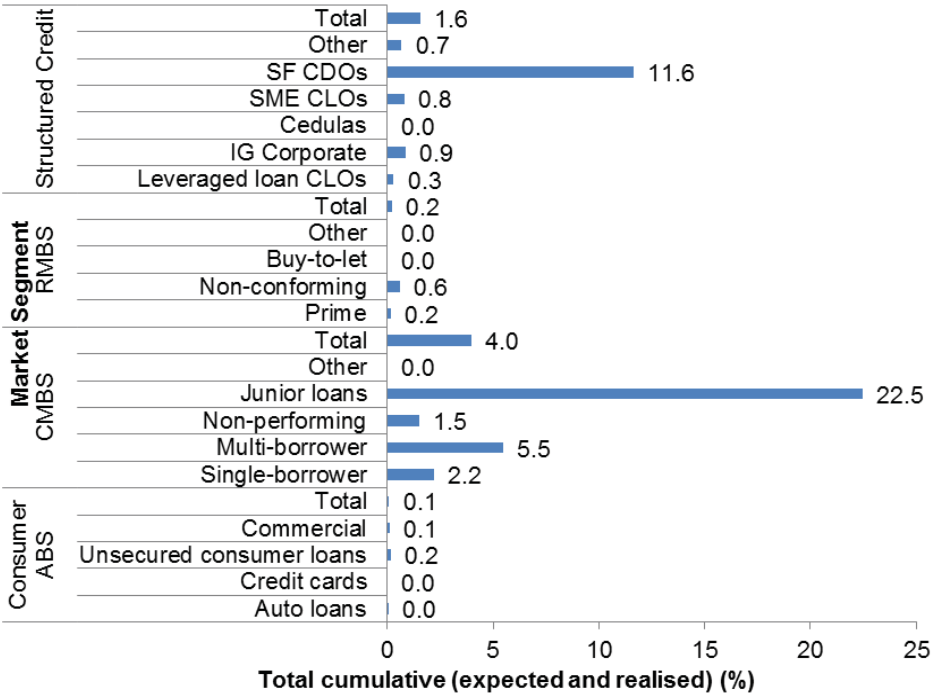
<sup>11</sup> These are available at <https://www.eba.europa.eu/documents/10180/950548/EBA+report+on+qualifying+securitisation.pdf>

**(a) Effectiveness - ensuring differentiation of STS deals from more opaque and complex ones**

The criteria set out in the Solvency II and LCR Delegated Acts exclude securitisations containing structured products or derivatives not used for hedging purposes on the basis that this adds an additional layer of complexity and risk (including counterparty credit risk). There is also a list of eligible underlying assets, which covers: residential mortgages; loans to SMEs; auto-loans; leasing; consumer finance and credit card receivables. This list includes only instruments which fulfil the identification criteria. For instance, instruments without common types of underlying assets (such as CDOs), or instruments involving important refinancing operations during the lifetime of the transaction (such as CMBS) cannot qualify. In the latter case it means in practice that investors in the securitisation instrument should be repaid before the underlying loans mature. This implies a need to refinance the underlying assets and thus a significant degree of uncertainty. This feature was the cause of significant losses during the crisis (CMBS generated losses 20 times higher than RMBS – see chart below)

The decision to include or exclude certain asset classes in the LCR and Solvency II delegated acts was based on EU/international standards and market practices (cf. PCS Label scope), which was based in turn on a historical assessment of their credit performance. The credit performance of CDOs (except Collateralised Loan Obligations, CLOs) and CMBS during the crisis was very poor compared to consumer ABS and RMBS (see Chart 15 and discussion in the 'problem definition' section). The BCBS-IOSCO working group and EBA advice continue to follow the same approach. This would clearly be effective in achieving differentiation and in fighting stigma.

**Chart 15: European securitisation losses 2000-2014, by market segment**

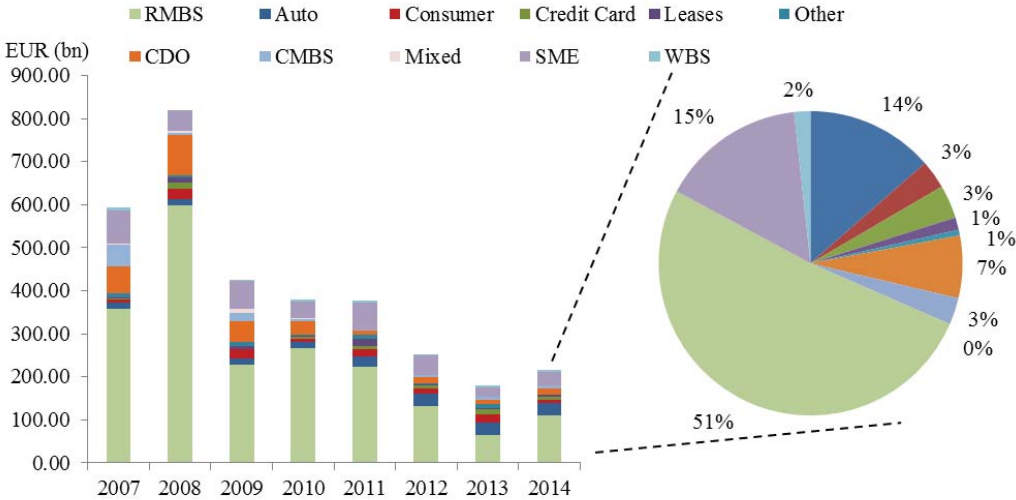


*Note: The chart shows total cumulative expected and realised losses on all Fitch rated European securitisation deals between 2000 and 2014. Source: Fitch Ratings*

**(b) Efficiency and impact for stakeholders**

This option would not impose additional administrative costs nor require substantial legislative effort from EU authorities. For investors, the exclusion of securitisations that generally did not perform well during the financial crisis can have a positive impact on the trust they have in STS securitisations. Moreover, since these excluded asset types (CMBS, CDOs) have a relatively small issuance in the EU (each represented 3% of 2014 EU issuance), it would not have a major impact on the market.

**Chart 16: European term securitisation issuance, by product type**



Source: SIFMA – See glossary annex for acronyms explanation

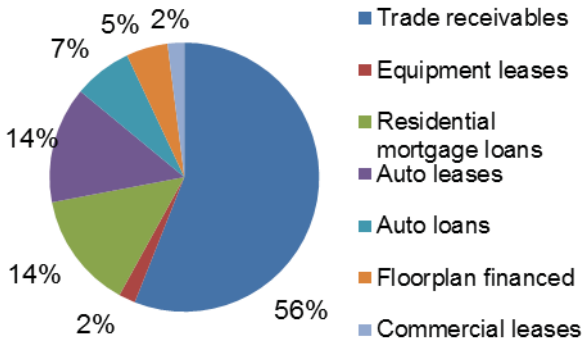
*6.2.2) Policy option 2.2: - cover term and ABCP securitisations*

In addition to criteria for term securitisations, this option would also set out additional criteria for identifying the simplest and safest types of short term securitisations, taking into account the specificities of the ABCP securitisation technique.

ABCP is a type of bond that is typically issued by a conduit sponsored by a bank. The commercial paper issued by the conduit is collateralised by the pool of assets. The maturity on ABCP is typically short (30-90 days), and the liabilities are refinanced at regular intervals. ABCP can be backed by a variety of collateral types but represents a sufficiently distinct structure from term securitisations that it warrants separate consideration. ABCP is a key source of short-term financing for a variety of underlying loan types (Chart 17). According to AFME, the European market for ABCP conduits was just over EUR 80 billion as at the end of Q4 2014. ABCP conduits provide a key alternative to bank funding for European SMEs.

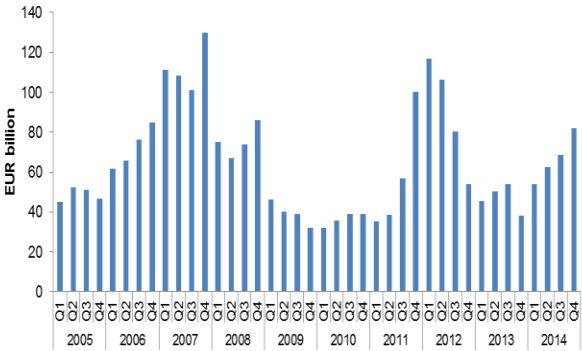
Similar to term securitisations, the outstanding volume and issuance of ABCP have dropped significantly post-crisis. According to BCBS-IOSCO,<sup>12</sup> at the end of 2013, outstanding ABCP in the US amounted to about a fifth of its 2007 peak. In Europe and Australia, the declines have been even more significant, with the outstanding volumes about an eighth to a tenth of the 2007 peaks. However, there has been some modest recovery in 2014 (Chart 18).

**Chart 17: European ABCP asset breakdown: Q4 2014**



Source: Moody's

**Chart 18: Historical quarterly European ABCP issuance, 2005-2014.**



Source: AFME

**(a) Effectiveness - ensuring differentiation of STS deals from more opaque and complex ones**

ABCP constitute an important source of short-term financing for European companies, particularly SMEs. The question is whether it is possible to distinguish between different types of ABCP structures and identify ABCP which may be deemed eligible to qualify as simple, transparent and standardised securitisations.

Complex and opaque ABCP structures such as arbitrage conduits and some SIV had a role in the global financial crisis. These structures tended to invest in securitisations of risky assets, rather than "real economy" assets, therefore representing complex re-securitisations. By contrast, simple ABCP structures have "real economy" assets such as trade receivables from SME companies, which performed well during the crisis. Thus, it appears possible to separate out those ABCP structures that are more stable, transparent and beneficial for the economy. Recognising this, the EBA is currently working on the identification of criteria able to achieve such a goal in order to isolate simple, transparent and standardised ABCP structures. This indicates that, as for term securitisations, there is scope to reduce stigma in the ABCP markets, through introducing STS criteria developed to the specific characteristics of this market.

**(b) Efficiency and impact for stakeholders**

The cost of introducing dedicated criteria for ABCP is likely to be minimal. Inclusion of ABCP criteria should support SME and broader corporate financing. Simple and transparent conduits have

<sup>12</sup> <http://www.bis.org/bcbs/publ/d304.pdf>

become a valuable short-term financing option in various Member States. Introducing them in the scope of STS would allow them to play a key role in alleviating the credit crunch currently suffered by European SMEs.

Strengthening a complementary funding channel for SMEs additional to banks would help protect vulnerable SMEs from experiencing problems relating to the banking sector in periods of financial stress. This is particularly important if one recalls that SMEs are typically short of funding alternatives to bank credit. From a financial stability perspective, a set of robust and detailed identification criteria need to be developed with the objective of avoiding the resurgence of arbitrage and leveraged structures such as SIVs.

### *6.2.3) Policy option 2.3: cover term, ABCP and synthetic securitisations*

This option would widen the scope of STS securitisation and introduce differentiated criteria for both ABCP and synthetic securitisations. At present, synthetic structures do not qualify for preferential treatment under the LCR and Solvency II delegated acts. The policy and regulatory work to date at EU (delegated acts/EBA advice) and global level (BCBS-IOSCO) also excludes synthetics structures from the scope. This has also been the approach of private sector initiatives such as the PCS label. However, as some synthetic structures may be used for supporting infrastructure and SME financing, this option is worth exploring (see also Annex 5 for further details on synthetics).

#### **(a) Effectiveness - ensuring differentiation of STS deals from more opaque and complex ones**

Synthetic structures mimic the transfer of ownership of the underlying assets/loans from the originating banks to the securitisation vehicle with a derivative contract, such as a credit default swap (CDS). This introduces an additional counterparty credit risk. The drafting of the CDS is usually not standardised and defines what risks are transferred and under what conditions. This introduces legal uncertainty and risks. Synthetic structures are therefore not simple or transparent. Their inclusion in the STS framework could be seen as contradicting the basic principles of the simple, transparent and standardised approach. This, together with the widely known role synthetic securitisation had in exacerbating the crisis (synthetic CDOs were the most common structure used to securitise subprime US mortgages in the run-up to the crisis), could undermine the credibility of the differentiation exercise and its ability to reduce the stigma surrounding securitisation.

Available data also suggests that EU synthetic securitisation has been substantially more likely to default than securitisation considered within the scope of STS. Synthetic CDOs have shown a default rate 19 times higher than STS products in 2007-2013. Even high-quality synthetics such as those issued by the EIF have generated 4 to 8 times higher losses than STS products.

For these reasons, international institutions (EBA, BCBS, IOSCO) have excluded synthetic products from the scope of STS securitisation and did not carry out work to identify specific criteria for synthetics. While in principle it may be possible to isolate a set of criteria that would allow a distinction between structures used for arbitrage and those intended for proper risk mitigation<sup>13</sup>, the additional complexity of such products requires further work in setting up this criteria.

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<sup>13</sup> The deals with an arbitrage purpose are normally sold by investment banks to replicate exposures to certain assets that they do not own and to give investors an indirect exposure to those assets. In deals with proper risk mitigation

Crucially, choosing this option would require the EU to move ahead of the global work and to disregard the advice received by the EBA sub-group on securitisation. EBA stated that it has reached the consensus to keep synthetic transactions out of the scope of the currently proposed STS framework, as more time is needed to develop criteria isolating simple and transparent synthetics from the rest. The subgroup acknowledged the relevance of this segment of the securitisation market for banking in the EU and is willing to engage in further work and analysis, for the potential development of an STS synthetic securitisation framework, after the technical advice on STS 'traditional' securitisation has been finalised and submitted. By contrast, international work on term and ABCP securitisations is mostly concluded and consensual criteria have been identified.

Considering the complexity of the structures involved, the data available, the lack of work on identifying criteria, and the high degree of consensus among supervisors and regulators, including synthetics in the STS framework would not be an effective option for fighting stigma and achieving differentiation in the securitisation markets.

**(b) Efficiency and impact for stakeholders**

On SMEs: originating banks often find that their SME customers do not want the bank to sell on their loans, so a traditional cash securitisation is not possible. Enabling synthetic transactions could in theory enable more investors to gain exposure to SMEs, which may in turn support SME financing. However, such exposure can be achieved via ABCPs.

On investors: as discussed, including synthetic structures within the scope of STS securitisation may send a mixed message, diluting the STS differentiation. In addition, synthetic structures do not allow investors to take control of the underlying assets in enforcement scenarios and they allow the risk of the underlying asset to be multiplied many times. This option may lead to less investor clarity and protection, with negative effects for overcoming stigma.

On issuers: while synthetic structures tend to be cheaper to set up than "true sale" securitisations, they provide only capital relief but no funding to the issuer. Therefore, only the revival of a "true sale" securitisation market would provide issuers with a tool to achieve both capital relief and funding.

**Stakeholders' view** – Two thirds of respondents consider criteria for short term securitisations should be developed. Most feel this criteria should differentiate between those structures devoted to real economy financing (e.g. multi-seller ABCP conduits) and those used for arbitrage (e.g. SIVs). Importantly, these views were expressed by the majority of investors (banks and non-banks) in securitisation as well as issuers and supervisors.

The majority of respondents (74%) agreed that synthetics may be currently excluded by the STS framework. The majority of respondents from industry associations (73%) and private companies (68%) are also of this view. Other categories (regulators, legislators, NGOs, private individuals) showed bigger majorities in favour of the exclusion. Annex 5 and 7 provide a detailed breakdown of replies by category of respondents.

intentions the owners of the reference assets are instead typically the originator and the assets are normally those originated as part of its ordinary business.

SMEs would remain out of the scope: ABCP and synthetic securitisations. Their importance suggests attention should be paid to their possible inclusion.

There are marked differences between these two products on a number of aspects important for their regulation. First, identifying simple, transparent and standardised ABCP conduits used to finance "real economy" assets such as SME loans seems to be an achievable goal. Indeed, EBA's work in this area is almost concluded; criteria for STS ABCP should be available before the summer. On the contrary, as discussed above, identifying STS synthetics is a harder task and no work on criteria has been done so far. Also, synthetics are intrinsically more complex products, meaning that a very strong case must be made to include them in the STS framework if the power of differentiation is to be preserved. Finally, available data shows EU synthetic products underperformed traditional STS securitisation. For these reasons, option 2.2 is preferable to option 2.3.

In view of the above, option 2.3 (**include term and ABCP securitisations**) is the preferred option. More evidence should be put forward before developing specific criteria for synthetic securitisations. However, the Commission would welcome further work to promote STS synthetic structures going forward.

	Option	Effectiveness	Efficiency	Impact on Stakeholders
2.1	Same scope as LCR and S2	(=)	(=)	(=)
2.2	2.1 + ABCP	(+) Stigma in the ABCP market reduced by introducing STS criteria developed to reflect its specific characteristics, as provided by EBA	(+) Introducing ABCP criteria may play an important role in alleviating the credit crunch currently suffered by European SMEs at minimal costs.	(=) Minimal costs of introducing criteria for ABCP.  (+) Simple and transparent conduits have become a valuable SME financing option in various Member States.
2.3	2.2 + synthetics	(-) Reduced anti-stigma effect with inclusion of more complex synthetic products; may be seen as contradicting the basic principles of the STS approach  (-) Lack of data and international work on criteria reinforcing the problem	(-) Reduced differentiation achieved with the introduction of products more complex in nature and widely seen as central in the global financial crisis	(+) Enable more investors to gain exposure to SMEs



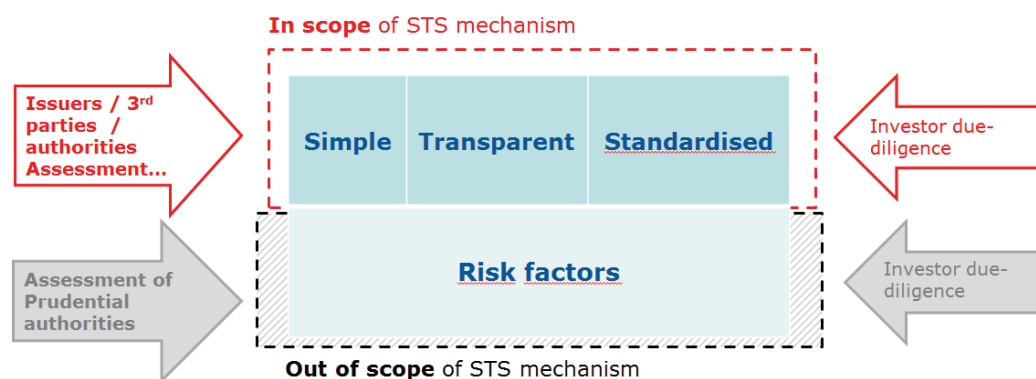
### 6.3) Section 3 - Ensuring compliance with STS criteria and consistency in implementation

This chapter describes and assesses three policy options to ensure compliance and consistency in the implementation of the criteria for STS instruments. Compliance will be crucial to the success of this initiative, as differentiation will only work if investors trust these new instruments. Irrespective of the decision taken on the options described in this chapter, **five general principles** must apply and contribute to the proper implementation of STS securitisation.

**a) Ensuring investors' due diligence (investors' responsibility).** The compliance mechanism is not intended to provide an opinion on the level of risk embedded in the securitisation. The scope of the compliance assessment should be strictly limited to criteria establishing the 'foundation approach', namely applying to the structure of the instrument. Investors should continue performing careful due diligence of STS instruments before investing. The financial crisis has shown that investor reliance on external credit ratings was excessive (cf. section 1.3.1). This trend led to a general relaxation of due diligence efforts by investors, notably in wrongly AAA-rated tranches.

The main purpose of this initiative is to reassure investors, giving them the transparency needed to assess STS products, without leading to any relaxation of their vigilance. This principle is essential to avoid 'moral hazard' situations where investors would be incentivised to reduce their scrutiny in assessing risks. The STS criteria are intended to make securitisation easier to analyse but not to be a substitute for due diligence. Increasing transparency and simplicity of the securitisation products, the STS initiative should allow investors, credit rating agencies and supervisors to assess with more precision the risk involved in the assets contained in securitisations. It follows that mechanistic reliance on credit rating to evaluate a deal's riskiness should be reduced.

**Chart on the assessment's scope**



**b) Responsibility to comply is first on originators.** Originators of STS instruments should be the first responsible in ensuring that a product fulfils the criteria. They will have to attest that the product is meeting all STS criteria. The onus would remain on originators as they are in possession of the most complete information regarding the transactions and are the best placed to make the determination on the characteristics of the instruments. In addition, if the originator is found liable for misleading/false attestation, sanctions on originators would be much more effective than sanctions on the *ad hoc* securitisation vehicle itself.

**c) Sanctions should be in place for non-compliance.** There is a need for appropriate sanctioning measures for participants in the STS market to set the right incentives. For originators, the measures would refer to normal supervisory sanctioning powers. Sanctions should be both proportionate and dissuasive to prevent investors being misled and could range from pecuniary fines to a prohibition against issuing new STS securitisation for a pre-determined period of time. There is also a need to consider the implications on investors (e.g. what happens if a securitisation is re-qualified as non-STS). Investors would no longer benefit from incentives attached to the 'STS category'. In this case, a transitional period could be foreseen for investors to prevent fire sales and pro-cyclical effects (avoiding 'cliff-edge' effects). Specific sanctions should also be applied to independent third parties involved in the process.

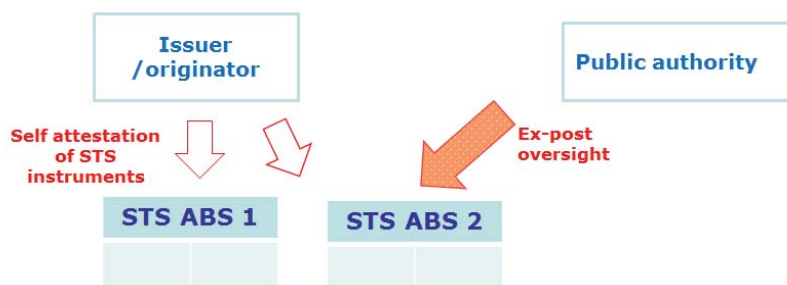
**d) Appropriate public oversight.** In the course of their regular assessments of prudential requirements (e.g. onsite/off-site examination of solvency requirements), supervisors will verify that STS instruments fulfil the criteria. This monitoring is important to ensure the accuracy of prudential ratios as 'STS' instruments may benefit from a differentiated prudential treatment. Specific monitoring arrangements should also be defined for originators of STS instruments – especially if they are not banking entities – and for potential third parties.

**e) The EU STS market should not be fragmented.** The vast majority of stakeholders (broadly represented in all categories – see annex 7) emphasise the need to ensure a consistent implementation of the STS criteria throughout the EU. To ensure investors' confidence and to avoid divergences across financial sectors and Member States, the set of criteria should be defined as clearly and objectively as possible. The credibility of this initiative should not be undermined by leaving the possibility to originators of entering into regulatory arbitrage or 'forum shopping' strategies. Thus an effective coordination mechanism involving the ESAs needs to ensure a clear and consistent interpretation of the criteria and of the prudential consequences. A potential 'race to the bottom' – as to attract new issuing structures in a given jurisdiction – would be detrimental to the whole project. This would in turn reinforce the current stigma and contribute to the fragmentation of the EU market. To ensure clarity and comparability for investors, transparency requirements should be applied to all securitisations.

- 6.3.1) Option 3.1 - Establishing a compliance mechanism based on self-attestation

Under this option, the responsibility for determining compliance with 'STS' criteria would lie with originator firms, which would be legally liable for attesting that all criteria were met. They would be required to disclose this attestation in the offer documents after an appropriate assessment of each of the criteria. Ex-post oversight would be carried out as in normal supervisory activities, the STS status of a securitisation (and its corresponding prudential treatment) would therefore still be subject to supervisory checks. Having the final word on the prudential treatment applied to a securitisation deal, the supervisor would also have the final word on the STS status of a deal.

### Chart for option 3.1



#### **(a) Effectiveness - ensuring differentiation of STS deals from more opaque and complex ones**

The attestation would establish legal liabilities for originators, thus affecting positively investors' views on STS securitisation. This approach would not eliminate investors' concerns about conflicts of interest that may affect the objectivity of originators in making their attestation. Originators would in fact have incentives to attest a deal is STS in order to reassure potential investors of its quality and allow them to enjoy a less burdensome prudential treatment. Misleading self-attestation is therefore the main risk of this approach. Nonetheless, false self-attestation would have serious consequences if unveiled: the sanctions and reputational damage suffered by the originator who attested a deal as STS while this has been rejected by the supervisor would provide a powerful incentive to comply.

This approach would also introduce detailed due diligence requirements by the part of investors on the underlying exposure packaged in the securitisation as well as on its structure. This would give a strong incentive to investors to take full responsibility for their investment decisions and thoroughly perform their due diligence, which is a key ingredient to a safe and sustainable market. Due diligence failings, which led to a mechanistic reliance of investors on credit ratings were indeed a key ingredient in the US subprime securitisation crash.

Supervisory checks on STS deals would continue to be performed on a regular basis, thus providing the overarching guarantee to the correct functioning of the system. As already pointed out, the final word on the STS status of a deal would be that of the supervisors.

This approach does not limit in any way the recourse to validation by third parties of a deal's STS status. If the latter will provide value added to investors and originators, they will require it and a market will arise. Giving third parties effective regulatory power (their decision would indeed impact profoundly the prudential treatment of deals) would require third parties to be regulated. It seems therefore more effective to regulate and supervise directly the securitisation deals than third parties "labelling" the latter.

Since securitisation transactions will likely involve banks, insurance companies and asset managers from different countries, in both the issuing and investing side of the deal, a number of supervisors will have to collaborate in the supervision work on securitisations. In some cases it may be the supervisor responsible for the issuer that may challenge an STS self-attestation. In other cases, it may be the supervisor responsible for the investor in such deal. In any case, the first check will be that of the investor, which will perform its due diligence on the STS criteria.

With a vast number of supervisors involved, it is important to limit legal uncertainty, ensuring consistency and speed of implementation of compliance decisions. With this aim, guidelines and technical standards will accompany the legislative initiative. These should ensure consistent interpretation and application of the STS criteria throughout the EU and its different financial sectors. Furthermore, in case of disagreement between supervisors on a specific securitisation deal, a mechanism of binding mediation by ESMA is envisaged.

## **(b) Efficiency and impact for stakeholders**

This option would increase originators' liability in case of wrongdoing. Originators have indeed shown in the responses to the public consultation (see "stakeholders' view" box on page 47) a strong preference for a system where responsibilities for STS attestation are shared with other parties (supervisors, independent third parties). In the absence of external checks on STS criteria, investors would have more incentives to perform robust and detailed assessments before investing. This option would limit moral hazard concerns as supervisors would only be involved ex post when reviewing prudential requirements. In addition, third parties could anyhow be involved in the compliance mechanism if the markets values such an involvement and is therefore willing to pay for it. This option will therefore not limit in any way the development of third party validation schemes. If these will provide value added to investors, these should require it and issuers should adapt.

This approach would have limited financial implications for investors and public budgets, as originators would have to support the self-attestation costs. In the absence of an ex-ante public intervention, this approach would not eliminate regulatory risks for investors as self-attested STS instruments could be re-qualified at a later stage. This option is seen as the most suitable by some supervisory authorities and central banks as long as appropriate public oversight is maintained.

### – 6.3.2) Option 3.2 - Option 3.1 with the involvement of third-parties

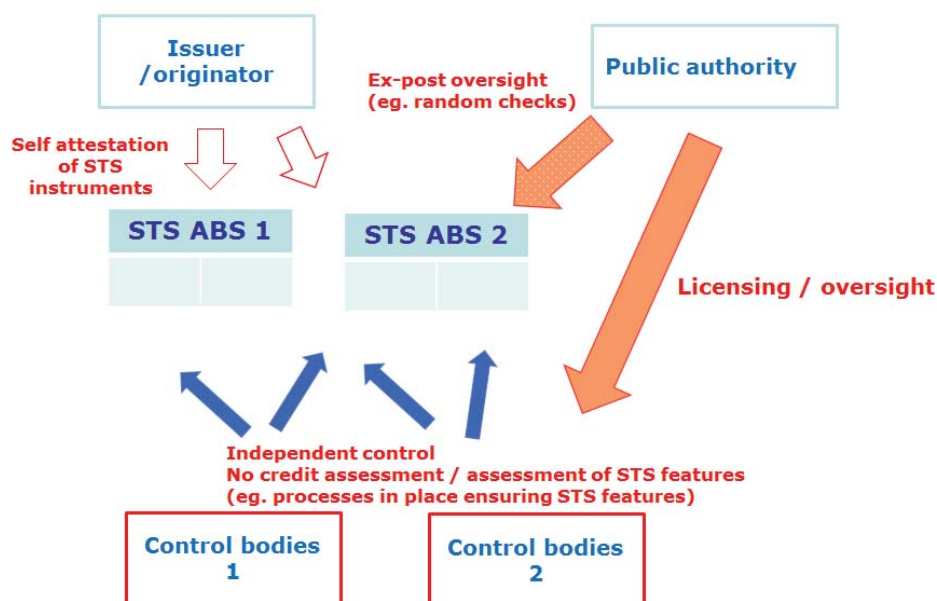
Similar to option 3.1, option 3.2 would rely on self-attestation by originators. It would however be complemented by the mandatory involvement of a third party, for certification and/or for management purposes. As investors may have concerns with the objectivity of the assessment performed by originators, they might view self-attestation as not sufficient to rebuild trust and overcome stigma. A control system relying on independent third parties could thus be established to prevent the issuance of non-compliant STS instruments.

This option could build on EU procedures in place to establish labelling in other areas<sup>14</sup>. 'Control bodies' could be designated to perform specific checks to assess compliance with STS criteria. These bodies would in turn respect requirements defining the nature, frequency and conditions of their controls. Potential conflicts of interest would need to be identified and managed carefully from the outset. Thus a specific oversight/licensing regime would have to be developed in order to authorise and monitor these independent bodies.

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<sup>14</sup> For instance for organic products (i.e. Council Regulation n°834/2007)

### Chart for option 3.2



#### **(a) Effectiveness - ensuring differentiation of STS deals from more opaque and complex ones**

Under option 3.2, the self-attestation would be complemented by an independent review of the STS criteria. This approach would help address objectivity concerns related to originators' assessments. An independent assessment of the securitisation would provide additional confidence to investors. These independent entities would have to fulfil requirements and detailed procedures to assess the STS instruments correctly. Appropriate safeguards would also be needed to prevent and address potential conflicts of interests with originators especially if third parties were to rely on "issuer-pays" models.

If properly informed and performed, third-party review would give additional assurance to investors in STS products. This would obviously increase effectiveness of the option. Nonetheless, the third-party review may induce lower scrutiny and due diligence by investors. This is precisely what happened in the build-up phase of the US subprime bubble.

#### **(b) Efficiency and impact for stakeholders**

This option would rely on private sector entities to perform independent assessments of STS securitisations. Several entities may enter into this market and competition could limit the costs for issuers. Involving private entities would make the mechanism more flexible and scalable to market activities. However, it would also imply additional costs.

The fees currently charged by "labelling" entities may offer a proxy for potential prices here (e.g. initial fees to award a label are typically around EUR 12 000 plus annual maintenance fees of around EUR 6 000). In addition, these entities would need to act under public oversight. Setting up such an oversight process would also imply additional costs. If oversight were to be done at national level, there would be costs for national supervisors, plus for ESAs for the necessary coordination. If oversight were to be organised at EU level, it would be more efficient, but would still need adding resources to the existing and constrained agencies.

Also, choosing third party validation as an option would not avoid the need for coordination among supervisors. In fact, with or without mandatory third party validation, securitisation transactions will likely involve banks, insurance companies and asset managers from different countries, in both the issuing and investing side. As such, a number of supervisors will have to collaborate in the supervision work on securitisations. The mechanism of binding mediation envisaged in the previous option would be needed under this option as well.

This approach would have similarities with other EU policy, in particular the procedures for EU labelling. Public oversight of the independent entities could also build on the approach developed for the registration and oversight of credit rating agencies. It is important to note that this approach may present similar issues and risks causing 'overreliance' on third parties such as credit rating agencies. Originators and investors are globally supportive of this option though, if they would share part of the liabilities with third parties. However, as the latter would often have limited activities and resource ("not for profit"), involving their liability may be an issue. In addition, investors would never get full regulatory certainty as the final prudential determination would remain in their hands.

- 6.3.3) Option 3.3 - Option 3.1 complemented by ex-ante supervisory checks on each issuance

Similar to option 3.1, option 3.3 would rely on the self-attestation of originators, complemented by ex-ante checks by supervisory authorities. This option would offer a higher degree of credibility due to the specific status of supervisory authorities. Furthermore, prudential authorities benefit from a wider overview of market practices and are less likely to be subjected to 'asymmetry of information' issues. Moreover, with no "issuer-pays" model, no conflicts of interest should arise.

This approval mechanism would be developed for each securitisation instrument. This would ensure that each individual instrument meets the STS criteria. Compared to the previous options it would, however, imply higher compliance costs for issuers as they would have to request that all issuances are checked. In this case, securities regulators would be better placed to perform this task.

Alternatively, an 'issuer-based approach' could be developed. This would mainly focus on processes implemented by originators/sponsors to ensure compliance with the STS criteria. This would result in a kind of license granted by authorities. The initial licensing/approval would be comprehensive and detailed but it would reduce the compliance costs for large originators as they would not be required to renew approval for every new transaction.

#### **(a) Effectiveness - ensuring differentiation of STS deals from more opaque and complex ones**

Instead of relying on independent third parties, supervisors would directly assess the compliance of STS securitisation. This approach would be the most powerful to ensure investors' confidence and overcome current stigma. This option would contribute to a sustainable development of the STS market while preventing the emergence of new financial stability risks.

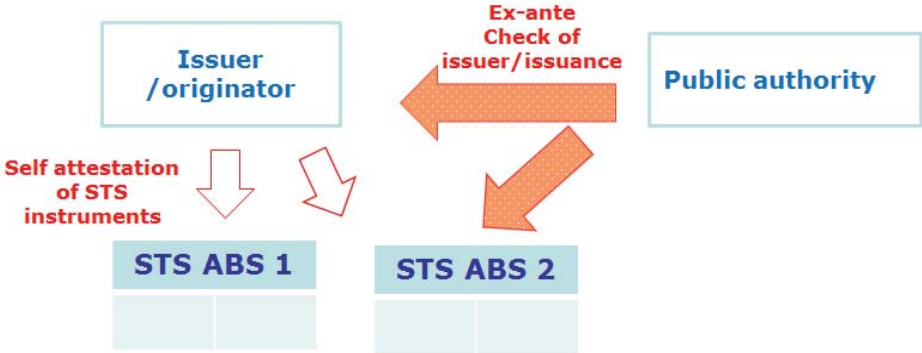
However, reliance on supervisors would reduce substantially investors' incentives to perform a thorough due diligence. Also, this would reduce the responsibility of issuers, as supervisory approval would be necessary. To counterbalance this, supervision would have to be very detailed and vigilant for every deal issued in the EU. This would require substantial new resources and EU coordination for supervisors relevant in the securitisation markets. While supervisory approval is necessary for prospectuses, because they concern products sold to retail investors, securitisation products would only be sold to institutional investors.

**(b) Efficiency and impact for stakeholders**

This option would be the most efficient in terms of ensuring the credibility of differentiation between different types of securitisation. However, it would require considerably greater public resources as supervisory authorities would have to establish new teams and develop new expertise to carry out these new tasks. A supervisory approach relying on a large number of authorities would generate risks of diverging interpretations and forum shopping in the absence of a strong coordination mechanism.

Supervisory authorities gave limited support for this option as they may face additional liabilities and are concerned with moral hazard issues. Investors and originators expressed appreciation for the legal certainty associated with a supervisory review, but a majority of them expressed concern with potential delay and a lack of timely reaction from public entities during the issuance process.

**Chart for option 3.3**



**Stakeholders' view** - Almost all respondents emphasise the importance of having appropriate enforcement and compliance mechanisms in place to build a sustainable STS securitisation market in Europe. Views are split on the best ways to ensure this objective.

Some respondents (most regulators and the supervisory community) argue that the onus of ensuring compliance with the STS criteria should be mainly on originators and investors. They argue that originators should self-attest that a given instrument meets the identification criteria. They consider this approach as the best way to avoid excessive reliance on assessments delivered by third parties, to reduce "moral hazard" risks and ensure proper due diligence by investors. Indeed, the vast majority of respondents underline the importance that investors make their own creditworthiness assessment and do not rely mechanistically on external credit ratings. Credit ratings should be only one element amongst other to be considered in the overall assessment.

Other stakeholders (mostly market participants and industry associations) argue that recourse to external parties is essential to overcome the current stigma attached to securitisations and to build investors' confidence in STS instruments. Within this category, some suggest that public authorities could be directly involved in providing this assessment, while a significant number of respondents support the involvement of private bodies acting as "certifiers" or "control bodies".

A number of stakeholders across all categories emphasise the importance of consistent interpretation of the STS criteria in all EU Member States, especially given the mobility of securitisation structures and originators. The responsibility for determining whether a particular instrument complies with STS criteria needs to be clearly assigned. The mechanism should ensure consistency in its application. A consistent EU approach has to be implemented in order to ensure a single market for STS. In order to achieve such objectives, several respondents suggest that STS assessment/certification should involve a European authority (e.g. an ESA).

#### – 6.3.4) Impact summary and conclusion

The attestation by originators (option 3.1) would ensure that originators remain liable for issuing instruments meeting STS criteria and should incentivise investors to perform appropriate due diligence. Issuers should face appropriate sanctions if they make wrong declarations. This approach would be combined with option 2 but on a non-mandatory basis. Originators would still have the possibility to ask for a review by an independent third party if they consider that this would provide added value.

In addition, to ensure a clear and consistent interpretation of the STS criteria and of the prudential consequences attached to this category, an effective coordination mechanism between supervisory authorities, involving binding mediation, is needed at EU level (ESMA, EIOPA and EBA). This would help ensure a high degree of consistency and lead to a common EU approach in the interpretation of STS standards.



<b>Compliance mechanism</b>				
3.1	Establishing a compliance mechanism based on self-attestation by originators	(=) Stigma would be slightly reduced and trust based on reputation of issuer and potential sanctions  (++) Reduced "moral hazard" risks as incentives for due diligence remain high	(+) Limited costs for public finance and public authorities resources.	(+) Better alignment of incentives between originators and investors (liability for potential risks) (-) Investors would not benefit from external support in assessing STS products.
3.2	Option 3.1 with the involvement of third-parties	(+) Stigma would be reduced as independent assessment of STS criteria will be available  (--) Increased "moral hazard" risks as incentives to investors' due diligence are weaker	(+) Higher flexibility and scalability of the process (-) Additional costs for originators and need to introduce public oversight for 3rd parties	(+) Would provide additional confidence to investors in assessing STS instruments  (-) Even with 3 <sup>rd</sup> parties involved, final prudential decisions would remain a competence for supervisors
3.3	Option 3.1 complemented by ex-ante supervisory checks on each issuance	(++) Strong and positive effects on current stigma  (--) Increased "moral hazard" risks as incentives to investors' due diligence are weaker	(-) Implication on public authorities resources	(=) Greater legal certainty for investors-originators but concerns on the scalability and timeliness of the mechanism (-) Potential reputation risks for public authorities

#### **6.4) Section 4 - Banking and insurance prudential treatment**

This section examines the effectiveness of the identified options in achieving the specific objective of 'differentiating STS products from more opaque and complex ones' as well as the general and the specific policy objectives.

The current framework for credit institutions investing in securitisations has been in force since 2007, implementing the 'Basel II' Accord. It has only been subject to small targeted changes in the 2013 Capital Requirements Regulation ("**CRR**"), which provides for specific credit risk capital charges for exposures to these instruments.

Under the CRR, a "securitisation" is defined by reference to two key features: the stratification or tranching of the credit risk associated with a pool of assets and the subordination between the securitisation "tranches" such that the performance (and risk) of the tranching securitisation exposures is dependent upon that of the underlying pool of asset and the relative position of the tranche in the payment waterfall.

These two key characteristics are the main drivers for the dedicated capital treatment for securitisation exposures. Other specific features that the current framework takes into account include the so-called "model risk" which is more relevant for securitisations than for other types of transactions because of the specific aspects of the securitisation structure (e.g. the correlations of underlying exposures, bespoke cash-flow waterfalls, trigger mechanisms that can alter cash flows, etc.).

The calculation of capital requirements is underpinned by the following key features of the framework:

there are two overarching types of approaches: the standardised and the internal ratings based approach. For their investments in securitisations, banks have to use the same type of approach that they are allowed to use to calculate credit risk for direct investments in the relevant underlying securitised asset;

within each type of approach, there is in turn a so-called "hierarchy of approaches". This hierarchy requires banks to always apply a "ratings based approach" where the securitisation tranches have been given an external rating. The framework allocates capital requirements on the basis of the external rating given to each tranche, which for the highest rated senior tranches must be no less than 0.56 Euro per 100 exposure under the Internal Ratings Based Approach and 1.60 Euro under the standardised approach. For mezzanine and junior tranches, risk weights increase as ratings lower, down to full deduction (100 Euro capital for 100 Euro of exposure); this is typically required for the "first loss piece" or most junior tranche.

for unrated securitisation tranches or positions (which is very often the case of the first loss piece in a rated transaction), the investor bank must either deduct its investment from capital or, if certain conditions are met, may be able to apply one of the alternative approaches to avoid deduction. For example, banks using the internal ratings based approach may use the "supervisory formula", in which the input to the calculation of capital requirements is determined by a formula provided for by the framework itself which has regard to the capital that must be held in relation to the underlying assets before being securitised. However, the conditions to allow the use of the supervisory formula are fairly stringent and require previous permission of the bank's supervisor.

The current framework, hence, treats all securitisation transactions in the same manner, relying on the tranche external rating (and regardless of the structural features of the transaction) as the key factor to allocate regulatory capital requirements.

However, certain securitisation transactions characterised by complex structures, bad underwriting practices, excessive leverage and maturity transformation performed significantly worse than the models underlying the external rating calibrations had assumed at their inception. These

securitisation transactions suffered heavy and sudden downgrades during the 2007-08 financial crisis which resulted in a rapid increase of capital requirements for banks that had invested in them. Although STS securitisations performed strongly compared to those more complex transactions, the market as a whole became tainted and stigmatised and issuance levels slowed down to a fraction of the pre-crisis levels from which it has not recovered yet.

In December 2014, the BCBS adopted a revision of the securitisation framework with a view to addressing some shortcomings of the Basel II standards<sup>15</sup>. As part of that work, the Committee is discussing the merits of a dedicated framework for STS products reflecting their lower complexity and greater transparency. Quantitative work on a potential calibration for STS securitisations is ongoing and the Committee might at best disclose available options for public consultation by the third quarter of 2015. The calibration of STS securitisation is also being explored at EU level and the EBA is expected to finalise their advice to the Commission in the coming weeks. The industry has singled out regulatory capital treatment of securitisations as the most influential factor in the efforts by public authorities to encourage a recovery of these markets.

For the purposes of this Impact Assessment, we have assumed the following two policy options regarding the regulatory capital treatment for STS securitisations:

*6.4.1) Option 4.1: - no change to the existing securitisation framework as set out in the CRR*

Under this option, no changes would be made to the current securitisation framework in the CRR. Accordingly, all securitisations (both STS and non-STS) would continue to be subject to the same prudential treatment.

**(a) Effectiveness - ensuring differentiation of STS deals from more opaque and complex ones**

The disadvantage of maintaining the status quo would be that, as noted above, the current securitisation framework has proved to be insufficiently risk sensitive to take into account properly the risks that materialised during the crisis for non-STS securitisations. The absence of a framework setting a clear distinction between STS and non-STS transactions would not help remove the stigma currently attached to all securitisations.

**(b) Efficiency and impact for stakeholders**

This option would have the benefit of not imposing transitional costs or additional burden on market players. Banks would avoid the costs of having to adapt to a new regulatory environment, while supervisors would not have to adopt new supervisory approaches.

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<sup>15</sup> These evolutions address especially i) the mechanistic reliance on external ratings, ii) increase risk weights for highly-rated securitisation exposures; iii) reduce risk weights for low-rated senior securitisation exposures; iv) reduce cliff effects; and v) enhance the risk sensitivity of the framework. See <http://www.bis.org/bcbs/publ/d303.htm>

6.4.2) Option 4.2: - develop a preferential capital treatment for STS securitisations

The Commission would amend the existing requirements in the CRR differentiating between STS and non-STs securitisations for regulatory capital purposes, with a risk-sensitive treatment for the former (e.g. lower capital requirements) relative to the latter. The new prudential treatment would be based on the advice to the Commission provided by EBA on July 6, 2015.

On the basis of both theoretical arguments and empirical evidence over the default and loss performance of different securitisation instruments throughout the crisis period, the EBA advises the Commission to re-calibrate the new Basel 2014 Securitisation Framework for STS securitisation positions in the following way:

lower the risk-weight floor (i.e. the minimum capital requirement) for senior STS securitisation positions from 15% (1.20 Euro per 100.00 Euro) value to 10% (0.80 Euro per 100.00 Euro)<sup>16</sup>; and

reduce the capital requirements under all 3 approaches of the new Basel framework (IRBA-ERBA-SA) reflecting the greater transparency and simpler structure of STS securitisations.

Focusing on the approaches based on external ratings, the table below compares the capital requirements of the current CRR/Basel II with the capital requirements under the new Basel framework and the EBA approach for STS securitisations. It is worth noting that the new Basel framework (and accordingly, the EBA approach) gives priority (and provides incentives) to the use of the IRBA approach whenever possible. However, IRBA capital requirements cannot be directly compared with the current CRR/Basel 2 capital requirements since these mainly depend on external ratings.

**Table 1: Examples of capital requirements in Euro per 100.00 Euro of securitisation exposure (senior position)**

	CRR/Basel II		Basel new (ERBA) (all banks)	EBA approach for SST (ERBA) (all banks)
	SA banks	IRB banks		
Rating	Capital charge	Capital charge	Capital Charge	Capital charge
AAA	1.60	0.56	1.20	0.80
A+	4.00	0.80	3.20	2.00
BBB+	8.00	2.80	6.00	4.40
BB+	28.00	20.00	11.20	8.40
B+	100.00	100.00	20.00	16.80

<sup>16</sup> For non-senior tranches under the ERBA the floor would be lowered from 20% to 15%

Under all three approaches (IRBA-ERBA-SA) the lowest possible capital requirement (80 cents per 100 Euro of exposure) remains slightly above the current CRR levels under the IRB approach (56 cents per 100 Euro of exposure/tranche rated AAA and 64 cents per 100 Euro of exposure/tranche rated AA). However, it should be noted that:

- this is in line with the capital requirements of 80 cents per 100 Euro of exposure for AAA rated covered bonds under the CRR and would ensure a level playing field between comparable funding instruments, as advocated by the majority of market participants as well as regulators;
- such increase would be largely compensated by the substantial reduction of capital charges for less well-rated tranches. For instance, the ERBA capital requirement for BB+ rated tranches capital requirements would be more than halved when compared with capital requirements under current CRR/Basel II. This would also mitigate the risk of (pro-cyclical) cliff effects; and
- finally, in all cases where banks are allowed by their supervisor to use the IRBA, they would benefit from generally lower requirements than under the ERBA, although the 0.80/100 Euro floor would apply in any case. According to EBA calculations on a sample of securitisations issued in the EU in the period 2000-2014, the use of the IRBA for STS would imply a reduction (on average) of the magnitude of 83% when compared to the current CRR treatment (IRB approach).

The increase in capital charges for non-STS securitisations which results from the revised Basel framework relative to the current CRR would enable the Commission to address the consensus among supervisors about the insufficient conservativeness of the current framework for non-STS securitisations. From the industry's perspective, this increase would be largely compensated by the decrease of capital charges for STS securitisations (which is the large majority of current and prospective EU securitisations) and address concerns regarding the alleged excessive conservativeness of the new Basel framework for these securitisations only.

Accordingly, adopting the approach proposed by the EBA would strike the right balance between the need to protect financial stability and to encourage economic growth through a safer, more transparent and sustainable securitisation market and therefore it is suggested as the way forward to implement option 4.2.

#### **(a) Effectiveness - ensuring differentiation of STS deals from more opaque and complex ones**

A framework that provided for a clear distinction between STS and non-STS securitisations by giving a preferential capital treatment to the former would have a number of positive effects, namely:

the resulting securitisation framework would be more risk-sensitive and better balanced: preferential capital requirements would be available for more transparent and simpler structures, which are less risky and typically back the flow of long term finance to the real economy (as opposed to highly risk and speculative investments);

capital requirements would incentivise banks to comply with differentiated STS criteria; such criteria would promote better behaviour and market discipline at all stages of securitisation transactions (e.g. structuring, execution...), thus reducing overall risk in the system and strengthening financial stability. Indeed, the STS criteria are designed to encourage simple, transparent and comparable securitisation structures with a sound and robust execution by all parties involved, features which the current framework fails to address;

investors would be encouraged to re-enter the securitisation market, as a differentiated framework would send a clear signal that risks are now better calibrated and, therefore, the likelihood of a systemic crisis reoccurring would have been reduced;

this option would reduce the negative effects of sovereign rate caps (see section 3.2.2 for a discussion of the problem). This is because for STS products the capital charges would be lower for all ratings and increasing more gradually as the rating declines. Therefore, an STS securitisation issued in a country where a sovereign rating cap is having an impact at present would face a smaller capital charge than it does currently.

### **(b) Efficiency and impact for stakeholders**

A preferential regulatory capital treatment for STS securitisations would require a recalibration of the current capital requirements, which the EBA is currently assessing with a view to putting forward a proposal to the Commission in short order. The recalibration could be limited to the most senior tranche of each STS-compliant transaction, that is, only such a tranche would be STS for regulatory capital purposes. Alternatively, the recalibration could be carried out across the whole waterfall structure, such that all tranches of an STS-compliant transaction would receive a beneficial regulatory capital treatment compared to non-STS securitisations. The latter option would be more likely to encourage the broadening of the investor base for STS securitisations, insofar as banks would not be unduly penalised from a regulatory capital perspective for holding mezzanine positions.

The obvious disadvantage of this option would be the transitional costs that would be avoided with option 1.

### **Prudential treatment of insurers' investments into STS securitisation**

In the context of the Solvency II standard formula, the following options regarding differentiated capital requirements for insurers' STS versus non-STS securitisation positions can be considered:

**option 4.3 (baseline):** keep the Solvency II standard formula unchanged, which **already provides for a tailored treatment** of insurers' investments in senior tranches of STS securitisation deals, but treats other tranches just as any non-STS securitisation.

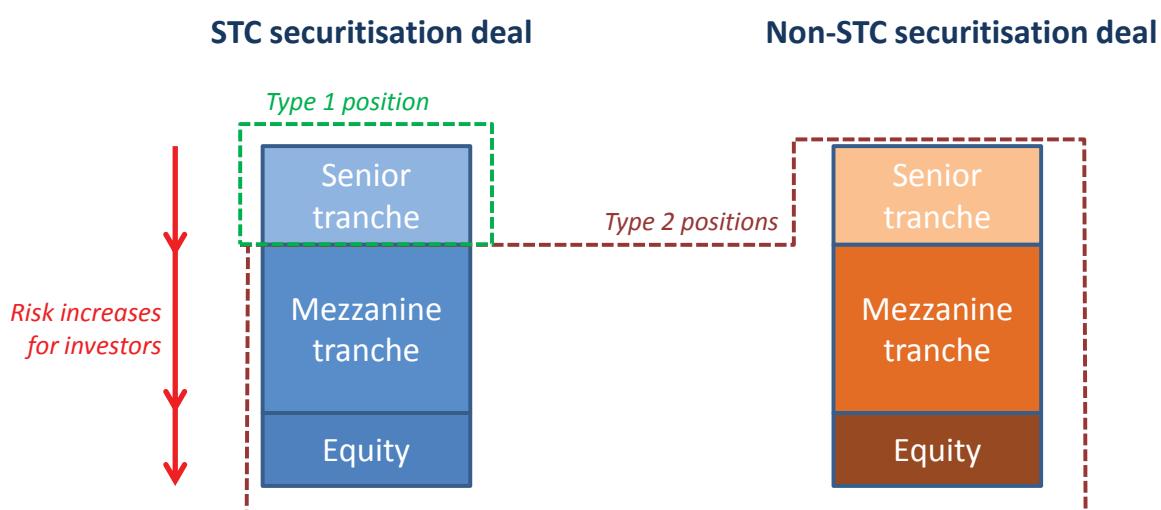
**option 4.4 :** refine the existing approach, without changing the scope of the differentiated approach (i.e. improve the risk-sensitivity of the calibrations for senior tranches only).

**option 4.5:** (in addition to the actions in 4.4) extend the differentiated approach to insurers' investments in **non-senior tranches** of STS securitisation deals (so that non-senior tranches of STS securitisation deals are not treated like any tranche of non-STS securitisation).

### 6.4.3) Option 4.3 – baseline: no further action

The Solvency II delegated act<sup>17</sup> already includes a definition of STS securitisation, which affects the amount of capital that insurers must hold against the risk of fluctuation of prices of such investments (spread risk). For the purpose of calculating capital requirements, the delegated act divides insurers' investments into securitisation in two types: Type 1 securitisation positions, which only include the most senior tranches of STS deals, and Type 2 securitisation positions, which cover everything else, including non-senior tranches of STS deals and generate significantly more onerous capital requirements (see chart below).

Chart 19: allocation of tranches between the existing Type 1 and Type 2 positions in Solvency II (Type 2 is more onerous).



#### (a) Effectiveness - ensuring differentiation of STS deals from more opaque and complex ones

Stakeholders (bank issuers, insurance companies as well as supervisors) have criticised the existing division for not being risk sensitive enough, and preventing insurers from fully supporting the growth of the STS securitisation market, given that insurers would rather be incentivised to invest in top tranches.

Stakeholders have nevertheless welcomed the fact that capital requirements for Type 1 positions were set no higher than those applicable to the typical underlying assets (unrated loans) on the basis of a look-through reasoning. Indeed, senior tranches are mechanically less credit-risky than the whole of the underlying pool of securitised assets if they were held directly. But stakeholders complain that the delegated act does not entirely follow the logic of this look-through approach, as certain loans held directly, such as residential mortgage loans, would still enjoy a less onerous treatment than the senior tranche of an STS securitisation backed by the same loans.

<sup>17</sup> Article 177 of Commission Delegated Regulation (EU) 2015/35

The limited differentiation present in the current approach (baseline) can therefore be improved in two ways: either refine the treatment of Type 1 securitisation (namely by fixing the inconsistencies in the look-through approach) without changing the dividing line between Type 1 and Type 2 or amend the Solvency II delegated act more substantially by providing a differentiated treatment for all tranches of STS securitisation.

*6.4.4) Option 4.4 – modify treatment for senior tranches only*

This policy option would improve the risk sensitivity of the existing calibration for Type 1 securitisation positions in 3 ways:

fixing the inconsistencies in the look-through approach between the capital requirements applicable to senior STS tranches and the underlying assets;

introducing some risk-sensitivity regarding external ratings, as the current capital requirement is identical for positions rated AA, A and BBB. This results from capping the calibration at the level of that applicable to underlying assets (3%) which was decided at the time of adoption of the delegated act<sup>18</sup>. Risk factors could be interpolated between the existing figures for AAA and BBB rated securitisation positions as shown below.

Credit quality step	0	1	2	3
Risk factor, per year of duration	2.1 %	3 % → <u>2.4 %</u>	3 % → <u>2.7 %</u>	3 %

the increase of risk factors with duration could be mitigated compared to the current proportional increase<sup>19</sup>. The same "kinking" pattern as for the risk factors applicable to corporate bonds could be translated in the risk factors for securitisation. However, this amendment may have a limited impact given that securitisation instruments are seldom very long-dated.

**(a) Effectiveness - ensuring differentiation of STS deals from more opaque and complex ones**

This option is helpful in fostering differentiation and supporting the development of the market for STS securitisation products, but only partially: insurers would be mostly incentivised to invest in senior tranches, with non-senior tranches not enjoying as large an investor base. From the point of view of a securitisation issuer, non-senior tranches would remain as hard to place as they are now

<sup>18</sup> See the Solvency II impact assessment report, section 5.1, preferred policy option #4 [http://ec.europa.eu/finance/insurance/docs/solvency/solvency2/delegated/141010-impact-assessment\\_en.pdf](http://ec.europa.eu/finance/insurance/docs/solvency/solvency2/delegated/141010-impact-assessment_en.pdf)

<sup>19</sup> The Solvency II capital charges for spread risk on bonds and loans are higher for instruments with longer maturities. The charges do not increase linearly with maturity though; instead the additional charge per year of maturity reduces in order to avoid excessive capital charges for longer maturities. The spread charge for securitisations, in contrast, currently increases linearly with maturity.



(where the overwhelming majority of non-senior tranches are retained by the issuer). Since the almost totality of the risk is borne by non-senior tranches, issuers would continue to be unable to transfer risk to investors. Securitisation would therefore remain confined to a tool to raise funding but not a risk-transfer tool. With cheaper sources of funding available (central bank repo operations, covered bonds..), securitisation will continue to be a scarcely appealing technique for EU issuers.

#### **(b) Efficiency and impact for stakeholders**

As all the refinement to the calibration under this option can be done relatively quickly, the option does not require a major administrative and legislative effort. Nevertheless, in terms of impact, the benefits of this option (namely, fixing the look-through approach) would be limited and accrue mostly to the market for residential mortgage backed securities. There is no impact on insurers in terms of administrative burden or costs.

#### *6.4.5) Option 4.5 – modify treatment for senior and non-senior tranches*

This policy option addresses the criticism that treating non-senior tranches of STS securitisation deals in the same way as any other non-STS securitisation is not appropriate. It is a more ambitious option since it would require calibrating from market data a specific set of risk factors for such non-senior STS tranches. The calibration would follow a look through approach based on the capital charge for the underlying exposures increased by a non-neutrality factor to capture the model risk of the securitisation. The capital charges of the underlying exposures would be based on the current Solvency II delegated act and the non-neutrality factor would be aligned with the average factors from the banking approach based on the EBA advice.

#### **(a) Effectiveness - ensuring differentiation of STS deals from more opaque and complex ones**

By creating a broad investor base for all tranches (not only senior), this option would address the concern that if insurers only invest in senior STS tranches, this may not be enough to stimulate the development of STS securitisation deals. The problems for non-senior tranches described above would indeed be tackled.

Furthermore, since STS structures would present lower modelling risk and thus render all tranches (senior and non-senior) less risky with respect to similar tranches in non-STS structures, recalibrating all tranches capital charges would better reflect the risk profile of the securitisation deal.

#### **(b) Efficiency and impact for stakeholders**

By allowing STS securitisation to perform both of its key roles (funding and risk transfer), this option would allow the differentiation to have a tangible effect, fostering the emergence of an STS market able to attract (and transfer risk to) non-bank investors as well, thus helping the EU economy to have a more balanced (bank and non-bank) funding structure. A more balanced funding structure would reduce risks to financial stability as the effects of a financial shock on the access to credit of EU firms and households would be less immediate and strong.

The higher effectiveness of this option compared with the previous offsets the higher costs in terms of time and effort required to design a specific calibration for non-senior tranches of STS products. There is no impact on insurers in terms of administrative burden or costs.

**Stakeholders' view** - With few exceptions, the overwhelming majority of respondents are in favour of differentiating the prudential treatment of STS securitisations versus other securitisations. Two views (more or less equally represented) were expressed as to how to achieve such differentiation. A first group led by industry representatives opposes the transposition of the new BCBS framework and is convinced that it would penalise securitisation and unduly discriminate vis-a-vis other debt instruments (e.g. covered bonds). A second group (mainly Public Authorities and investor associations) judges positively the use of the new BCBS framework (modified with a more favourable treatment for STS securitisations) as baseline for the review of CRR provisions to ensure, inter alia, global consistency. A minority of respondents (mainly including issuers/originators and investors) think that CRR provisions in most cases adequately address risks attached to securitisations and would like to see no (or marginal) amendments implemented. In general stakeholders belonging to this group support a correction of the “one-size-fits-all” approach to take into account the specific features of STC securitisations;

There is also vast support for improving risk-sensitivity in the Solvency II formula from all categories of respondents (investors, issuers and supervisors). It is widely felt that calibrations are too onerous. A vast majority of respondents considers that calibrations applied to "Type 2 securitisation positions" are punitively high, because they are partly based on US subprime data. It is argued that such calibrations shrink significantly the investor base for STC securitisation. It is unanimously felt that STC qualification should apply at transaction level, not at tranche level. However, there is a wide variety of (sometimes contradictory) suggestions to achieve this. Views are split as to how granular calibrations should be (there are concerns about complexity of the standard formula).

Most stakeholders consider that the introduction of a credible STS framework should in itself help expand the institutional investor base for EU securitisation beyond insurance companies. Please see Annex 7 for an extensive summary of responses to the public consultation.

#### *6.4.6) Impact summary and conclusion*

Taking into account the weaknesses of the current banking prudential framework to calibrate properly the risk of non-STS securitisations and the potential advantages of developing a preferential capital treatment for STS transactions, option 4.2 with a full recalibration of all tranches, based on the EBA advice received by the Commission on 6 July 2015 should be followed.

Similar considerations are valid for the capital treatment of insurers' exposure to securitisation. While the no action option (4.3) would entail some differentiation of STS products, this would be far too limited to render STS products recognisable and economically viable to invest in. As things stand, insurers would still be incentivised to invest in top tranches alone. This problem would therefore not be eliminated by improving the capital treatment of senior tranches of STS deals alone (option 4.4). Recognising that simplicity, transparency and standardisation are features of a deal and not just a tranche, recalibrating capital charges for all tranches of an STS securitisation would be more justifiable and, even more importantly, it would create a broad non-bank investor base for all tranches and allow STS securitisation to perform both of its key roles (funding and risk transfer).

This option is more effective than the previous one, as it would incentivise insurers to invest in all tranches of STS products, depending on their risk appetite, with risk-sensitive calibrations for each level of tranches.

Should the recalibration of prudential capital charges lead to overheating of the securitisation market, macro prudential tools can be used to reduce issuance and cool down the market. For example, loan-to-value limits could be tweaked for mortgage markets. These represent the vast majority of issuance and outstanding amounts in securitisation markets. Slowing down their growth would thus go a long way in reducing risks to financial stability arising from eventual overheating. As noticed in the introduction, the initiative is likely to impact Member States in different degrees, depending on the development and structure of their markets, as well as their macroeconomic environment. For this reason, (if needed) macro prudential tools should be set on a national basis.

	<b>Option</b>	<b>Effectiveness</b>	<b>Efficiency</b>	<b>Impact on Stakeholders</b>
4.1	No change to the existing securitisation framework as set out in the CRR	(--) the insufficiently risk-sensitive framework will not differentiate STS from non-STS products	(=)	(=) no transitional costs or additional burden imposed on market players
4.2	Develop a preferential capital treatment for STS securitisations	(++) preferential capital requirements for more transparent and simpler structures	(+) costs of recalibration and transition counterbalanced by recognition of STS risk-profile in prudential treatment	(-) recalibration and transitional costs for supervisors, issuers and investors  (+) foster the reemergence of the STS market
4.3	No further action on Insurance prudential treatment	(=)	(=)	(=)
4.4	Modify treatment for senior tranches of STS products	(=) Unable to sell non-senior tranches, issuers continue to be unable to transfer risk to investors, STS products remain hard to invest in for insurers	(=) Limited costs and limited benefits, accruing mostly to RMBS market	(=) Insurers further incentivised to invest in senior tranches only

4.5	Modify treatment for all tranches of STS products	(++) Creates a broad non-bank investor base for all tranches allowing securitisation to perform its funding and risk transfer roles	Higher effectiveness offsets higher costs to design a specific calibration for non-senior tranches of STS products.	Fosters the emergence of an STS market able to attract non-bank investors as well
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### 6.5) Section 5 - Standardisation and harmonisation

This chapter describes and assesses three policy options aiming at fostering the standardisation of processes and practises as well as tackling regulatory inconsistencies. The absence of standardisation is frequently perceived as one of the main obstacles to the development of securitisation markets within and across the EU. The vast majority of stakeholders of all categories (see annex 7) express their support for addressing current inconsistencies in the regulatory framework and for further standardisation of securitisation in the EU. This would increase legal clarity and comparability across asset classes, it would ease investors' assessments and it would facilitate and reduce issuance costs for originators. This standardisation may also help supervisory authorities to monitor the risk profile of financial intermediaries and macro-prudential risks. Greater standardisation of the instruments would also increase market liquidity and help the development of secondary markets.

#### Description of policy options to foster standardisation and address inconsistencies

This section considers three main policy options to foster standardisation and address regulatory inconsistencies. The first option is the baseline option, where the EU would not intervene and rely solely on reforms adopted in the past years and on what market operators and Member States may decide to implement. The second option would result in an EU legislative initiative setting up a single consistent EU securitisation framework based on existing EU legislation defining securitisation, transparency, disclosure, due diligence and risk retention rules. Building on this horizontal legislation, the EU would encourage market participants to develop further standardisation of securitisation documentation. The third option would go further than the second option adopting – on top of the horizontal legal instrument - an EU securitisation framework harmonising Member States' legal frameworks for securitisation vehicles (including modalities to transfer assets to SPVs and the rights and obligations of note holders).

##### 6.5.1) Option 5.1 – Baseline - No EU action

Under this option, the main focus would be on finalising the implementation of the agreed reforms and addressing the remaining issues such as completing some of the missing pieces of the securitisation framework. It would notably imply finalising the establishment of a centralised website collecting and disseminating detailed information of all securitisation instruments as

required by the Credit Ratings Agencies Regulation (CRA3, article 8.b)<sup>20</sup>. Having this infrastructure being operational in a reasonable period of time is key to ensure transparency. This option could also include the development of additional templates to collect data of specific securitisation market segments which are not yet covered by the CRA3 Regulation.

Under this option, other limited initiatives would also be envisaged such as implementing risk retention rules in areas where this requirement is not yet in place (for example for mutual funds, under UCITS) and adjusting the modalities of implementation (cf. EBA recommendations of December 2014).

**(a) Effectiveness - Fostering standardisation and addressing inconsistencies.**

This option would help in reducing some regulatory inconsistencies and fixing a limited set of issues such as impediments to the development of a centralised website for securitisation instruments. The main assumptions beyond this approach are that i) the effects of past reforms (e.g. Solvency II, Liquidity Coverage Ratio delegated acts, CRA3) have still to materialise and that ii) the market will organise itself in the medium to long term to promote standardisation. However, since the agreed reforms tackle only some sector-specific standardisation issues, their effect in reducing inconsistencies across financial sectors and foster standardisation will remain very limited. Administrative burden associated with current inconsistencies and lack of standardisation would continue representing a considerable hindrance to a sustainable revival of securitisation. Thus, this option scores poorly in achieving the standardisation objective.

**(b) Efficiency and impact for stakeholders**

This approach would imply limited costs for public finance. No budget has indeed been foreseen for the setting up of the centralised ESMA securitisation website, casting doubts of the feasibility of such website. Coordination costs for the private sector are likely to be significant, whereas potential long terms benefits would remain uncertain. In addition, the administrative burden will remain important as most of the current inconsistencies will not be tackled (cf. current inconsistencies regarding originators' disclosure and investors' due diligence requirements as highlighted by the ESAs Joint-Committee report). The expected impacts on stakeholders will remain limited. Most investors/originators as well as supervisory authorities are concerned with existing overlaps and inconsistencies across financial services regulations and sometimes within the same sector (e.g. on disclosure/due diligence requirements, as highlighted in the Joint-Committee report). These elements and the lack of standardisation would not be addressed by potential market initiatives.

*6.5.2) Option 5.2 – Establishing a single consistent EU securitisation framework and encouraging market participants to develop further standardisation*

Under this option, the objective would be to develop a uniform set of criteria and rules underpinning the numerous pieces of EU legislation dealing today with securitisation. This approach would not be limited to 'STS securitisation' but encompass all securitisation instruments. It would notably introduce a list of common definitions (e.g. securitisation, special purpose entities,

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<sup>20</sup> As of today, there are important impediments to be fixed in order to have this website effective. Specific efforts should notably be performed to make this website economically viable as there is currently no funding to allow this website to be developed.

originator...) applying across EU financial sectors. This single legal instrument covering all securitisation instruments, would also include common provisions governing transparency, disclosure, due diligence and risk retention requirements. This horizontal text would build on existing EU rules and address as much as possible current inconsistencies and gaps across financial sectors. Under this approach, corresponding provisions in sector-specific texts would be repealed and cross-references to the horizontal act introduced. If the decision to introduce in a general manner STS securitisation in EU law were to be taken, this single text would also lay down all STS criteria for the EU financial sector. This common set of consistent rules would clarify and simplify the EU regulatory framework for originators, investors and supervisors. This would help market participants to launch further standardisation initiatives. Building on the positive outcome of the Private Placement initiative, the EU could encourage efforts in two specific areas:

**i) The development of standardised securitisation documentation** - The reporting requirements introduced by several central banks in Europe have been a major achievement to standardise loan-level information on securitisation instruments. This has already contributed to providing investors with many more elements on underlying risks. However, this initiative could be complemented by further standardisation efforts. For instance the lack of harmonisation in definitions within and across Member States is an impediment to assessing and comparing instruments. Promising initiatives have been launched in certain Member States such as in the Netherlands for the RMBS segment (e.g. the Dutch Securitisation Association initiative).

**The Dutch example** - The private sector Dutch Securitisation Association (DSA) has developed a standard template for Dutch securitisation transactions in order to reduce complexity and improve transparency. The DSA was established in October 2012 with the aim of promoting the interests of both issuers of and investors in Dutch securitisation transactions. In response to the decline in market activity, the originators of Dutch RMBS transactions jointly started an initiative in 2010 to improve transparency and reduce complexity of Dutch securitisation transactions. This initiative has resulted in the introduction of a standard for Dutch RMBS transactions, in respect of both investor reporting and documentation. According to Dutch authorities, this standardisation and the existence of a template are appreciated by the Dutch financial sector.

**ii) The development of standardised contracts/framework** - Some stakeholders also suggest developing standardised contracts (e.g. "master agreements") to be used as a reference for securitisation issuances. This could constitute the main corpus of securitisation documentation and be complemented by ad hoc provisions which may not be applied in all transactions or in all Member States. Entities would only need to refer to such agreements instead of reproducing the full list of provisions. Any deviations should be made immediately visible and should be explained. The existence of material deviations from the standardised documentation would be an indication as to whether the instruments comply or not with the "simplicity, transparency and standardised" features. This initiative would rely on the private sector to develop these market standards. Similar initiatives as for Private Placement or for Derivatives (ISDA protocol) could be used as examples.

**(a) Effectiveness - Fostering standardisation and addressing inconsistencies**

This option would ensure legal and regulatory clarity for originators and investors. This would simplify the current piecemeal approach in EU regulations for originators and investors and tackle potential ambiguities generated by the current juxtaposition of sometimes almost identical – but not

identical - sets of rules in sector-specific regulations (e.g. on risk retention, disclosure). This approach would also help in addressing some unnecessarily diverging rules across financial sectors (e.g. on due diligence requirements for investors). This would also reduce risk arbitrage opportunities and simplify monitoring by supervisory authorities monitoring. In addition, this option would offer opportunities to address existing inconsistencies or implementing problems of adopted legislation such as for the transparency website. This would allow increasing the effectiveness of already agreed reforms and interventions in the field such as the Solvency II, Liquidity Coverage Ratio delegated acts and CRA3.

This approach would rely on market participants and trade association to foster greater standardisation of securitisation. This bottom-up approach will ensure greater consistency and accuracy in the harmonisation process. It would also reflect the best practices and limit the risks of introducing provisions which may have unintended consequences on the market. This approach has been successful in the Netherlands for the RMBS market. However, the likelihood of reaching an agreement at the EU level would be more challenging as national specificities and constraints (e.g. contract, property and insolvency law) would be much more important. However, difficulties may also be important for some market segments, RMBS being quite standardised instruments.

#### **(b) Efficiency and impact for stakeholders**

This approach would have a limited impact on public finance. This option will reduce administrative burden for market participants mainly originators and investors as they would obtain greater clarity on the applicable rules. It would also reduce their regulatory/compliance risks and it would become easier to standardise securitisation on the basis of the harmonised framework. Stakeholders generally support the simplification of the current EU framework for securitisation as a single legal instrument could further contribute to the development of a robust securitisation market.

As regards the standardisation of securitisation documentation, this approach may take longer as it implies market participants will need to get organised and to agree on a consensual set of rules. Incentives to develop these frameworks may also be limited in the short term. It would imply administrative and legal costs for the private sector and the collective gains may take time to materialise ("free rider" behaviour). However, among stakeholders there is a consensus on the merits of encouraging further standardisation in the documentation of securitisations without imposing a "straitjacket" framework which may not be suitable for certain segments of the market.

#### *6.5.3 Option 5.3 – Adopting a comprehensive EU securitisation framework*

This option would build on option 2 and be complemented by the adoption of an EU legal framework harmonising Member States' frameworks for securitisation. It would be a wide-encompassing initiative including notably common rules for the setting-up of the special purpose vehicle, the modalities to transfer assets to SPVs and the rights and obligations of note holders. While some Member States have legal frameworks for securitisation (cf. box and annex 8), important national markets rely on contractual arrangements (e.g. UK, NL). Introducing this approach would result in the adoption of an EU legal framework which may supersede current national arrangements or be optional (i.e. a 29<sup>th</sup> regime).

For investors, such an EU securitisation structure could reduce unnecessary burden in the due diligence process and save time spent in analysing country-specific securitisation practices. In turn, a harmonised framework may increase their confidence to invest in securitised instruments. The

objective would be to establish a structure that helps issuers as well as boosts investor appetite in EU securitised products.

**National regimes in the EU:** A questionnaire was addressed to all Member States in the context of the Financial Services Committee in March 2015 (see annex 8 for detailed responses). Out of the 15 respondents:

- Nine Member States (Austria, Bulgaria, Croatia, the Czech Republic, Finland, Germany, the Netherlands and the United Kingdom) indicated that they do not have in place specific legislative provisions for securitisation besides the measures transposing the relevant EU legal acts. However, in some countries guidance, regulations and guidelines relevant to securitisation have been issued by regulators as well as market sponsored bodies.
- Seven Member States (France, Greece, Italy, Latvia, Portugal, Romania and Spain) noted that they have established a legal framework regarding securitisation of debts.

#### **(a) Effectiveness - ensuring differentiation of STS deals from more opaque and complex ones**

This option would score very highly in achieving standardisation of securitisation markets in the EU. It may contribute to the greater harmonisation of securitisation practices, help create economies of scale, and provide access to securitisation for smaller lenders in Member States where securitisation markets are underdeveloped.

#### **(b) Efficiency and impact for stakeholders**

This approach would have structural effects on some Member States especially those that do not rely on a legal framework for securitisation. Unintended consequences could be important for some local markets which remain active in some segments. A number of stakeholders see the theoretical merits of such an initiative. However, most stakeholders have doubts as to the possibility of developing an EU harmonised legal framework to support the establishment of securitisation vehicles, the transfer of assets or the subordination among noteholders in the short to medium term. The vast majority of stakeholders – especially from the financial sector - highlighted that while standardisation efforts would be beneficial in the long term, regulators should not jeopardise short/medium term benefits by delaying the whole initiative.

**Stakeholders' view** - The importance of increased standardisation is underlined by the majority of respondents, who are in favour of a principle based approach that is compatible with the differing national securitisation regimes. Market participants from both the issuing and investing side of the business as well as supervisors think this is a key area of intervention in order to revive the securitisation market.

More than two thirds of respondents (broadly spread across all categories) think that a single EU securitisation instrument would contribute to the development of the EU securitisation market. On the other hand, 7 respondents are not in favour of developing a single instrument, while a number of other respondents (4) have a nuanced position pointing out that cross-sectoral consistency and a level playing field are more important than creating a single EU securitisation instrument.

Those stakeholders that do not support the development of a single instrument mainly point out that the requirements in different sectors are of a different nature (e.g. prudential requirements, diversity assets, risk profile assets and their duration,); that a single instrument would require harmonisation of property/contract law and would run into legal and taxation issues, that the market already knows the existing Member State framework very well and above all that it would be very challenging to further harmonise. Respondents also mentioned



#### *6.5.4) Impact summary and conclusion*

Option 5.1 would leave the administrative burden associated with current inconsistencies and lack of standardisation across financial sectors unchanged. Establishing a single and consistent EU securitisation framework (option 5.2) would instead increase legal certainty for originators and investors and reduce current regulatory inconsistencies. This would be achieved with limited impact on public finances. Option 5.3 would potentially achieve higher standardisation than option 5.2, and have similar effects on legal clarity and the reduction of inconsistencies. However, progress on key files such as insolvency laws and taxation regimes is likely to be slow and would depend chiefly on Member States actions, with uncertainty on the scope, depth and timing of the initiative. Such uncertainty is indeed shared by most stakeholders (public and private) that responded to the consultation.

Establishing a clear and consistent EU legal framework for securitisation (option 5.2) would ensure greater clarity for investors and originators. Having this horizontal EU instrument in place would aid market participants in launching initiatives to further standardise securitisation frameworks especially for harmonising securitisation documentation. This approach is seen as more flexible and practicable than the third option, as the final outcome is not depending on standardisation in other complex areas such as insolvency law and taxation regimes.

	<b>Option</b>	<b>Effectiveness</b>	<b>Efficiency</b>	<b>Impact on Stakeholders</b>
5.1	No further action at EU level	(=) Limited effects in reducing inconsistencies across financial sectors (=) No impact on standardisation in ST/MT	(=) No additional costs on public finances	(=) Limited impacts on stakeholders. Administrative burden associated with current inconsistencies and lack of standardisation would remain
5.2	Establishing a single and consistent EU securitisation framework and encouraging market participants to develop further standardisation	(++) Would increase legal clarity for originators and investors and reduce current regulatory inconsistencies (+) Foster standardisation by relying on market participants' initiatives	(=) Limited impact on public finances (+) Standardisation would take longer as market participants are left to organise themselves	(++) Positive impacts on investors and originators with reduced administrative burden and greater flexibility to steer the standardisation process.
5.3	Adopting a comprehensive EU securitisation framework	(++) Same effect as option 2 on legal clarity and reduction of inconsistencies. (++) Would introduce a high degree of standardisation of the 28 securitisation frameworks throughout the EU	(=) Limited impact on public finances (-) Uncertainty of the standardisation aspects as progress depends on other files (e.g. insolvency law, taxation regimes)	(=) Lengthy discussions would generate regulatory uncertainty (-) Potential negative impacts on Member States with well-functioning securitisation markets (+) Positive impact on Member States with no national framework for securitisation

## **7) THE RETAINED POLICY OPTIONS AND INSTRUMENT**

### **7.1. The retained policy options**

Based on the analysis above, the first objective (to differentiate simple, transparent and standardised securitisation products from more opaque and complex ones) is best fulfilled by a combination of options 1.3, 2.2, 3.2, 4.2 and 4.5. These are therefore the retained options. These options together should introduce an immediately recognisable STS product in EU securitisation markets. Backed by an efficient compliance mechanism, STS products will be trusted by investors and can thus provide the legal basis for an amended capital treatment. This will indeed reflect more closely the risk profile of STS products, thereby allowing investors and issuers to reap the benefits of simple, transparent and standardised structures.

The most effective and efficient policy option to achieve the second objective (to foster the spread of standardisation of processes and practises in securitisation markets, tackle regulatory inconsistencies) is option 5.2, which is therefore retained. Establishing a single and consistent EU securitisation framework and encouraging market participants to develop further standardisation will increase legal clarity for originators and investors and reduce current regulatory inconsistencies. This will in turn positively impact investors' and originators' administrative burden.

### **7.2. The choice of the instrument**

The proposed legislative measures aim in particular at creating a sustainable market for Simple, Transparent and Standardised (STS) securitisation products. To this end the legislative measure will stipulate the criteria to be met by securitisation products in order to be considered STS, create a specific prudential treatment for these products and harmonise existing provisions in EU law on securitisation related to risk retention, disclosure and due diligence.

STS securitisation products will have to meet a number of criteria that should be uniform across the EU. Comparable criteria with a more limited scope are currently in place in two delegated regulations adopted by the Commission (the LCR and Solvency II delegated acts). The prudential treatment of securitisation instruments is laid down in the Capital Requirements Regulation (CRR) and the SII Delegated Act. Finally, the substantial rules on disclosure, risk retention and due diligence are laid down in a number of different EU regulations (CRR, Solvency II Delegated Act, the CRA delegated Regulation and the AIFM delegated Regulation).

Article 114(1) TFEU provides the legal basis for a Regulation creating uniform provisions aimed at the functioning of the internal market. STS securitisation products, their prudential treatment and the harmonisation of the existing provisions in EU law on securitisation related to risk retention, disclosure and due diligence will underpin the correct and safe functioning of the internal market. A directive would not lead to the same results, as implementation of a Directive might lead to divergent measures being adopted at national level, which are likely to lead to distortion of competition and regulatory arbitrage. Moreover, the EU provisions already in place in this area have been adopted in the form of Regulations.

The creation of this legal framework will require the adoption of a number of legal acts. First, a securitisation Regulation that will create uniform definitions across financial sectors and harmonised rules on risk retention, due diligence and disclosure. The same regulation will stipulate

the criteria for STS securitisation for all financial sectors. This regulation should also repeal provisions in sectoral legislation that will become superfluous due to the introduction of the securitisation regulation. Secondly, legal acts for a more risk-sensitive prudential treatment of securitisation for banks and insurers will have to be adopted. For banks the current prudential framework is laid down in CRR and for insurers in the Solvency II delegated act. For the banking treatment a proposal for amending CRR should be adopted, while for insurers the Solvency II delegated act will be amended to revise the prudential treatment once the new securitisation regulation enters into force.

### **7.3. The impact on SMEs**

The policy options chosen should have several positive effects on SME financing (see Annex 6 for a detailed analysis). First of all, the inclusion of ABCP in the STS framework, with consequential improvement in their capital treatment, will foster the growth of this important source of short-term SME financing.

Secondly, the initiative should provide banks with a tool for transferring risk off their balance sheets. This in turn means that banks should free more capital that can then be used to grant new credit. While in recent years banks have tended to use their resources to buy government bonds and other debt rather than providing new credit to firms and households, this is more likely to happen now in an environment of minimal (if not negative) interest rates paid by government bonds and similar assets. As a consequence, freed capital should be increasingly used by banks to provide new credit to households and firms, most of which are SMEs in the EU.

Finally, by introducing a single and consistent EU securitisation framework and encouraging market participants to develop further standardisation, the initiative should reduce operational costs for securitisations. Since these costs are higher than average for the securitisation of SME loans, the fall should have an especially beneficial effect on the cost of credit to SMEs. Several respondents to the Commission's public consultation on securitisation have highlighted the importance of documentation and product standardisation to render SME securitisation more economically viable (see Annex 6).

### **7.4. Social impact**

To the extent that the proposed policies will create a new channel of financing for the EU economy, one that is less dependent on banking sector conditions, they will reduce the effect of financial crises on credit provision and thus on growth and employment. The social costs of such crises will be reduced. Furthermore, by fostering the spread of securitisation structures whose risks can be analysed, understood and priced, the policy options will foster a securitisation market conducive to better funding of the economy in a context of financial stability.

### **7.5. Environmental impact**

Nothing would suggest that the proposed policy will have any direct or indirect impacts on environmental issues.

### **7.6. Impact on third countries**

As described in section 1.4, the work on securitisation has an important international angle. International standards to identify simple, transparent and standardised securitisations are being developed by a Task Force led by the Basel Committee on Banking Supervision (BCBS) and the International Organisation of Securities Commissions (IOSCO) and are close to finalisation. The

criteria to be adopted in the EU should be based on this international standard, but will be more operational.

As described in section 3.1.1 there is a strong consensus among European and international supervisors, regulators, central banks and market participants that the post-crisis reputation of securitised products issued in Europe was severely tarnished by practices and events taking place in the US: US securitisation products performed far worse than EU products.

At this point of time it is not clear whether other jurisdictions will implement STS standards in their legal frameworks. The US, as the largest securitisation market in the world, requires special attention, because EU investors invest in these US products and are thus interested in their prudential treatment.

The STS criteria will be based upon international standards developed by BCBS-IOSCO and would in principle allow issuers of securitisation products from third countries to comply with the criteria and thus be qualified as STS securitisation. The attestation by originators that the products comply with the STS criteria will be complemented by a certification by independent third-parties. Those third parties should be supervised by a public authority from the EU. Where third countries implement the criteria in their legal framework, equivalence could be considered for their rules and the certification of STS products.

The preferential prudential treatment offered to EU bank and insurers investing in STS securitisation should also be open for non-EU products, which would ensure that no barriers are created for third countries products. As regards the risk retention, due diligence and disclosure rules these would be based on existing EU law provisions.

The new STS framework may moreover provide third country investors with an interesting category of investments in which to invest, while for third country regulators it might be an interesting avenue to further develop their own legal frameworks.

## **8) MONITORING AND EVALUATION**

Ex-post evaluation of all new legislative measures is a priority for the Commission. Evaluations are planned about 4 years after the implementation deadline of each measure. The forthcoming Regulation will also be subject to a complete evaluation in order to assess, among other things, how effective and efficient it has been in terms of achieving the objectives presented in this report and to decide whether new measures or amendments are needed.

In terms of indicators and sources of information that could be used during the evaluation, data on the price and characteristics of securitisation deals prevailing in the market will be obtainable from the European DataWarehouse, which already covers the vast majority of the market and whose quality is checked periodically by the ECB. Private financial data providers such as Bloomberg or Reuters may also be useful.

The most important indicator for the achievement of the first objective (Differentiate simple, transparent and standardised securitisation products from more opaque and complex ones) will be the difference in the price of STS versus non-STS products. If the objective is achieved, this difference should increase from today, with STS products being more highly valued and thus more highly paid than non-STS ones by investors. Of course, this could and should trigger an increase in the supply of STS products, reason for which the achievement of this objective will also be measured with the growth in issuance of STS products versus non-STS ones.

The second objective (Foster the spread of standardisation of processes and practises in securitisation markets, tackle regulatory inconsistencies) will instead be measured against three criteria: 1) STS products' price and issuance growth (since a decline in operational costs should translate in higher issuance and/or higher prices for STS products), 2) The degree of standardisation of marketing and reporting material and finally 3) feedback from market practitioners on operational costs' evolution (hard data on this may not be publicly available).

## **ANNEX 1 – Glossary**

**ABCP:** Asset backed commercial paper. It is a form of commercial paper (short-term credit to companies) that is collateralized by other financial assets.

**ABS:** Asset backed security. A financial security backed by a loan, lease or receivables against assets other than real estate and mortgage-backed securities.

**AFME:** Association for financial markets in Europe

**AIFMD:** Alternative Investment Fund Managers Directive

**BCBS:** Basel committee for banking supervision

**BOE:** Bank of England

**CDO:** Collateralised debt obligation. A structured financial product that pools together cash flow-generating assets– such as mortgages, bonds and loans – that are debt obligations themselves.

**CDS:** Credit default swap

**CLO:** Collateralised loan obligation. A security backed by a pool of debt, usually corporate loans.

**CMBS:** Commercial mortgage backed security. A type of mortgage-backed security that is secured by the loan on a commercial property.

**CRA:** Credit rating agency

**CRA3:** Credit rating agency directive 3

**CRR:** Capital requirements regulation and directive

**EBA:** European banking authority

**ECB:** European central bank

**EIF:** European investment fund

**ERBA:** External rating based approach of the Basel framework for bank prudential capital regime adopted in December 2014

**GDP:** Gross domestic product

**IG:** Investment grade. A rating that indicates that a bond has a relatively low risk of default. 'AAA' and 'AA' (high credit quality) and 'A' and 'BBB' (medium credit quality) are considered investment grade.

**IMF:** International monetary fund

**IOSCO:** International Organization of Securities Commissions

**IRB:** Internal rating based approach of the previous Basel framework for bank prudential capital regime

**IRBA:** Internal rating based approach of the Basel framework for bank prudential capital regime adopted in December 2014

**LCR:** Liquidity coverage ratio

**MBS:** Mortgage backed security. A type of asset-backed security that is secured by a mortgage or collection of mortgages

**PCS:** Prime collateral security

**RMBS:** Residential mortgage backed security

**SA:** Standard approach of both the pre- and post-2014 Basel frameworks for bank prudential capital

**SC:** Structured credit

**SF:** Structured finance

**SME:** Small and medium enterprise

**SPV:** Special purpose vehicle. A "bankruptcy-remote entity", usually a subsidiary company, with an asset/liability structure and legal status that makes its obligations secure even if the parent company goes bankrupt.

**STS:** Simple, transparent and standardised

**TSI:** True sale international

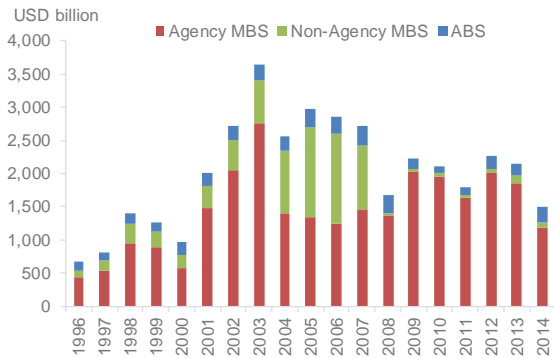
**UCITS:** Undertakings for the collective investment in transferable securities

**WBS:** Whole business securitisation. A specific type of synthetic securitisation.



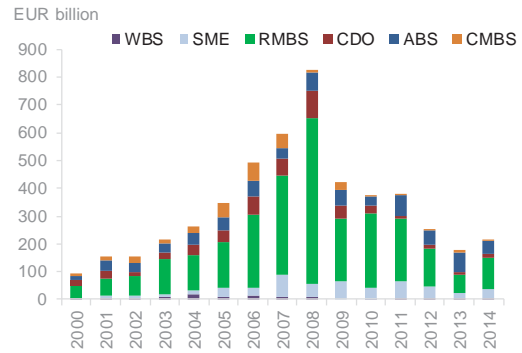
# ANNEX 2 – Stylised facts on securitisation markets

Chart 1: US securitisation issuance



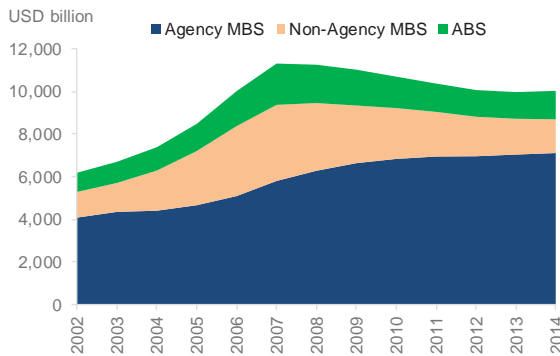
Source: SIFMA

Chart 2: European securitisation issuance<sup>a</sup>



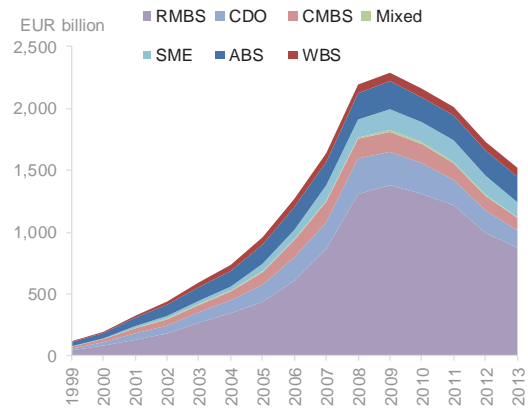
Source: SIFMA, Commission Services

Chart 3: US securitisation outstanding



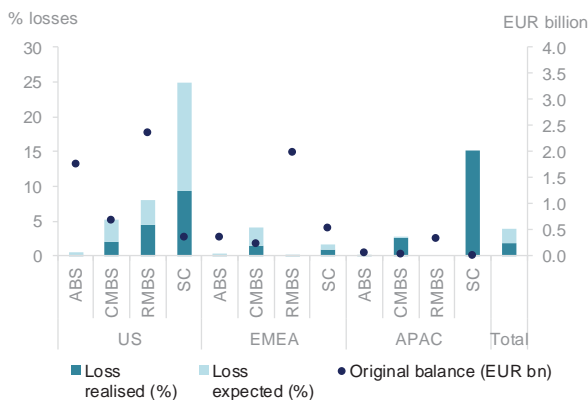
Source: SIFMA

Chart 4: European securitisation outstanding



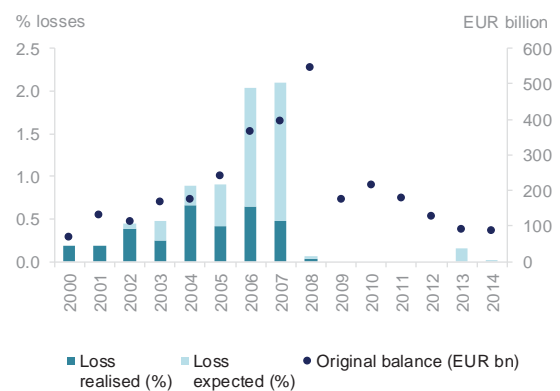
Source: SIFMA

Chart 5: Cumulative losses for 2000-2014 securitisation issuances, by region and product type<sup>b</sup>



Source: Fitch Ratings

Chart 6: Cumulative losses for EMEA 2000-2014 securitisation issuances, by vintage<sup>b</sup>



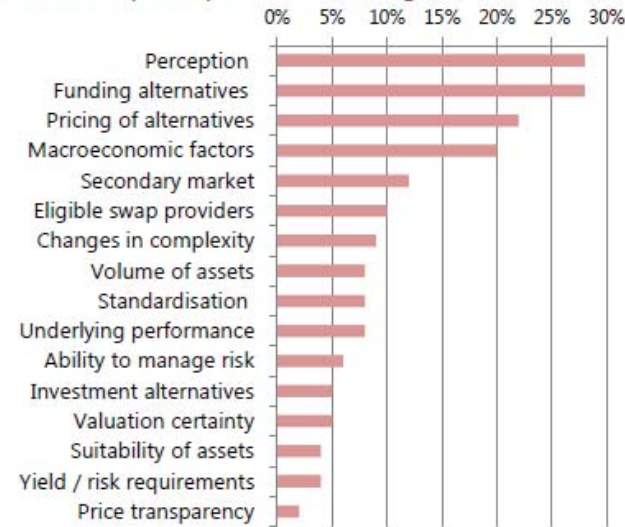
Source: Fitch Ratings

<sup>a</sup>includes retained issuance

<sup>b</sup>Fitch rated deals only; EMEA = Europe, Middle East, Africa; APAC = Asia and Pacific. ABS = Asset Backed securities; CMBS = Commercial Mortgage Backed Securities; RMBS = Residential Mortgage Backed Securities; SC = Structured Credit.

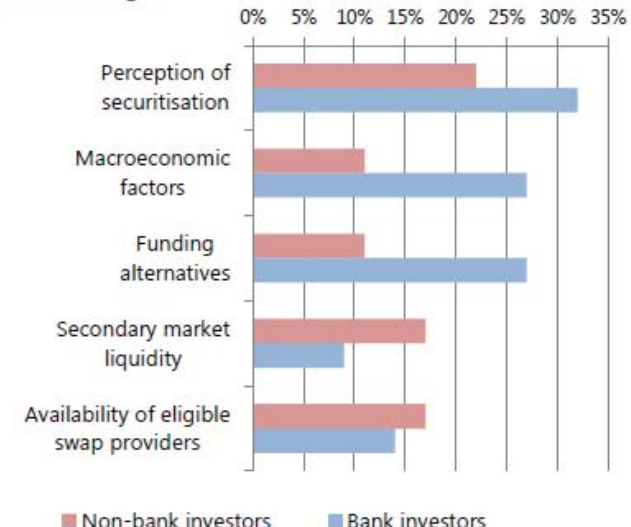
# ANNEX 3 – BCBS-IOSCO survey on "Impediments to sustainable securitisation markets"<sup>21</sup>

**Chart 1:** Most important market factors contributing to market developments since 2009 (% market participants nominating).



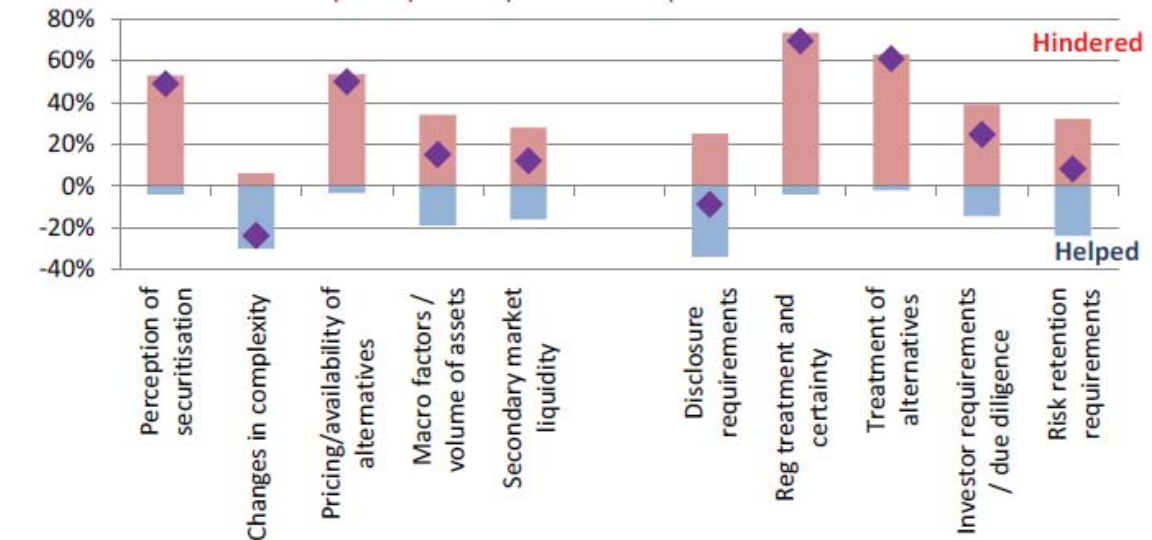
Source: Responses to the TFSM Survey.

**Chart 2:** Most important market factors contributing to market developments since 2009 (% investors nominating)



Source: Responses to the TFSM Survey.

**Chart 3:** Balance of market participant responses on impact on securitisation market since 2009



Regulatory treatment category includes capital and liquidity treatment. Purple markers reflect net results. Source: Responses to the TFSM Survey.

<sup>21</sup> Survey conducted in summer 2014. More details can be found in the original document: <http://www.bis.org/bcbs/publ/d304.pdf>

## ANNEX 4 – STS criteria in the LCR and Solvency II delegated acts

The criteria to identify highly transparent, simple and standardised securitisation instruments set out in the Solvency II and Liquidity Coverage Ratio delegated acts are based on recommendations from the European Insurance and Occupational Pensions Authority (EIOPA) and a detailed analysis of the liquidity of different instruments from the European Banking Authority (EBA).<sup>22</sup>

These criteria do not include any risk retention requirements (i.e. requirements that the originator, sponsor or original lender should retain a material net economic interest in the transaction). This is because risk retention requirements are already implemented in EU law and apply across the board, to all types of securitisation instruments (whether high-quality or not) held by insurance undertakings<sup>23</sup> and credit institutions<sup>24</sup>.

As set out in paragraph 1 below, most criteria are common to the Solvency II and LCR delegated acts. However, as the purpose is different in each act – the Solvency II standard formula concerns capital requirements, while the LCR delegated act prescribes rules for the assets held by banks in their liquidity buffer – some criteria are specific to the LCR delegated act, to ensure that high-quality securitisation instruments are also highly liquid.

### 1. Requirements common to the Solvency II and LCR delegated acts

#### 1.1. Maximum seniority

The tranche must be the most senior in the securitisation transaction, and it must remain so at all times, even after events that may impact the relative seniority of tranches, such as the delivery of an enforcement or acceleration notice. This criterion ensures that the credit quality of the tranche is indeed enhanced as compared to the credit quality of the entire pool of underlying exposures. Maximum seniority is among the more relevant features justifying a prudential treatment that is aligned to the underlying exposures.

#### 1.2. Homogeneous eligible underlying exposures

Homogeneity in the type of underlying exposures increases soundness, simplicity and transparency (in particular, loan-level reporting is easier to produce and interpret). All underlying exposures must belong to only one of the following types:

Residential loans: securitisation positions may be backed by loans secured by a first-ranking mortgage and/or by fully-guaranteed residential loans as referred to in Article 129(1)(e) of the Capital Requirements Regulation. In both cases, the pool of loans must feature on average a loan-to-value ratio lower than or equal to 80%. In the case of mortgage loans only, it is possible to derogate from this loan-to-value requirement, provided that instead, the national law of the Member State where the loans are originated provides for a maximum loan-to-income ratio not higher than

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<sup>22</sup> This analysis examined the liquidity of some asset backed securities against a number of metrics. However, this work was not sufficient for EBA to recommend the inclusion of ABS (apart from RMBS) as HQLA for the purposes of LCR.

<sup>23</sup> By virtue of Article 135(2) of Directive 2009/138/EC (Solvency II).

<sup>24</sup> By virtue of Article 405 of Regulation (EU) No 575/2013 (CRR).

45%, and each loan in the pool complies with this limit. The relevant national law must be communicated to the Commission, and EBA and/or EIOPA.

Loans, leases and credit facilities to undertakings, in particular SMEs: securitisation positions may be backed by commercial loans, leases and credit facilities to undertakings to finance capital expenditures or business operations other than the acquisition or development of commercial real estate, provided that at least 80% of the borrowers in the pool in terms of amount are small and medium-sized enterprises at the time of issuance of the securitisation.

Auto loans or leases: securitisation positions may be backed by a loans or leases for the financing of a broad range of vehicles. Such loans or leases may include ancillary insurance and service products or additional vehicle parts, and in the case of leases, the residual value of leased vehicles<sup>25</sup>. All loans and leases in the pool shall be secured with a first-ranking charge or security over the vehicle or an appropriate guarantee in favour of the securitisation special purpose vehicle.

Consumer loans and credit card receivables: securitisation positions may be backed by loans and credit facilities to individuals for personal, family or household consumption purposes. As a consequence of this closed list of eligible underlying exposures, commercial mortgage backed securities (CMBS) and collateralised debt obligations (CDOs)<sup>26</sup> are excluded. This is justified given their poorer performance, as shown in EIOPA's advice and other studies of CMBS.<sup>27</sup>

No re-securitisations, no synthetic securitisations: re-securitisations are explicitly excluded, as they are typically complex and less transparent structures, where the cascading of investor losses is very difficult to understand due to re-tranching.

The same goes for synthetic securitisations, where the underlying exposures are not transferred to the special purpose vehicle. Instead, the transfer of risk is achieved by the use of credit derivatives or guarantees, while the exposures being securitised remain with the originator. The transfer of the assets to be securitised ensures that securitisation investors have recourse to those assets should the Securitisation Special Purpose Entity (SSPE) not fulfil its payment obligations. Such recourse cannot be granted in synthetic transactions, due to the fact that only the credit risk associated with the underlying assets, rather than the ownership of such assets, is transferred to the SSPE. Such a structure also adds counterparty risk on derivatives or guarantees, and hampers investors' rights to the proceeds of the underlying exposures. In addition, most synthetic structures add to the complexity of the securitisation in terms of risk modelling.

### **1.3. Restricted use of derivatives and transferable financial instruments**

Derivatives can only be used for hedging currency and interest rate risk. This also excludes the synthetic securitisations described in the above paragraph. The pool of underlying exposures must not include transferable financial instruments (this effectively means CDOs are excluded), except

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<sup>25</sup> Auto loans or lease securitisations including residual values must however comply with paragraph 0 below, which prevents the repayment of the securitisation depending predominantly on the sale of the vehicles.

<sup>26</sup> CDOs are also excluded by virtue of the criteria in point 0 because their underlying exposures usually include transferable debt instruments, such as non-investment grade bonds.

<sup>27</sup> See page 121 of EIOPA's technical report (2013).

financial instruments issued by the securitisation special purpose entity itself, in order to accommodate master trust structures.

#### **1.4. 'True sale' and absence of severe 'claw back' provisions**

The transfer of the underlying exposures to the securitisation special purpose vehicle must be sufficiently certain from a legal point of view:

- the transfer must be enforceable against any third party and the underlying exposures be beyond the reach of the seller (originator, sponsor or original lender) and its creditors, including in the event of the seller's insolvency ('true sale' requirement);
- the transfer of the underlying exposures to the SSPE may not be subject to any severe clawback provisions in the jurisdiction where the seller is incorporated because such provisions induce legal insecurity on investors' rights.

#### **1.5. Continuity provisions for the replacement of servicers, derivative counterparties and liquidity providers**

The underlying exposures must have their administration governed by a servicing agreement which includes servicing continuity provisions to ensure, at a minimum, that a default or insolvency of the servicer does not result in a termination of servicing. Where applicable, the documentation governing the securitisation must also include continuity provisions to ensure, at a minimum, the replacement of derivative counterparties and liquidity providers upon their default or insolvency.

The aim of these two criteria is to mitigate credit risk with different counterparties involved in the securitisation transaction, whose default or insolvency could jeopardise the smooth running of the transaction.

#### **1.6. Absence of credit-impaired obligors**

At the time of issuance of the securitisation or when incorporated in the pool of underlying exposures at any time after issuance, the underlying exposures must not include exposures to credit-impaired obligors (or where applicable, credit-impaired guarantors). The definition of credit-impaired obligors or guarantors is both backward-looking (e.g. the obligor has declared bankruptcy, or has recently agreed with his creditors to a debt dismissal or reschedule, or is on an official registry of persons with adverse credit history) and forward-looking (e.g. the obligor has a credit assessment by an external credit assessment institution or has a credit score indicating a significant risk that contractually agreed payments will not be made compared to the average obligor for this type of loans in the relevant jurisdiction). This criterion effectively excludes 'sub-prime' loans from the high-quality securitisation category.

#### **1.7. Absence of loans in default**

At the time of issuance of the securitisation or when incorporated in the pool of underlying exposures at any time after issuance, the underlying exposures must not include exposures in default, as defined in the banking prudential rules in Article 175 of Regulation (EU) No 575/2013. This criterion ensures that the securitisation does not contain loans or leases already in default when the securitisation transaction begins or when new exposures are transferred to the SSPE.

#### **1.8. Reliance on the future sale of assets securing the exposures**

The repayment of the securitisation position must not be structured to depend predominantly on the sale of assets securing the underlying exposures; however, this shall not prevent such exposures from being subsequently rolled over or refinanced.

The point of this criterion is to exclude transactions where the ability of the SSPE to repay the securitisation notes is subject to an unacceptable level risk of risk, due to overreliance on the proceeds of the sale of assets securing the underlying exposures such as used cars when an auto lease securitisation transaction matures. While recognising that auto lease securitisations including residual values may be eligible as high quality (see paragraph 0), the repayment of those securitisations should not rely predominantly on the future realisation of those residual values.

### **1.9. Pass-through requirement for non-revolving structures**

Cash proceeds from the underlying exposures should flow in a simple and transparent way to investors. Structures where a significant amount of cash is retained within the SSPE (for example, securitisations with bullet payments) would not comply with this pass-through profile and, therefore, are excluded.

### **1.10. Early amortisation provisions for revolving structures**

Where the securitisation has been set up with a revolving period, the transaction documentation provides for appropriate early amortisation events, which shall include at a minimum all of the following:

- a deterioration in the credit quality of the underlying exposures;
- a failure to generate sufficient new underlying exposures of at least similar credit quality;
- the occurrence of an insolvency-related event with regard to the originator or the servicer.

High-quality securitisations should ensure that, in the presence of a revolving period mechanism, investors are sufficiently protected from the risk that principal amounts may not be fully repaid. Sufficient protection should be ensured by the inclusion of provisions which trigger amortisation of all payments at the occurrence of adverse events such as those mentioned in the criterion.

### **1.11. At least one payment at the time of issuance**

At the time of issuance of the securitisation, the borrowers (or, where applicable, the guarantors) must have made at least one payment. This is intended to exclude securitisation backed by newly-originated loans. However, this requirement would not be proportionate in practice for the securitisation of credit card receivables. Hence there is a derogation for this type of securitisation.

### **1.12. Absence of self-certified loans**

In the case of securitisations backed by residential loans, the pool of loans must not include any loan that was marketed and underwritten on the premise that the loan applicant or, where applicable intermediaries, were made aware that the information provided might not be verified by the lender.

This requirement is essential to exclude loans where the applicant and, where applicable, intermediaries, might be incentivised to misrepresent essential information, e.g. to overstate their income. This criterion also helps exclude 'sub-prime' lending.

### **1.13. Assessment of retail borrowers' creditworthiness**

In the case of securitisations where the underlying exposures are residential loans, auto loans or leases, consumer loans or credit facilities, the creditworthiness of the borrowers must be assessed thoroughly, in accordance with the Mortgage Credit Directive (Directive 2014/17/EU) or the Consumer Credit Directive (Directive 2008/48/EC) or equivalent rules in third countries, where applicable. This requirement effectively excludes flawed securitisation business models, relying on unsound underwriting practices.

#### **1.14. Transparency and disclosure of loan-level data**

Where either the originator or sponsor of a securitisation is established in the Union, they must comply with transparency requirements set out in the Capital Requirement Regulation. Furthermore, in accordance with Article 8b of Regulation (EU) No 1060/2009, the European Securities and Markets Authority (ESMA) will in 2017 set up a website centralising the publication of information regarding structured finance instruments, i.e. securitisations. Through this website, the issuer, originator or sponsor of the securitisation will be able to publish information on the credit quality and performance of the underlying assets of the structured finance instrument, the structure of the securitisation transaction, the cash flows and any collateral supporting a securitisation exposure as well as any information that is necessary for investors to conduct comprehensive and well-informed stress tests on the cash flows and collateral values supporting the underlying exposures.

Where neither the issuer, nor the originator, nor the sponsor of a securitisation is established in the Union, comprehensive loan-level data in compliance with standards generally accepted by market participants must be made available to existing and potential investors and regulators at issuance and on a regular basis.

#### **1.15. Listing requirement**

Both the Solvency II and LCR delegated acts require that high-quality securitisation positions should be listed on a regulated market/recognised exchange, or admitted to trading on another organised venue, with a robust market infrastructure. The drafting of this criterion could not be strictly aligned in the two acts because of legal constraints stemming from differences in the corresponding 'level 1' legislation<sup>28</sup>. In addition, under the LCR delegated act, securitisation positions may be deemed highly liquid if they are tradable on generally accepted repurchase markets. This was not included in the Solvency II delegated act as repurchase transactions to generate liquidity are not typical for insurers.

#### **1.16. Credit quality**

Both the Solvency II and LCR delegated acts require that high-quality securitisation positions receive a minimum external credit assessment, on issuance and at any time thereafter. The minimum external credit assessment is one of the elements for high-quality securitisation positions and does not constitute sole and mechanistic reliance, in accordance with the principles of the Financial Stability Board for reducing reliance on CRA ratings<sup>29</sup>.

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<sup>28</sup> On the one hand, the Solvency II Directive uses the concept of a "regulated market" as defined in Article 13(22). On the other hand, the Capital Requirements Regulation uses the concept of a "recognised exchange" as defined in Article 4(1)(72). While the latter is also based on the concept of a "regulated market", the CRR definition also includes clearing mechanism requirements.

<sup>29</sup> Available at: [http://www.financialstabilityboard.org/publications/r\\_101027.pdf](http://www.financialstabilityboard.org/publications/r_101027.pdf)

In Solvency II, the position should be investment grade, i.e. be assigned to credit quality step 3 at least. In order to ensure that the securitisation position is highly liquid, the LCR delegated act requires that it is assigned to credit quality step 1. The mappings of external credit assessments onto the respective scales of credit quality steps applicable in banking and insurance legislation is prepared by the Joint Committee of the European Supervisory Authorities.

## **2. Requirements specific to the LCR delegated act**

The LCR delegated act includes all the requirements for high quality securitisations set out in the Solvency II Delegated Act but adds some additional requirements specifically for liquidity purposes. It would not be justified to assume that all high quality credit securitisations would be sufficiently liquid in a market stress scenario.

### **2.1. Minimum issue size**

The larger the issue size, the deeper the secondary market. Therefore, the LCR delegated act provides for a minimum issue of EUR 100 million.

### **2.2. Maximum weighted average time to maturity**

Securitisations with a short-weighted average life and high prepayments have proven to enjoy good liquidity during periods of stress, as they convert into cash in a short time span (this is the case of auto loan ABSs, for example). Accordingly, the LCR delegated act will only recognise positions in securitisations where weighted average time to maturity is less than 5 years, assuming call or certain prepayment options are exercised.

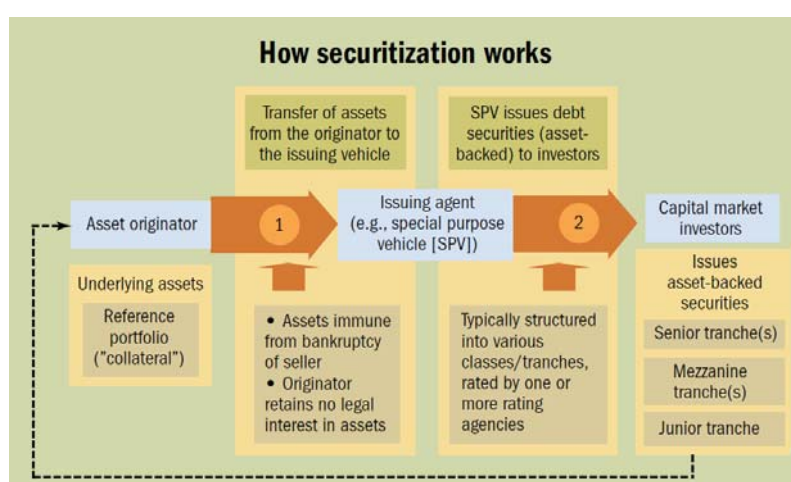


## ANNEX 5 - Synthetic securitisation

This annex is aimed at explaining the basics of synthetic securitisation, its benefits and risks.

- What is a securitisation process?

In its most basic form, securitisation involves two steps. Firstly a company (the "originator") with loans or other income-producing assets—identifies assets it wants to remove from its balance sheet and pools them into what is called the reference portfolio. It then sells this asset pool a special purpose vehicle (SPV), specifically set-up to purchase the assets and realize their off-balance-sheet treatment for legal and accounting purposes. Secondly, the issuer finances the acquisition of the pooled assets by issuing tradable, interest-bearing securities that are sold to capital market investors. The investors receive cash flows generated by the reference portfolio.



*Source:* IMF 2008<sup>30</sup>

- What is a synthetic securitisation?

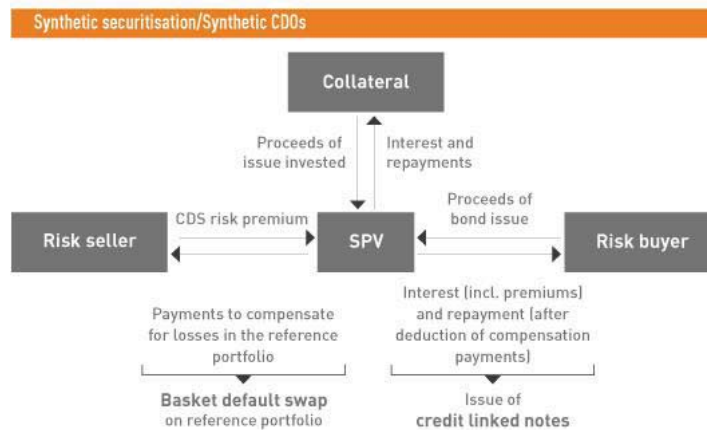
In synthetic structures **there is no transfer of ownership** of the underlying assets/loans from the originating banks to the securitisation vehicle. Instead, a **derivative contract, such as a credit default swap (CDS), is used to gain credit risk exposure to a specified pool or portfolio of underlying assets.**

**Synthetic structures provide the issuer with capital relief** (i.e. lower capital charges), as the credit risk of the assets underlying the securitisation (e.g. bank loans to SMEs) is transferred to a third party with the CDS contract. Synthetic structures **do not provide funding** however, as the assets (in the previous example, SME loans) remain on the issuer's balance sheet, they are not sold. That is a main difference with "true sale" securitisation, which provides both credit risk transfer and funding for the issuer.

<sup>30</sup> <http://www.imf.org/external/pubs/ft/fandd/2008/09/pdf/basics.pdf>

- What are the potential risks of synthetic securitisation?

A synthetic structure introduces more **complexity and uncertainty** in the transactions. This type of structure creates an additional counterparty credit risk, on top of a "true sale" securitisation, that must be managed. The nature of this additional **counterparty risk** is dependent on the way it is structured (e.g. risks attached to the entities providing protection via the CDS, nature of the collateral).



*Source:* True Sale International <sup>31</sup>

A key additional risk lies in the legal drafting of the derivative used to mimic the asset transfer from the originator to the issuer of the securitisation. Such drafting is usually not standardised and defines what risks are transferred and under what conditions. This introduces **legal uncertainty and risks that must be taken into consideration**. By contrast, a "true sale" securitisation has a clear and standardised form of risk transfer, as the asset underlying the securitisation are effectively sold to the issuer of such securitisation.

**Synthetic structures were abused** in order to reduce prudential capital requirements, rather than used in order to obtain genuine transfer of risk. In the run-up to the 2007-2008 financial crisis, there was an emergence of "**arbitrage structures**" that generated important losses for investors. The US Financial Crisis Inquiry Report concluded that "the synthetic CDOs proliferated, in part because it was much quicker and easier for managers to assemble a synthetic portfolio out of pay-as-you-go credit default swaps than to assembly a regular cash CDO out of mortgage backed securities (...) and they tended to offer the potential for higher returns on the equity tranches." When the bubble burst, hundreds of billions of dollars in losses in mortgages and mortgage-related securities shook markets as well as financial institutions. The synthetic structuring, through derivatives, magnified these losses. There are famous examples such as the deal arranged by Goldman Sachs called **ABACUS 2007-AC1**. The German bank IKB lost almost all of its \$150 million investment in this instrument.

**In Europe too**, synthetic structures generated losses that are a multiple of those generated by simple and transparent structures. Based on historical data, **the probability of a synthetic CDOs**

<sup>31</sup> <http://www.true-sale-international.de/en/abs-im-ueberblick/wasistabs/>

**defaulting is 19 times higher than that of simple structures** such as RMBS and credit cards ABS (see table below, from AFME).

Table A.1 – losses generated by EU term securitisations 2007 to 2013

	Original Issuance (€bn)	Default Rate (%)
<b>Europe</b>		
<b>Total PCS eligible asset classes</b>	<b>960.2</b>	<b>0.15</b>
Credit Cards	33.2	0.00
RMBS	756.0	0.12
Other consumer ABS	68.0	0.13
SMEs	103.0	0.41
Only senior tranches to be PCS labelled, the default rate for which is zero, like covered bonds		
<b>Total Non-PCS eligible asset classes</b>	<b>728.9</b>	<b>5.66</b>
Leveraged loan CLOs	70.6	0.10
Other ABS	69.1	0.00
Corporate Securitisations	64.9	0.13
Synthetic Corporate CDOs	254.4	2.87
CMBS	163.3	10.34
Other CDOs	77.8	6.54
CDOs of ABS	28.9	41.04
<b>Total European securitisation issuance</b>	<b>1,689.1</b>	<b>2.53</b>
Covered Bonds	1,085.0	0.00
<b>Total European issuance</b>	<b>2,774.1</b>	<b>1.54</b>
<b>Select US asset classes</b>		
Credit cards	295.4	0.07
Autos	198.2	0.04
Student loans	266.9	0.34
RMBS	3,254.9	22.05

Source: AFME

Simpler synthetic structures such as those issued by the EIF generated losses of 0.8% on average. This level is identical to that of average EU structured credit products (see Figure 6 in the main text). While these losses were considerably smaller than those of their US counterparts, **structured credit and EIF synthetics have nonetheless underperformed traditional securitisations considerably**. Traditional EU securitisations such as RMBS and ABS generated losses of 0.0% and 0.1% respectively. The available data does not support the introduction of synthetics in the STS scope.

- What is the current state of play in the policy discussions?

The **financial sector** globally agrees that more work is needed in order to develop STS criteria for synthetic securitisation. They acknowledge the political sensitivity of this segment due to the financial crisis and the higher complexity of such products, both requiring caution. For instance the main private body developing a label for high quality securitisations - **Prime Collateralised Securities (PCS)** - has excluded synthetic securitisations from their list of eligible securitisation instruments. They are likely to develop criteria but only in the medium-term.

Synthetics are neither eligible for **ECB/BoE refinancing operations**. It follows that central banks do not accept synthetics as safe collateral against which to lend funds to banks. Also, the ECB excludes synthetics from the list of assets purchasable under its **ABS Purchase Programme**.

No work on identifying criteria for simple and transparent synthetics has been carried out by international organisations. Neither the **BCBS-IOSCO** nor the **EBA** did include synthetics in the scope of simple, transparent and standardised securitisation. They do not plan to develop criteria to identify simple for synthetics in the near future.

Two **MS** with sizeable securitisation markets are reluctant to progress quickly. A few other **MS** are more open to integrate synthetics but only at a later stage, recognising that further work is needed if there is to be properly defined additional specific criteria for synthetics.

**An overwhelming majority of respondents to the Commission's public consultation on securitisation agreed with the exclusion of synthetic products** from the STS scope. Notably, the majority of industry associations and private companies also agreed. A detailed breakdown of responses by category is presented in the table below. Under the column "YES" is presented the percentage of respondents who agreed on the criteria excluding synthetics while under "NO" is the percentage that argued against the exclusion.

Table A.2 – Percentage of respondents agreeing with STS criteria excluding synthetic securitisations

<b>Category</b>	<b>YES</b>	<b>NO</b>
Private individual	75%	25%
Company, SME, micro-enterprise, sole trader	68%	32%
Consultancy, law firm	100%	0%
Legislators, Regulator and Supervisor	85%	15%
Industry association	73%	27%
Non-governmental organisation	100%	0%
Other	40%	60%
<b>TOT</b>	<b>74%</b>	<b>26%</b>

*Source: European Commission*

## **ANNEX 6 - Financing SMEs with the securitisation tool**

### *State of play*

Recent changes in the regulation for securitisation include preferential rules for SME securitisation. First, the (LCR) Delegated Act allows SMEs securitised products to be included in the liquid asset pool for the LCR. This should support financing of SMEs. However, only senior tranches are eligible, which implies that the amount of SME ABS to be included in the LCR pool will be small.

Secondly, the Delegated Regulation for Solvency II includes a definition of high-quality securitisation (simple, sound, transparent, comparable) with a more favourable capital treatment including loans to SMEs as admissible underlying asset (Article 177(2)(h)(iii) of the Delegated Regulation). Whether or not that's enough to significantly change the extent of investment in SMEs by insurers will also depend on relative yields to other products.

Promotional banks have supported the development in SME ABS in their countries and more generally in Europe through special programs. KfW, for example, was very successful with the PROMISE infrastructure for SME securitisation (72 transactions with a volume of € 126bn from 2000 to 2012). However, the majority of transactions under this scheme are currently short term ABS (ABCPs) rather than SME ABS.

While beneficial, the LCR and Solvency II rules are unlikely to fight stigma and revive the market for securitisations alone (see section 6.1.1). The same stands true for SME securitised products. Regarding promotion banks' schemes, while these have met some success, they have not been able to counteract the decline seen in SME securitisation issuance since the crisis. It appears that the problems that have affected securitisation markets in general, analysed in the previous chapter, have prevented such schemes to reach their full potential.

### *Introducing STS and a risk-sensitive prudential framework*

Differentiating between STS products and the rest, and applying such differentiation in the capital treatment applied to securitisations, the Commission's initiative would allow the securitisation technique to perform both its funding and risk transfer functions. This would help banks to free up capital currently needed to fund existing credit exposures. In this way, banks would be able to extend new credit.

In a context of improving macro conditions and extremely low interest rates paid by other assets (e.g. government bonds), banks are incentivised to give new credit to firms, which are mostly SMEs. Reviving the securitisation market should then help easing credit conditions for SMEs and improving their access to credit.

It is not easy to provide a reliable estimate on the additional provision of loans a revival of the securitisation market could provide. This depends indeed on a multitude of factors: a) monetary policy, b) demand for credit, c) developments in alternative funding channels (covered bonds, unsecured credit to name a few). All of these are likely to change through time, affecting the final outcome. With these caveats in mind, one can say however that, all things equal, if the securitisation market would go back to pre-crisis issuance levels, banks would be able to provide an additional €157bn of credit to the private sector. This would represent a 1.6% increase in credit to EU firms and households (this is still 4.7% below its peak).

Such an increase in loans provision would be likely distributed among all types of loans, including loans to SMEs. This is an important point because it makes clear that by freeing up capital, securitisation revival would indirectly help SME credit access. Assuming stable shares of SME loans to total loans (18.5% in OECD jurisdiction, with wide variations, e.g.: 49% in Greece), this would imply a 1.6% increase in SME loans.

On top of the indirect effect described, the direct effect of the Commission initiative on SME lending should be sizeable as the more risk sensitive capital treatment would reduce capital charges to STS SME securitisation, increasing the returns of such products compared to the returns generated by keeping the SME loans on the bank's balance sheet. This problem has been highlighted by the IMF as a key obstacle to SME securitisation (see page 21 for more details).

Furthermore, the inclusion of ABCP conduits satisfying criteria of simplicity, transparency and standardisation in the STS perimeter will foster the growth of this key source of financing for SMEs. It is worth recalling that an average €240bn of ABCP have been issued in the last five years and that 63% of these instruments fund trade receivables, floorplan loans and equipment leases, which are primarily granted to SMEs.

Finally, promoting securitisation market as a whole will develop investor and issuer expertise and build an effective infrastructure around assessing, pricing and trading securitisations. This in turn should reduce due diligence and credit analysis costs, helping SME loans to become a more viable asset as investors seek higher yields and issuers seek diversification of their funding structure and balance sheet management.

#### ***Public guarantee schemes***

SME securitisation could also be supported through public schemes such as those ran by EIF or various Member States in the past. Guarantees normally are time-limited and targeted on specific asset segments (e.g. SME ABS).

Such schemes could help implementing the STS securitisation agenda aimed at helping SME access to credit without prejudice to a legislative programme at a later stage. They would also increase incentives for products standardisation (e.g. example of the US mortgages agencies) and would promote liquidity.

The costs involved in such schemes are however high. For the guarantee scheme to have a meaningful effect at an EU level, substantial fiscal costs would have to be borne by Member States, in a context where budget reduction is a binding constraint across many EU jurisdictions. Additional risks on taxpayers as well as moral hazard issues would also have to be considered.

Such schemes would also overlap with the various guarantee schemes existing in EU jurisdictions as well as carried out by the EIB/EIF group such as the SME initiative (SMEI). This is an EU-wide joint financial instrument of the EIB Group, the European Commission and the Member States, approved by the European Council in 2013 and aiming at supporting SMEs through risk-sharing financial instruments. In practice it relies either on guarantee facilities and securitisation tools. In 2015 an €800mn scheme was launched in Spain under the umbrella of SMEI. This is expected to set the base for future financial instruments to support SMEs.

## **ANNEX 7 – Summary of responses to the Commission's public consultation on securitisation**

The Commission held a public consultation between **18 February and 13 May 2015** to explore the challenges and opportunities related to an EU framework for simple, transparent and standardised securitisation (STS securitisation).

This consultation was part of the **Commission's Green Paper on the Capital Market Union (CMU)** and aimed at collecting views on 18 specific questions, grouped in 10 sections:

Identification criteria for qualifying securitisation instruments

Identification criteria for short term instruments

Risk retention requirements for qualifying securitisation

Compliance with criteria for qualifying securitisation

Elements for a harmonised EU securitisation structure

Standardisation, transparency and information disclosure

Secondary markets, infrastructures and ancillary services

Prudential treatment for banks and investment firms

Prudential treatment of non-bank investors

Role of securitisation for SMEs

**120** responses to the public consultation were received from:

Member States government and financial authorities;

Issuers and originators of securitisation;

Investors in securitisation;

Financial institutions and their associated bodies;

Service providers to securitisation;




Non-financial institutions; and,

Individual citizens, academics and associations.



The list of public contributors to the consultation is annexed to this document. Please note that 10 respondents asked for their contributions to be kept confidential.

## 2. STATISTICS ON RESPONDENTS






- Categories of respondents

		Replies	%
Organisations or companies		93	77%
Public authorities or international organisations		22	18%
Private individuals		5	4%





- Confidentiality request

		Replies	%
Yes, I agree to my response being published		110	91.6%
No, I do not want my response to be published		10	8.3%

- Type of organisations:














		Replies	%
Industry association		52	43%
Company, SME, micro-enterprise, sole trader		22	18%
Other		8	6%
Consultancy, law firm		6	5%
Non-governmental organisation		5	4%

- Type of public authorities



		Replies	%
Government or Ministry		11	9.17%
Regulatory authority, Supervisory authority or Central bank		7	5.83%
Other public authority		2	1.67%
International or European organisation		2	1.67%





- Geographical origin of respondents













		<b>Replies</b>	<b>%</b>
United Kingdom		28	23.3%
France		16	13.3%
Belgium		16	13.3%
Germany		11	9.1%
Other country		7	5.8%
Spain		5	4.1%
Austria		5	4.1%
Ireland		5	4.1%
Italy		5	4.1%
The Netherlands		4	3.3%
Luxembourg		3	2.5%
Finland		3	2.5%
Denmark		2	1.6%
Norway		1	0.8%
Portugal		1	0.8%
Slovakia		1	0.8%
Malta		1	0.8%
Sweden		1	0.8%
Switzerland		1	0.8%
Croatia		1	0.8%
Czech Republic		1	0.8%
Greece		1	0.8%
Hungary		1	0.8%

- Role in securitisation markets

		<b>Replies</b>	<b>%</b>
Issuers / originators		26	21.6%
Investors / potential investors		19	15.8%

Services providers (infrastructures, ancillary services providers.)		9	7.5%
Other (public authorities, non-financial entities, individuals...)		66	55%

- Field of activity or sector (multiple replies were possible):

		Replies	%
Banking		40	33.3%
Investment management (e.g. hedge funds, private equity funds, venture capital funds, money market funds, securities)		34	28.3%
Other		30	25%
Not applicable		15	12.5%
Market infrastructure operation (e.g. CCPs, CSDs, Stock exchanges)		12	10%
Insurance		11	9.1%
Credit rating		8	6.6%
Pension provision		7	5.8%
Auditing		5	4.1%
Academia / research		4	3.3%
Accounting		3	2.5%
Social entrepreneurship		2	1.6%

### 3. SUMMARY OF THE RESPONSES

#### 1. Identification criteria for qualifying securitisation instruments

##### *Question 1:*

*A. Do the identification criteria need further refinements to reflect developments taking place at EU and international levels? If so, what adjustments need to be made?*

*B. What criteria should apply for all qualifying securitisations ('foundation criteria')?*

##### Main messages:

There is a strong support for differentiation based on modular approach. EBA/BCBS/IOSCO seen as natural and authoritative base for criteria. Slight preference for BCBS-IOSCO principle-based approach, while EBA approach is seen as a bit too prescriptive by various stakeholders (mostly industry). Support for STS differentiation not including credit risk elements and applying to all tranches (cf. "it's about the originating and structuring procedure so applies to all tranches of the deal"). Strong emphasis on the importance to have consistency of legislation at EU level and the need to avoid proliferation of criteria/definitions/regimes (CRR, S2, LCR..)

The vast majority of respondents (74%) agreed that synthetics may be currently excluded by the STS framework. The majority of respondents from industry associations (73%) and private companies (68%) are also of this view. Other categories (regulators, legislators, NGOs, private individuals) showed bigger majorities in favour of the exclusion. A detailed breakdown of responses by category is presented in the table below. Under the column "YES" is presented the percentage of respondents who agreed on the criteria excluding synthetics, while under "NO" is the percentage that argued against the exclusion.

<b>Category</b>	<b>YES</b>	<b>NO</b>
Private individual	75%	25%
Company, SME, micro-enterprise, sole trader	68%	32%
Consultancy, law firm	100%	0%
Legislators, Regulator and Supervisor	85%	15%
Industry association	73%	27%
Non-governmental organisation	100%	0%
Other	40%	60%
<b>TOT</b>	<b>74%</b>	<b>26%</b>

Finally, some stakeholders are requesting more detailed **on some criteria** notably on those related to comparability, homogeneity, definition of impaired credit and borrower, definition of significant risk too vague and inconsistent.

## **2. Identification criteria for short term instruments**

### ***Question 2:***

***A. To what extent should criteria identifying simple, transparent, and standardised short-term securitisation instruments be developed? What criteria would be relevant?***

***B. Are there any additional considerations that should be taken into account for short-term securitisations? "***

**Number of contributions on this specific question: 78**

*Of which:*

Originators/issuers:18

Investors: 11

Public authorities: 15

Service providers: 5

Others: 30

### **Main messages:**

**Majority view:** Almost two thirds respondents consider criteria for short term securitisations should be developed. Most feel this criteria should differentiate between those structures devoted to real economy financing (e.g. multi-seller ABCP conduits) and those used for arbitrage (e.g. SIVs).

Many respondents suggest the criteria should take into account the type of underlying assets and the level of overcollateralisation. There were also proposals for the criteria to limit maturity mismatches and require frequent reporting of underlying risks and structures and the nature of the liquidity support provided by the financial institution, amongst others.

**Minority views:** One tenth of respondents feel that the focus should first be on term securitisation and that short term securitisation criteria should not be rushed ahead to avoid repeating previous mistakes. One of these suggested that if such a criteria was developed it should then only apply to the securitisation of trade receivables.

## **3. Risk retention requirements for qualifying securitisation**

### ***Question 3:***

***A. Are there elements of the current rules on risk retention that should be adjusted for qualifying instruments?***

The overwhelming majority of respondents (almost 70%) are in favour of maintaining the level and forms of risk retention as they are or tightening them. Of these, some suggest that the level of risk retention should be increased (to 15-20%).

All the regulatory community, central banks and finance ministries argued that the risk retention requirements are a crucial tool to align interests of the various actors in the

securitisation chain and that their level and form are currently working fine, so that they see no reason for changing them. This view was shared also by the majority of industry organisations and private companies, with a vast majority (almost 60%) of private sector respondents arguing for keeping the rules as they are. Three more technical issues were raised by several respondents and require attention: the definition of "originator" in CRR, the exclusion of managed CLO and purchased receivables.

***B. For qualifying securitisation instruments, should responsibility for verifying risk retention requirements remain with investors (i.e. taking an "indirect approach")? Should the onus only be on originators? If so, how can it be ensured that investors continue to exercise proper due diligence?***

Respondents have somewhat diverging views on how this shift should happen concretely. About 60% of respondents (mostly industry stakeholders) argued for shifting the responsibility to originators/issuers/sponsors (i.e. substituting the current indirect with the direct approach). About a third of the respondents (mostly public authorities but not exclusively) supported instead the EBA proposal of accompanying the indirect approach with the direct approach thereby rendering both investors and issuers responsible. The second group justified maintaining investors' responsibility in two ways: i) this would continue ensuring EU investors invest only in securitisation backed by solid risk retention regimes and ii) this would maintain the incentives for investors' due diligence in risk retention aspects

#### **4. Compliance with criteria for qualifying securitisation**

##### ***Question 4.A and 4.B***

***How can proper implementation and enforcement of EU criteria for qualifying instruments be ensured? How could the procedures be defined in terms of scope and process?***

**Number of contributions on this specific question: 79**

*Of which:*

Originators/issuers: 17

Investors: 14

Public authorities: 18

Service providers: 4

Others: 26

##### ***General process:***

Almost all respondents emphasise the importance of having appropriate enforcement and compliance mechanisms in place to build a sustainable STS securitisation market in Europe. Views are split on the best ways to ensure this objective.

Some respondents argue that the onus of ensuring compliance with the STS criteria should be mainly on originators and investors. Originators may for instance be required to self-attest that a given instrument meets the identification criteria. They consider this approach as the best way to avoid excessive reliance on assessments delivered by third parties. This approach is seen as the most efficient way to reduce "moral hazard" risks and ensure proper due diligence by investors.

Other stakeholders believe that the recourse to external parties is essential to overcome the current stigma attached to securitisations and to build investors' confidence in STS instruments. In practice, some stakeholders suggest that public authorities could be directly involved in providing this assessment, while a significant number of respondents are supporting the establishment of private bodies acting as "certifiers" or "control bodies". These entities – under the supervision of public authorities - would be requested to assess the compliance of STS.

***Due diligence / moral hazard:*** Originators and investors should remain responsible for fulfilling their obligations, even though this could be facilitated to a certain extent through elements provided by external parties. Investors should not reduce their own risk assessment and interpret STS criteria as credit quality indicators. To this aim, sufficient information should be accessible to them. This should include notably loan level and performance data and publication by originators of comprehensive information with regard to aspects of the STS criteria that cannot be verified directly by investors (e.g. underwriting standards). An independent attestation/certification process should not lead to overreliance on STS qualification.

***Clarity:*** EU legislation on STS criteria should be precise enough to give a clear guidance to originators and investors. The EU criteria should provide a minimum certainty to investors even if STS qualification could be challenged or denied by competent supervisors (e.g. in the context of an onsite examination). Legal certainty is an important means of building trust and restarting the securitisation markets.

***Timeliness/costs of the process:*** To make high-quality securitisation attractive for investors and originators, the cost of implementing and enforcing the criteria would have to remain within reasonable limits. Excessive delays in providing this compliance assessment/certification would impede originators activities and be detrimental to the development of an STS market. Some stakeholders suggest that not every securitisation instrument or structure should be checked again for compliance with the criteria. In some cases, it should be possible for a securitisation structure that has already been certified once to be copied without the need for a full renewed check.

***Avoiding fragmented approaches / ensuring EU Consistency:*** A number of stakeholders emphasise the importance of a consistent interpretation of STS criteria in all EU Member States, especially given the mobility of securitisation structures and originators. The responsibility for determining whether a particular instrument complies with STS criteria needs to be clearly assigned. The mechanism should ensure consistency in its application. A consistent EU approach has to be implemented in order to ensure a single market for STS instruments and to avoid "forum-shopping" risks. In order to achieve such objectives, some respondents suggest that STS assessment/certification could be done directly by a European authority (e.g. ESA).

***Sanction regimes:*** The monitoring mechanism should foresee clear processes in case of a breach in compliance either due to a wrong appreciation at the origination or due to a change

in the securitisations' structure during its life. These processes should notably address originators and third parties in charge of assessing STS criteria. Where an investor benefits from a preferential regulatory treatment with regard to a particular STS securitisation position and does not meet these verification requirements by negligence or omission, the regulation could include appropriate measures for sanctioning such negligence or omission.

#### *Question 4.C*

*To what extent should risk features be part of this compliance monitoring?*

**Number of contributions on this specific question: 63 responses**

*Of which:*

Originators/issuers: 12

Investors: 9

Public authorities: 13

Service providers: 3

Others: 23

A vast majority of respondents consider that the compliance monitoring should cover the securitisation structure and the relevant STS criteria. However, it should not cover the credit risk posed by the underlying assets. While credit risk features are an essential part, they should be addressed within the due diligence process. Including risk features in the compliance scope would raise several issues. It may in particular introduce a confusing message to investors. These criteria are not aimed to provide an opinion on credit risks but to make investors' assessments of risks more straightforward. The STS approach should help investor to properly analyse the credit risk of the underlying assets in their due diligence process.

Investors should be fully responsible for their due diligence as they would for any other type of financial instrument. The approach should avoid replicating the errors of the subprime crisis and the overreliance on external entities (e.g. credit rating agencies). It is therefore difficult to see how assessments or monitoring of these credit risks (for instance by an independent third party) would help to achieve the STS objective. Compliance with STS criteria should only ensure that due diligence process is less time-consuming due to strict requirements limiting the complexity of securitisations and enhancing transparency and standardisation. Several respondents underlined however that information on risk developments during the life cycle of the transaction is of utmost importance. Thus originators should provide timely elements to investors which should keep on requesting risk information in regular reports.

However, some stakeholders consider that it could be logical to include some credit risks criteria in the compliance monitoring while addressing potential risks related to moral hazard. Some underline that risk features are already part of the supervision of national competent authorities over credit institutions. Therefore if an issuer-based approach would be taken, these risk features would be monitored.

## **5. Elements for a harmonised EU securitisation structure**

### ***Question 5:***

***A. What impact would further standardisation in the structuring process have on the development of EU securitisation markets?***

**Number of contributions on this specific question: 72 responses**

*Of which:*

Originators/issuers: 17

Investors: 16

Public authorities: 11

Others: 28

The majority of the respondents argue that a standardisation in the structuring process will have a positive impact in the development of the securitisation market. It is claimed that such standardisation i) will incentivise liquidity of the secondary market for securitized products, ii) will ease investing in structured finance, iii) enhance investor confidence and promote the further development of such markets. Moreover standardisation will enhance comparability for investors by creating a level playing field with similar credit products such as covered bonds and thus make securitisations more attractive. It will also help build the new market of standard simple product for less sophisticated investors. Some argue that a more benign capital treatment for the qualifying instruments will allow consideration of a wider range of products with marginal additional resources. Finally a standardisation of the structures may help enhancing secondary markets.

However, most stakeholders have doubts on the possibility for the Commission to develop – in short/ medium terms - a harmonised legal framework to frame the establishment of securitisation vehicles, the transfer of assets or the subordination among noteholders. Discussions on taxation regimes, insolvency laws, and securities laws would be required as pre-requisite. There is also support of encouraging further standardisation in the documentation of securitisations by market participants themselves. The example of the Dutch Securitisation Association is perceived as a promising initiative which could be expanded to other asset classes and Member States.

A minority of respondents claim that it would be very difficult and undesirable to come up with one European securitization structure. The advantages of securitisation, as a flexible tool to design investment products best fitted to specific situations may disappear. It is suggested that the European Commission should not risk of hampering the redevelopment of the



European securitization market, by setting up a pan European securitisation structure, which may require considerable time to be implemented due to two fundamental structural differences between countries i.e. property ownership and insolvency laws. These Structures have been developed over many years to accommodate particular national contract, property and insolvency laws of the Member States. It is also proposed that imposing standardisation would give a special advantage to those players who can benefit from standardization, namely large institutions with “middle of the road” objectives.

***B. Would a harmonised and/or optional EU-wide initiative provide more legal clarity and comparability for investors? What would be the benefits of such an initiative for originators?***

**Number of contributions on this specific question: 67 responses**

*Of which:*

Originators/issuers: 13

Investors: 14

Public authorities: 12

Others: 28

The majority of respondents underlined that a harmonised regime would make analysing a transaction easier for investors and provide more legal certainty by easing the burden and cost of having to comply with differing requirements or choose which label/s to conform to. It would also facilitate cross-border investments within the EU, allowing access to a much wider market by allowing for greater comparability of transactions and creating a level playing field for investors. Moreover, some respondents stress that more harmonised legal environment and disclosure frameworks would reduce potential barriers to the availability of transaction counterparties. It would subsequently increase investor confidence and generate a development of an EU wide securitisation market. For originators the main benefit would be in reducing complexity within the structuring process, as well as within the recurring transaction processes, through more consistent and simple documentation.

As regards the benefits of harmonisation a minority of respondents argue that the securitisation process is already regulated in an adequate manner and further harmonisation could lead to overregulation without providing an additional value. Standardisation in the structuring process is difficult to achieve in the EU due to the differing national regulations on securitisation. Other measures - stopping short of a new EU structure established by legal instrument – may well yield quicker benefits; it would thus be preferred to develop industry standards and best practices concerning the origination documentation and structure of SPVs. Some of the matters (such as the nature and extent of subordination) should be left to markets to define, rather than being set out in legislation. Harmonisation may be beneficial, but the lack of a harmonised framework is not seen as a principal impediment to securitisation

investment and/or issuance.

***C. If pursued, what aspects should be covered by this initiative (e.g. the legal form of securitisation vehicles; the modalities to transfer assets; the rights and subordination rules for noteholders)? (60 replies)***

The majority of the respondents consider that the initiative should cover the legal form of the securitisation vehicle the form of assignment and notification requirements the rights and entitlements of the noteholders as well as disclosure and documentation requirements.

Relating to the aspects covered by the initiative it is argued by some respondents that harmonisation of securitisation requires harmonisation in various areas of law including: general civil law issues; limited recourse and non-petition clauses; the law governing standard terms and conditions; the law governing securities and debentures/debt securities, provisions governing set-off; Insolvency law; general tax law issues and cross-border taxation and data protection.

It is also proposed that a flexible approach with minimum fixed eligibility criteria should be sufficient. Some suggest that the creation of a supra-national structure that would promote cross-border investment without impacting the current national securitisations regimes has also been proposed as has the definition of quality assets and underlying assets and eligibility criteria.

***D. If created, should this structure act as a necessary condition within the eligibility criteria for qualifying securitisations?***

**Number of contributions on this specific question: 56**

*Of which:*

Originators/issuers: 12

Investors: 9

Public authorities: 7

Others: 28

The majority of respondents consider that a standardised structure should not be considered a necessary condition within the eligibility criteria for qualifying securitisations. The majority supports a principles based harmonisation as opposed to a one size fits all approach. Moreover, legal harmonisation may take a while to be completed and making a standard structure a necessary prerequisite will hinder the Commission's goal to quickly restart the securitisation market.

The minority view is that a structure must act as a necessary condition within the eligibility

criteria for qualifying securitisations.

## **6. Standardisation, transparency and information disclosure**

### **Number of contributions on this specific question: 93**

*Of which:*

Originators/issuers: 22

Investors: 16

Public authorities: 15

Service providers: 5

Others (please specify if there is a specific category reacting on this question): 35

### ***Question 6:***

***A. For qualifying securitisations, what is the right balance between investors receiving the optimal amount and quality of information (in terms of comparability, reliability, and timeliness), and streamlining disclosure obligations for issuers/originators?***

### **Main messages**

There is a large support for transparency on SFI. Market participants shall have access to at least the same amount of information as credit rating agencies (CRAs). The importance of increased standardisation is underlined by the majority of the respondents, provided there is a reasonable degree of flexibility to take into account the characteristics of different asset classes and provided that the amount of information is balanced to the needs of investors (some mentioned PRIPs as an example of balanced approach).

Some suggest considering possible exemptions from standard templates for transactions that cannot be adequately covered. Some also insist on the need of consistency of enforcement across Member States). Strong emphasis on the quality of information provided (not only quantity). Large support also for the standardised templates provided by the CRA RTS on structured finance instruments (2015) which are considered very useful. There is also a very strong support for the set-up of a centralised transparency website for securitisation, so that information could be submitted only once, in one place and in a single format. Many contributors mention the European DataWarehouse (EDW) as a very positive experience, very useful for investors.

### **Granular pools**

Many contributors consider that the disclosure of loan to loan data for transactions backed by very granular pools of assets: i) creates unnecessary burden for issuers; ii) is not useful for investors and suggest limiting disclosure to aggregated data which in their opinion would be more relevant/easier to assess by investors.

Some respondents considered that the approach taken in ESMA's RTS is excessive as it may

give investors enough information to figure out pricing/business strategies of their competitors; this in turn may reduce incentives to use such instruments. However, according to detailed elements provided by a public authority, these concerns would not be justified for the following reasons:

- issuers already have this data, in an easy to disclose form; so the argument of additional burden for issuers would not be justified;
- educated investors would strongly benefit from receiving loan level information which will enable them to aggregate data according to their own criteria, and avoid them to depend on the aggregation method used by issuers; in addition, in the absence of disclosure of loan to loan data, it is impossible to check the quality of the underlying data.

#### **Private transactions**

Many contributors on the industry side are concerned about the application of art. 8b of the CRA III Regulation (publication on the SFI website of loan to level data) also to private transactions. They argue that in private transactions, investors are free to determine contractually the level of transparency they consider necessary and in many instances that level would be higher than in public transactions. Some of these contributors are also concerned by the need to protect commercial secrets. In their view, in such cases, extending public disclosure on private transactions may act as a disincentive for such transactions. On the other side, many of the above mentioned contributors on the industry side would appreciate that private transactions be eligible for STC (with the understanding however, that private transactions seeking eligibility would need to comply with loan level disclosure requirements, provided this information is disclosed only to relevant parties and the supervisors).

#### **Minority views:**

- Some stakeholders mention that transparency is not sufficient to ensure that all investors have the capacity to assess the information; promoting simple structures is equally important in their view;
- Standardisation would be difficult to achieve, given the great variety of transactions. Some indicate that adjustments are more needed for CMBS and RMBS, while would be less meaningful for revolving transactions
- Standardisation would be useful, but should ensure sufficient flexibility in order not to prevent the development of innovative.

### ***B. What areas would benefit from further standardisation and transparency, and how can the existing disclosure obligations be improved?***

There is a strong support in favour of standardisation of investors' reports. Also, many respondents highlighted that standardisation of definitions/key transaction terms (including of important ratios) used would be helpful. Some stakeholders were also in favour of further standardisation of performance metrics and of qualitative characteristics of securitisation (e.g. servicing characteristics).

***C. To what extent should disclosure requirements be adjusted – especially for loan-level data – to reflect differences and specificities across asset classes, while still preserving adequate transparency for investors to be able to make their own credit assessments?***

Many respondents suggest adjusting disclosure requirements to the characteristics of each asset class.

***Question 7:***

**Number of contributions on this specific question: 66**

*Of which:*

Originators/issuers: 18

Investors: 12

Public authorities: 17

Service providers: 5

Others (please specify if there is a specific category reacting on this question): 14

***A. What alternatives to credit ratings could be used, in order to mitigate the impact of the country ceilings employed in rating methodologies and to allow investors to make their own assessments of creditworthiness?***

The vast majority of respondents underline the importance that investors make their own creditworthiness assessment and do not rely mechanistically on external credit ratings. Credit ratings should be only one element amongst other to be considered in the overall assessment.

Respondents suggest several type of alternatives (see below), but many of them are realistic about the difficulty to completely eliminate reliance on ratings. Most frequently suggested alternatives are:

- disclosure is viewed as the most important tool for reducing reliance on ratings, as it enables investors to make their own risk assessment;
- use an internal risk/ratings based approach (e.g. in terms of expected loss);
- promote simple structures.

Some minority contributors suggest additional alternatives such as:

- use of monoline insurers or over-collateralisation to limit the impact of country ceilings;
- creation of one or several non for profit, supra national, capital market or multilateral funded rating agency (to be funded by investors)

***B. Would the publication by credit rating agencies of uncapped ratings (for securitisation instruments subject to sovereign ceilings) improve clarity for investors?***

The majority of respondents consider that the publication also of uncapped ratings (without the country ceiling) would offer additional clarity for investors and enable them to make their own analysis of the sovereign risk.

There is however a significant proportion of respondents that highlight that the publication of uncapped ratings, although interesting for information purposes, would have however limited value for investors as long, as prudential legislation would continue to take into account the “capped ratings” (with the country ceiling).

Some stakeholders highlight the need not to underestimate the country risk and the need for investors to perform some kind of country risk assessment. Some stakeholders also raise awareness about the need to avoid interfering with CRAs methodologies.

**7. Secondary markets, infrastructures and ancillary services**

***Question 8.A: For qualifying securitisation, is there a need to further develop market infrastructure?***

**Number of contributions on this specific question: 63**

*Of which:*

Originators/issuers:18

Investors: 7

Public authorities: 11

Service providers: 4

Others: 23

***In favour of developing further market infrastructure: 46 responses (of which 20 were focusing only on information)***

***Not in favour of developing further market infrastructure: 16 responses***

***No reply: 57***

Most of respondents focus on infrastructures aiming at collecting and disseminating information on securitisation markets in the EU. The development of central repository would be necessary for market participants and investors in particular. Existing infrastructures such as the European Data warehouse (EDW) are perceived as positive initiatives which should be further developed. A number of respondents underlined the necessity to develop synergies and avoid diverging reporting requirements in this area (e.g. for central banks, supervisors and rating agencies). It was also suggested that additional elements could be collected such as information on trading activity and deal prices. It may encourage new investors to participate in the market. There was no strong call for the establishment of other type of infrastructures in the short/medium term.

Some respondents underlined that the ability to trade securitisation instruments – notably qualifying instruments - on an exchange would open it up to a broader base of potential

investors and increase liquidity on secondary markets (e.g. money market funds as tradability is a mandatory prerequisite for investing). To promote these secondary markets, respondents also highlighted the need to be careful on potential interactions with the current discussion on the review of the trading book requirements by the Basel Committee.

A number of stakeholders mention the importance of addressing specific issues related to ancillary services (bank account and swap providers) with a view to enhance the SPV's economic and legal position in an insolvency situation. Some suggest that consideration could be given to the extent to which, for qualifying securitisations, public entities (EIB, promotional banks) could be more involved in the provisions of ancillary services.

### ***Question 8.B***

***What should be done to support ancillary services? Should the swaps collateralisation requirements be adjusted for securitisation vehicles issuing qualifying securitisation instruments?***

***Number of contributions on this specific question: 53***

*Of which:*

Originators/issuers:17

Investors: 5

Public authorities: 10

Service providers: 3

Others: 18

***In favour of doing something to support ancillary services: 39 responses***

***Not in favour of doing something to support ancillary services: 14 responses***

***No reply: 67***

Most of respondents highlight the key role of ancillary services in the securitisation chain. Two specific areas are identified by stakeholders: the provision of swaps services (interest rates or FX swaps) and of bank accounts to securitisation structures. The majority of respondents indicate that the number of "eligible" counterparties is limited as the list of entities benefitting from sufficiently high quality ratings has been reduced over the last years. In practice stakeholders would like to decrease the existing overreliance on credit ratings and/or to explore alternative options. Several entities suggest that public entities such as central banks, supranational institutions or promotional banks could provide part of these ancillary services to securitisation vehicles.

Several respondents suggest reducing the risks associated with the bankruptcy of counterparties. For instance some underlined that carving out swaps or bank account arrangements in a case where a financial institution (counterparty to the securitisation structure) goes into resolution would give more confidence to investors and agencies. The examples of Italian and French laws making the securitisation vehicles bank accounts

independent from the depository bank insolvency estate are seen as interesting options to assess.

Many originators and trade associations support the Bank of England and European Central Bank position that derivative collateralisation requirements for securitisation special purpose entities should apply in the same way as for derivatives executed by covered bond issuing entities. It means mainly that securitisation vehicles could be exempted from the legislative requirements to provide collateral under EMIR regulation. This proposal is – however – not shared by all respondents especially by some public authorities.

### *Question 8.C*

*What else could be done to support the functioning of the secondary market?*

**Number of contributions on this specific question: 53 responses**

*Of which:*

Originators/issuers: 15

Investors: 10

Public authorities: 11

Service providers: 4

Others: 13

***No reply: 67***

Most of the respondents are in favour of initiatives supporting the well-functioning of secondary markets for securitisation.

A number of stakeholders emphasize that the **introduction of criteria to identify simple, transparent and standardised** securitisation (and a more risk sensitive prudential treatment) will help in promoting demand on secondary markets. **Increased transparency** - through the establishment of centralised database collecting and disseminating information on underlying assets and documentation of the different transactions - will also contribute to increase liquidity on these markets.

Several members point out the importance of having an appropriate calibration of the **capital requirements on trading book positions in the banking regulation**. These provisions – currently under review by the Basel Committee – play an important role in the emergence of market makers. Equally important for the private sector representatives are the pre and post-trade transparency requirements in the MIFIR-MIFID context.

Some stakeholders also highlight the potential benefits of **adjusting the "indirect approach"** to risk retention requirement to ensure greater legal clarity for potential investors. Adjustments to sector-specific regulations are also mentioned as possible options such as allowing UCITS funds and MMF to invest more in STS securitisation.

Improving market making could also be achieved through the development of specific liquidity solutions and the establishment of "last recourse buyer". Some stakeholders are of



the views that recognized public or supranational guarantors could add to the market liquidity.

## **8. Prudential treatment for banks and investment firms**

**Number of contributions on this specific question: 63**

*Of which:*

Originators/issuers: 18

Investors: 5

Public authorities: 15

Others : 23

Services providers: 2

***Question 9: "With regard to the capital requirements for banks and investment firms, do you think that the existing provisions in the Capital Requirements Regulation adequately reflect the risks attached to securitised instruments."***

The majority of respondents consider the current regulatory treatment for various reasons not suited to properly reflect the risks inherent in securitisation products and are in favour of revising it. This group of respondents can be divided in two sub-groups:

A first sub-group mainly composed of Industry representatives in the area of issuers/originators consider the current treatment already punitive and not reflecting historical performance of EU securitisation markets and would favour a downward re-calibration:

- to implement a capital neutrality principle, particularly for senior tranches and/or STC securitisations;
- to align treatment (also in the area of liquidity rules) with that of comparable investment (particularly recurrent the reference to the unjustified incentives to the benefit of covered bonds);
- to address the distortions (i.e. overstatement of risks) in the case of rating based approaches after the tightening of criteria by CRAs and in relation to sovereign rating caps

A second sub-group including mainly Public Authorities (Supervisors, Ministries, Regulators) consider it necessary to address a series of shortcomings of the existing EU framework (mechanistic reliance on external ratings, inappropriately distributed capital charges across tranches, cliff-effects), on the basis of the recent BCBS proposals (possibly with some adjustments/ fine-tuning, e.g. reversing the hierarchy with regard to ERBA and SA approaches)

A minority of respondents (mainly including issuers/originators and investors) think that CRR provisions in most cases adequately address risks attached to securitisations and would like to

see no (or marginal) amendments implemented. In general stakeholders belonging to this group support a correction of the “one-size-fits-all” approach to take into account the specific features of STC securitisations;

Some respondents consider it necessary to enhance the harmonization of rules about the conditions to recognise the Significant Risk Transfer.

***Question 10: If changes to EU bank capital requirements were made, do you think that the recent BCBS recommendations on the review of the securitisation framework constitute a good baseline? What would be the potential impacts on EU securitisation markets?***

**Number of contributions on this specific question: 60**

*Of which:*

Originators/issuers: 19

Investors: 7

Public authorities: 11

Others : 22

Services providers: 1

The respondents can be divided in 2 groups more or less equally represented.

A first group led by private sector representatives opposes the transposition of the new BCBS framework and is convinced that it would penalise securitisation and unduly discriminate vis-a-vis other debt instruments (e.g. covered bonds). In particular the following issues are of concern for these respondents:

Substantial departure from the capital neutrality principle;

Disregard for the (good) performance of European ABS during the crisis;

Difficulties for non-originating banks to use the IRB and the consequent expected prevalence in the EU of the (more penalising) ERBA over the other 2 approaches;

The treatment of exposures to ABCP (including liquidity assistance) which could penalise term securitisations;

Excessive penalisation of senior tranches;

Lack of calibration per asset class;

The definition of tranche maturity and the level of RW floor.

A second group (mainly Public Authorities and investor institutions) judges positively the use of the BCBS revised framework as baseline for the review of CRR provisions to ensure, inter

alia, global consistency. However the majority of the respondents included in this group consider it necessary to implement some adjustments with in primis a more favourable treatment for STS securitisations.

***Question 11: How should rules on capital requirements for securitisation exposures differentiate between qualifying securitisations and other securitisation instruments?***

**Number of contributions on this specific question: 72**

*Of which:*

Originators/issuers: 17

Investors: 11

Public authorities: 13

Others : 27

Services providers: 4

With a few exceptions, the large majority of respondents are in favour of differentiating the prudential treatment of STS securitisations versus other securitisations. As regards the methodological approach main suggestions are:

Keeping for STS the current CRR treatment;

Implementing for STS a (near to) neutrality principles;

Aligning or approximating the treatment of STS to that of Covered Bonds;

Calibration for STS should focus on reducing the RW floor (some suggest a 10% or keeping the current 7% under IRB or even cancelling it) and on re-scaling RW in all 3 approaches through a scaling factor or, alternatively, adjusting the “p” factor (SEC-IRBA and SEC-SA);

Calibration for non-STs should not be reviewed upward;

Using BCBS treatment as the backstop treatment for non-STs securitisations.

Many respondents included in this group (and generally falling in the category of issuers/originators) draw the attention of the Commission to the need of avoiding cliff effects between STS and non-STs and to pay attention to the impact of those STS criteria that are dynamic (e.g. retention requirement). Ensuring a consistent treatment across different legislations (capital, liquidity and collateral regulations) and not discriminate negatively against ABCP are also among the main concerns of this group of respondents.

A small number of respondent are against any differentiation since this would create an unjustified barrier for non-STs securitisations and would contribute to “unwarranted RWA

variability”

***Question 12: "Given the particular circumstances of the EU markets, could there be merit in advancing work at the EU level alongside international work?"***

***Number of contributions on this specific question: 65***

*Of which:*

Originators/issuers: 18 (including associations representing bank originators)

Investors: 10

Public authorities: 12

Others: 25

Although not spelt out as such in the question, most respondents have understood it as a binary decision between either front-running international standards with a dedicated EU framework for STS securitisation or holding European developments until there is an international agreement.

Against that background, a slim majority of respondents would be in favour of front-running international standards. However, it should be noted that many of the respondents in this camp have expressed strong caveats. In general, those respondents would prefer to have consistency between European and international standards for STS securitisations in as much as possible. Accordingly, they suggest the Commission should try to secure international agreement first and only front-run global standards in the event that agreement at that level cannot be reached reasonably soon.

There were several respondents that opposed front-running international developments to various degrees, although caveated responses were less common in this case. That is, respondents in this camp tended to take a straightforward position in favour of consistency between EU and international standards on STS securitisation. The remaining respondents did not take a clear line either way.

Among the constituent groups identified above, a clear majority of public authorities and originators/issuers favoured front-running international standards, either decidedly or with caveats. In the other camp, it is worth highlighting that a majority of investors were very clearly against front-running international standards, while only a few were in favour but with reservations in some cases.

## **9. Prudential treatment of non-bank investors**

***Question 13: Are there wider structural barriers preventing long-term institutional investors from participating in this market? If so, how should these be tackled?***

**Number of contributions on this specific question: 71**

*Of which:*

Originators/issuers: 14

Investors: 12

Public authorities: 13

Service providers: 4

Others: 28.

Many respondents felt that the introduction of STS criteria, if implemented in a credible and effective manner, would help reduce investor stigma and make securitisation more attractive to investors. There were a number of comments about the regulatory and non-regulatory restrictions on pension and insurers that stop them from investing in securitisations. For pension funds those mentioned were often market led (e.g. in investor mandates) or restrictions in national frameworks. For insurers, Solvency II capital charges were frequently raised as an impediment. It was widely felt that pension funds and insurers were natural potential investors in securitisations, but that market conditions would need to adapt for this to be realised. Many respondents felt that Solvency II capital charges, in particular for mezzanine tranches, should be recalibrated.

Some commented that uncertainty was holding back investors in a number of jurisdictions. A supervisor felt that greater standardisation of structures could draw in a greater institutional investor base by reducing the required cost of analysis. A few other replies suggested that the investor base could be expanded by improving credit assessment capabilities.

***Question 14.A: For insurers investing in qualifying securitised products, how could the regulatory treatment of securitisation be refined to improve risk sensitivity? For example, should capital requirements increase less sharply with duration?***

**Number of contributions on this specific question: 57**

*Of which:*

Originators/issuers: 8

Investors: 11

Public authorities: 15

Others: 23

There is vast support for improving risk-sensitivity in the Solvency II standard formula and avoiding alleged cliff-edge effects in calibrations. But there is a wide variety of (sometimes contradictory) suggestions to achieve this. For example, a few respondents suggest increasing

certain calibrations on other assets classes rather than cutting existing calibrations for senior STC securitisation (which are at or below the level of direct unrated loans, by virtue of the look-through approach).

While supporting the current look-through approach, a quarter of a respondents complained that it is not properly implemented on two types of underlying assets:

residential mortgage loans, which attract a significantly lower charge under the counterparty risk module.

secured unrated loans, which can attract charges lower than 3% per year of duration even in the framework of the spread risk module.

Many respondents also found that the existing calibration for STC securitisation lacks risk-sensitivity because it was artificially flattened at 3% for several rating classes.

Beside the possible tweaks mentioned above, it is widely felt that calibrations are too onerous, but few practical solutions for recalibration are proposed. Around 15% of respondents consider that calibrations on STC securitisations should be reduced in line with corporate bonds, or even covered bonds, of the same credit quality. Although many respondents from the industry mention the very good track record of STC securitisation in terms of default rates, only three respondents actually suggest that securitisation positions should be exempted from spread risk and instead, be subject to counterparty default risk, automatically or depending on insurers' intention to hold those positions to maturity or not.

On the contrary, another 15% of respondents caution against lowering the existing calibration for STC securitisation, arguing that this would lack empirical grounds and that the Solvency II regime has not yet been tested. Authorities in a MS find the current calibration on senior tranches unjustifiably low.

As for the dependence on duration, there is significant support to mitigate its effects, but dependence on duration is rather seen as of secondary importance compared to the initial level the calibration. EIOPA points to the lack of relevant data necessary to kink spread risk factors along duration.

***Question 14.B: Should there be specific treatment for investments in non-senior tranches of qualifying securitisation transactions versus non-qualifying transactions?***

A vast majority of respondents consider that calibrations applied to "Type 2 securitisation positions" (including non-senior tranches of STC securitisation) are punitively high, because they are partly based on US subprime data. They argue that such calibrations shrink significantly the investor base for non-senior tranches of STC securitisation.

It is unanimously felt that STC qualification should apply at transaction level, not at tranche level. However, consequences for calibrations are less clear-cut. Views are split as to how granular calibrations should be (there are concerns about complexity of the standard formula).

Two central banks suggest that there should be four sets of calibrations, to accommodate STC

vs. non-STC products, and senior vs. non-senior tranches of those products. There are diverging opinions as to the relative levels of those calibrations: should capital requirements on non-senior STC tranches be more or less onerous than on senior non-STC tranches? In two rating agencies' opinion, experience suggests that both are possible, depending on the specifics of each transaction.

Almost 20% of respondents argue in favour of 'capital neutrality' at the level of a whole securitisation structure (instead of capital neutrality on senior tranches only). In their view, the total capital requirement applicable to all tranches of a given STS securitisation should not be higher than those applicable to the whole underlying portfolio.

More specifically, an additional 15% of respondents argue that the same set of existing calibrations (Type 1) could be used for senior and non-senior tranches of STC securitisation. Anyway, seniority gives rise to differences in ratings anyway, so that spread risk factors would capture this difference, without the need to derive a new calibration on scarce data (EIOPA's concern).

Only two supervisors and a central bank are explicitly opposed to any specific calibration for non-senior STC tranches.

**Question 15:**

**A. How could the institutional investor base for EU securitisation be expanded?**

**B. To support qualifying securitisations, are adjustments needed to other EU regulatory frameworks (e.g. UCITS, AIFMD)? If yes, please specify.**

**Number of contributions on this specific question: 70**

*Of which:*

Originators/issuers: 15

Investors: 11

Public authorities: 11

Service providers: 3

Others: 30.

Most stakeholders consider that the introduction of a credible STS framework should in itself help expand the institutional investor base for EU securitisation. The harmonising of concepts, definitions, due-diligence and reporting requirements were also viewed as important factors that would bring the costs for prospective investors. Greater consistency of rules between banks and insurers was also highlighted as being important. Many stakeholders feel that banks will have to continue to play a big role in the investor base, at least until a much larger non-bank investor community in securitisation can be sustained.

The majority of respondents do not consider amendments to the AIFMD or UCITS rules are

needed to enable the investors caught by these rules to invest in securitisation, although some call for an adjustment to the risk retention requirements so the onus for monitoring is on originators, not investors. Many also stated that investor due-diligence requirements should be significantly streamlined and relaxed.

Some public authorities stated that it was important that the STC criteria maintains high standards and excludes the more complex securitisations. A consumer association states that the investor base should not be expanded at all, while some private stakeholders advised that the criteria should be widened to include a wider range of asset classes, such as CMBS, to broaden the investor base. A supervisory authority said that it would be important not to stigmatise non-qualifying securitisations. It was noted that the listing of securitisations could make them eligible to UCITS and thus more attractive to investors. In some countries, such as Croatia, no securitisation framework exists, so developing one would be a first step to expanding the investor base. Some stakeholder called for a re-evaluation of risk retention requirements and no increase in bank capital charges.

## **10. Role of securitisation for SMEs**

### ***Question 16:***

*Number of contributions on this specific question: 76*

*Of which:*

Originators/issuers: 19

Investors/potential investors: 11

Public authorities: 14

Others (NGOs): 4

Others (Industry associations): 18

Others (Services providers): 7

Others (Consultancy, law firm): 3

### ***A. What additional steps could be taken to specifically develop SME securitisation?***

The importance of increased standardisation is underlined by the majority of respondents. A distinction is being made between more standardisation at the level of documentation and more product standardisation. Standardised information should be collected on a centralised basis and access should be free for all market participants. There is support for allowing some forms of synthetic securitisation to qualify as simple transparent and standardised.

Current capital weightings prescribed by Solvency II are considered to have a disproportionate effect and should be lowered. Allowing the application of the SME scaling



factor to securitisation positions would provide more incentives for regulated firms to actively engage in securitisation. It should be ensured that SME securitisation falls within the regulatory definition of STS instruments.

The role of Asset-Backed Commercial Paper (ABCP) in financing SME loans is seen as very important. The development of a scoring system for SME companies in Europe is also perceived as invaluable.

***B. Have there been unaddressed market failures surrounding SME securitisation, and how best could these be tackled?***

The SME securitisation market is blamed to be only national and having information asymmetry between the issuers and investors. Also the respondents noted market failures stemming from the compulsory reference to external credit ratings, the severe changes in rating methodologies, the favourable treatment of on-balance sheet SME loans by MS and the ABS risk weightings.

The respondents make reference to several unaddressed market failures, including: the inability for funds to originate loans and other types of debt in some markets, the exclusion of non-deposit taking entities to provide direct SME credit, the lack of transparency and standardisation of SME loans, as well as the current risk weightings for CLOs and the "one size fits all" approach to risk retention. To correct the internal market failures, the respondents suggested actions such as increasing transparency, standardisation, introducing quality standards and enabling synthetic securitisation as an alternative method.

A couple of stakeholders stress that 'tranching' was argued to be one of the key factors to provide investor protection in the SME securitisation markets and thus this procedure should not be penalised. This is because the bankruptcies of SMEs are common, due diligence for each issuing businesses is expensive and there is a lack of reliable risk assessment models or measures of SME creditworthiness.

***C. How can further standardisation of underlying assets/loans and securitisation structures be achieved, in order to reduce the costs of issuance and investment?***

The majority of respondents consider that due to the large variety of SMEs in terms of company size and business models, it is important that originators have comprehensive flexibility with regard to structuring their SME loans and tailoring these loans to the needs of individual SMEs. Any further standardisation for STS securitisations should be based on general principles which lead to certification/labelling. Further standardisation should be achieved by exploring already existing private sector initiatives such as the Prime Collateralised Securities Initiative (PCI), the True Sale International (TSI) or the Short term commercial paper program (STEP label).

Minority views underline that further standardisation of underlying assets and securitisation structures should be determined by the market and not by legislative intervention.

***D. Would more standardisation of loan level information, collection and dissemination of comparable credit information on SMEs promote further investment in these instruments?"***

The majority responded that a certain degree of standardisation at loan level information, collection and dissemination of comparable credit information on SMEs is considered to be essential for promoting investment in SME securitisation

Minority views pointed out that there is already sufficient standardisation of loan level information (via Prospectus Directive, Capital Requirements Regulation, Article 8b of the Credit Rating Agencies Regulation and its associated regulatory technical standards, as well as initiatives such as the Bank of England and ECB ABS reporting standards). Any additional transparency requirements that go beyond those already in place would be counterproductive. The same applies for any additional collection and publication of data and information.

**11. Miscellaneous**

***Question 17:***

***To what extent would a single EU securitisation instrument applicable to all financial sectors (insurance, asset management, banks) contribute to the development of the EU's securitisation markets? Which issues should be covered in such an instrument?***

***Number of contributions on this specific question: 64***

*Of which:*

Originators/issuers:16

Investors:13

Public authorities: 13

Service providers: 4

Others: 18

***No reply: 56***

7 respondents replied that a single EU securitisation instrument would to a great extent contribute to the development of the EU's securitisation market, while 20 agreed that a single instrument would contribute to the development of the market. 16 respondents did not directly reply to the question, but pleaded in favour of more regulatory consistency and a level playing field. 11 respondents thought that the creation of a single instrument is not appropriate and/or not a priority.

Those stakeholders that did not think the development of a single instrument is appropriate mainly pointed out that the requirements in different sectors are of a different nature (e.g. prudential requirements, diversity, risk profile and duration of assets); that a single instrument would require harmonisation of property/contract law and would run into legal and taxation issues; that the market already knows the existing Member State framework very well and/or that it would be very challenging to (further) harmonise.

Respondents also mentioned that the harmonised approach to STS securitisation could be a first step towards a single EU securitisation instrument. Overall, in their replies respondents did not focus too much on the legal instrument that would have to be used, but more on the effects of the legal instrument which should ensure more cross-sectoral consistency, more clarity of the existing rules in place and the potential time needed to put in place the new legal framework.

On the issues to be covered in such an instrument:

- Many stakeholders mentioned the STS criteria;
- Quite a number of respondents mentioned:
- Capital charges for banks and/insurers;
- Definitions (e.g. of default, performance metrics, boundaries between securitisation and investment);
- Disclosure rules;
- Risk retention;
- Harmonisation and/or simplification of the existing rules.
- A limited number of respondents mentioned the due diligence rules

***Question 18A:***

***For qualifying securitisation, what else could be done to encourage the further development of sustainable EU securitisation markets?***

**Number of contributions on this specific question: 43**

*Of which:*

Originators/issuers: 8

Investors: 4

Public authorities: 11

Service providers: 6

Others: 13

***No reply: 77***

Many of the things that according to respondents could be done to encourage the further development of sustainable EU securitisation markets were already mentioned in relation to other questions.

The most important elements mentioned were:

Harmonise and make more consistent the legal framework, standardisation;

The creation of a level playing field across instruments for prudential treatment;

Give an appropriate capital treatment to STS that is better than for non-STS;

Provide a more precise definition of what constitutes a significant risk transfer, also in context leverage ratio;

The costs securitisation vehicles incur when entering into derivatives and third party service agreements should not be increased unnecessarily;

Investigate whether off balance sheet treatment-tests are always applied consistently by auditors and whether processes can be improved;

Active participation and promotion of STS by local state and regulator, financial and publicity support of new intermediation models by public institutions;

Promotion of STS securitisation;

Due consideration should be given to the trading side under the MIFID rules so that there are no counterincentives to trade these instruments;

There may be a need to create a process for licencing the operators, product information, etc. based on the models of AIFMD or UCITS;

Consideration therefore needs to be given to the cost that regulatory changes have added to a securitisation issue;

SWAP counterparty availability and GIC accounts are a problem, which could be removed when a central bank would provide these services;

Ancillary facilities ranking senior or pari passu to rated positions have historically been unrated. At the moment a rating can be inferred from a rated position, only where this rated position is subordinated in all aspects to the unrated facility. This results in a higher cost of capital for providing these facilities. Being able to infer a rating from a rated position which ranks pari passu to the ancillary service would go some way to ensuring a more appropriate capital treatment for these unrated positions;

Makes an assessment whether non-bank investors are able to adequately assess the credit risks transferred and have the capacity to absorb or control these quantities of credit risk. These products shall not to be directly marketed to retail investors (Clarify certain conditions relating to the use of unfunded credit protection under Regulation 575/2013 (CRR), in particular Article 213(1)(c)(i) of CRR;

Credit quality should be irrelevant to the qualifying securitisation criteria;

Regulators and other participants must encourage investors to analyse securitisations with rigor and

objectivity;

All qualifying transactions and securities should be registered with a not-for-profit, jointly owned, limited purpose data repository (a “Utility”) to enable real-time monitoring of both the transaction’s actual vs. projected performance as well as the Market’s systemic dimensions (i.e. size, volume, participants and inter-linkages).

Look at costs for SME loans securitization.

***Question 18B: In relation to the table in Annex 2 are there any other changes to securitisation requirements across the various aspects of EU legislation that would increase effectiveness or consistency?***

**Number of contributions on this specific question: 25**

*Of which:*

Originators/issuers: 8

Investors: 1

Public authorities: 8

Service providers: 2

Others: 6

***No reply: 95***

The 25 respondents that replied to this question mentioned a large number of different issues. In many cases the issues also relate to other questions in the consultation.

The topic that was most raised was cross-sectoral consistency of the (interpretation/application of the) EU securitisation rules, including the STS terminology.

Other issues mentioned were:

Clarify the application of AIFM Directive on securitisation vehicles.

Ensure a non-discriminatory regulatory treatment of securitisation compared to similar asset classes.

Exclude securitisation vehicles from collateralisation requirements under EMIR for securitisation;

Concerns about minimal rating requirements for swap providers that are necessary for a securitisation to obtain a given rating;

Regulatory and prudential provisions should be adapted/clarified. For instance, leverage ratio rules allow for too much scope of interpretation/should allow deduction of any securitisation tranches sold to third party investors from the total balance-sheet size used for the computation of the leverage ratio and NSFR creates a too harsh treatment of securitisation;

The creation of a uniform European standard (for tax, civil and insolvency law issues), at least for the securitisation of bank loans, would be desirable.

Do public business promotion and economic development programs on a national and EU level, linking securitisation and public economic promotion

Give due consideration on the trading side under the MIFID rules so that there are no counterincentives to trade these instruments (EBF, Luxembourg Bankers' Association)

May need to create a process for licencing the operators and product information based on the models of AIFMD or UCITS;

Essential that the Money Market Funds Regulation preserve the ability of money market funds to invest in qualifying securitisations in both the long term ABS and the short term markets ABCP market;

Concerns that the revised securitisation framework results in excessive risk weights for both senior and junior CMBS bonds, as compared to other financial instruments;

Originators should ensure that their offering documentation includes specific relevant information disclosures to make it easier for investors to satisfy specific contractual, fiduciary or statutory compliance requirements for certain investments;

Either increasing the 'illiquid' bucket in UCITS from 10% or specifically determining qualifying securitisations to be 'liquid' for purposes of UCITS;

Legal ring-fencing of trust accounts related to co-mingling and/or set-off amounts would ideally be achieved to reduce cash reserve requirements which increase the costs of issuing securitisations due to lack of legal clarity/risk;

When developing the STS criteria the national legislations concerning inter alia insolvency and company law should not be overlooked;

Harmonised application of accounting standards;

Consideration may also be given to Delegated Regulation (EU) 1187/2014 as regards RTS for determining the overall exposure to a client or a group of connected clients in respect of transactions with underlying assets;

Systematic support of Member States for the securitisation issued in their countries is not needed, nor any other type of guarantee provided by State agencies. Public support should be limited to an efficient legal framework.

#### **4. LIST OF RESPONDENTS**

Advisory Committee of the CNMV (Spanish National Securities Market Commission)

AMAFI

AMUNDI

APG Asset Management N.V.

Asset Management and Investors Council (AMIC) at the International Capital Market Association (ICMA)

Association for Financial Markets in Europe

Association Française de la Gestion financière (AFG)

Association française des Sociétés Financières

Associazione Bancaria Italiana

Assogestioni

Austrian Federal Economic Chamber, Division Bank and Insurance

Austrian Federal Ministry of Finance, Austrian Financial Market Authority

Autorité des Marchés Financiers

AXA INVESTMENT MANAGERS

Banking & Payments Federation Ireland (BPFI)

Banque de France/Autorité de Contrôle Prudentiel

Barclays Bank

BBVA

Better Finance

BlackRock

BNY Mellon

British Bankers Association

Building Societies Association

Bundesarbeitskammer Österreich

Bundesverband der Deutschen Industrie, Deutscher Industrie- und Handelskammertag, Deutsches Aktieninstitut

Casey Campbell

CNCIF

Commercial Real Estate Finance Council (CREFC) Europe

Confederation of Finnish Industries EK ry

Czech Ministry of Finance

Danish Bankers Association

Deutsche Bank

Deutsche Bundesbank

Dr Orkun Akseli

Dutch Securitisation Association

EACB - European Association of Co-operative Banks  
EIOPA  
EMPLOYERS OF CONSTRUCTION OF ARAGON CONFEDERATION  
EURONEXT  
European Association of Public Banks  
European Banking Federation  
European Central Bank  
European Fund and Asset management Association (EFAMA)  
European Mortgage Federation  
European Savings and Retail Banking Group (ESBG)  
European Securities and Markets Authority (ESMA)  
Fédération Française des Sociétés d'Assurances (FFSA)  
Federation of Finnish Financial Services  
Finance & Leasing Association  
Finance Norway  
Finance Watch  
Financial Law Committee of the City of London Law Society  
French banking Federation  
German Banking Industry Committee  
German Federal Ministry of Finance  
Gouvernement Français  
Groupe GTI  
HM Treasury  
ICI Global  
Insurance Europe  
INTERMONEY TITULIZACION, SGFT,S.A.  
International Capital Market Association  
Irish Debt Securities Association  
Irish Department of Finance (Ministry)  
Irish Securitisation Industry Working Group  
Irish Stock Exchange  
K&L Gates LLP  
Leaseurope and Eurofinas (joint response)  
Loan Market Association



Luxembourg Investment Fund Association (ALFI)  
M&G Investment Management Ltd.  
Magyar Nemzeti Bank (Central Bank of Hungary)  
Managed Funds Association  
MEDEF  
Ministry of Finance  
Ministry of finance of the Slovak republic  
Moody's Investors Service  
Nomura International plc  
ORRICK, HERRINGTON & SUTICLIFFE  
Osterreichischer Sparkassenverband  
PensionsEurope  
Philippe CREPPY  
Prime Collateralised Securities (PCS)  
Realkreditaadet (Association of Danish Mortgage Banks)  
REGULATION PARTNERS  
Risk Control Limited  
RJM Consulting  
Schroders  
Scope Ratings AG  
Société française des Analystes Financiers  
Spanish National Securities Market Commission (Comision Nacional del Mercado de Valores - CNMV)  
Standard & Poors Rating Services  
State Street Corporation  
States of Guernsey  
Structured Finance Industry Group  
Swiss Finance Council  
The Alternative Investment Management Association (AIMA)  
The Association of Corporate Treasurers  
The Investment Association  
The Luxembourg Bankers Association - The ABBL  
The Netherlands Ministry of Finance, also on behalf of the Netherlands Authority for the Financial Markets (AFM) and the Dutch Central Bank (DNB)  
The Swedish Government and the Swedish authorities (Finansinspektionen and Riksbanken)

Thomas Zmugg

True Sale International GmbH, Frankfurt am Main, Germany

UBS AG

UEPC

UniCredit

Union Asset Management Holding AG

Verband der Automobilindustrie e.V. (VDA)

William J. Harrington, Experts Board - Key Expert on Structured Finance Topics, Wikirating

## **ANNEX 8 – Findings from the COM Questionnaire to FSC Members on securitisation**

The European Commission has received 17 replies on the FSC questionnaire on simple transparent and standardised securitisation (Austria, Bulgaria, Croatia, the Czech Republic, Estonia, Finland, France, Germany, Greece, Italy, Latvia, Lithuania, the Netherlands, Portugal, Romania, Spain and the United Kingdom).

### **A. General**

*The EU framework for EU securitisation is composed of a large number of EU legal acts. These include the Capital Requirements Regulation for Banks, the Solvency II Directive for insurers and the UCITS and AIFMD Directives for asset managers. Legal provisions, notably on information disclosure and transparency, are also laid down in the Regulation on Credit Rating Agencies and the Prospectus Directive.*

#### ***Question 1***

**a) Are there in addition to the transposition measures of the EU legal acts mentioned above specific legislative and regulatory provisions in your country that create a legal framework for securitisation? Is there any specific soft-law or guidance that covers this issue?**

Ten respondents (Austria, Bulgaria, Croatia, the Czech Republic, Estonia, Finland, Germany, Lithuania, the Netherlands and the United Kingdom) indicated that they do not have in place specific legislative and regulatory provisions for securitisation, besides the measures transposing the relevant EU legal acts. Some of these respondents pointed out that despite the inexistence of a specific legal framework, guidance, regulations and guidelines relevant to securitisation have been issued by regulators as well as market sponsored bodies.

Seven respondents (France, Greece, Italy, Latvia, Portugal, Romania and Spain) noted that they have established a legal framework regarding securitisation.

**b) If there are such specific provisions, soft-law or guidance, what has been the impact of these on the market? Please include, where possible, references to data or studies that underpin your analysis.**

With regard to the impact of the securitisation legal framework on the market two respondents (Latvia, Romania) pointed out that such impact cannot be estimated due to the lack of securitisation activity in the country, while **Greece** replied that such data are not available. **Spain** indicated that even though the existence of a solid regulatory framework has shielded the market from episodes of financial instability, securitisation activity has been subdued for the past 7 years. Finally, **France** noted that the solid legal framework helps securitisation structures remain simple.

**c) Do you believe that any evolutions in these rules, soft-law or guidance are needed to re-boot securitisation markets taking notably into account developments at international and EU levels?**

There is no consensus on the need for evolution of the established national legal framework to re-boot the securitisation market. Three respondents (France, Greece and Portugal) noted that the framework currently in force is reliable and resilient, pointing out other obstacles (such as the rating caps imposed by the rating agencies and the increased capital charges for investments in securitisation), which inhibit the development of securitisation. **Romania** and **Latvia** indicated that a review of the national securitisation framework, in light of the developments at the EU and international level, is necessary and fitting. **Italy** explained that the Italian securitisation framework will be revised to reflect the developments agreed at international and European level especially as to the initiatives for developing a simple and transparent securitisation market. **Spain** indicated that they have already adopted a new legal framework, which updates the regime on securitisation.

## **B. Harmonisation of securitisation structures**

### **Question 2:**

**a) Are there any specific legislative and regulatory provisions in your country that create a specific legal framework for the structure of securitisation transactions? Please describe the main characteristics of this framework.**

Six respondents (France, Greece, Italy, Portugal, Romania and Spain) provided details of the specific legislative provisions which create a framework for securitisation and regulate issues such as: the establishment of a special purpose vehicle, the transfer of receivables, the taxation of the transfers and the SPVs, the insolvency of the originator and data protection. Three respondents (Germany, the Netherlands and the United Kingdom) explained that there is no specific framework for securitisation and transactions are carried out under general law provisions.

**b) What best practices from your market could in your view be useful at EU level in order to help issuers as well as boost investor appetite in EU securitised products?**

**France** stated that establishing a vehicle that is supported by a strong legal framework, is subject to strong regulatory requirements and is monitored by a responsible actor with legal personality acting in the best interest of investors, is a good practice that could be useful at EU level. **Germany** indicated as a best practice from its market, the True Sale International GmbH (TSI), which was founded on the initiative of 13 German banks. The TSI has established standards for transparency, investor information, lending and loan processing and also provides certification services for a

corresponding and widely accepted German securitisation standard.<sup>32</sup> In addition to that, a wholly owned subsidiary of the TSI provides special purpose vehicles (SPVs) under German law that have been used since 2005 in almost 100 securitisations transactions. **Portugal** highlighted the fact that under its law the same STC (credit Securitisation Company) may be used by different originators to issue an unlimited number of separate transactions is often seen as an efficient solution for originators. **Spain** mentioned as good practices the favouring of true sale operations (compared to synthetic operations), that only credit claims can transferred to the SPV (other types of movable and immovable property are not allowed) and the especially demanding transparency requirements. The **United Kingdom** indicated that the flexibility of its regime which has enabled innovation in securitisation and the securitisation of a wide range of asset classes is well regarded by market operators.

**c) Are there in you jurisdiction any obstacles for the transfer of pools of assets to SPVs established outside your jurisdiction?**

Ten respondents (Austria, Czech Republic, Germany, Greece, Italy, Latvia, Lithuania<sup>33</sup>, the Netherlands, Spain and the United Kingdom<sup>34</sup>) reported no specific obstacles that would prevent the transfer of pools of assets to SPVs established outside the country's jurisdiction. **Romania** indicated that such transfers are only permissible to SPVs authorised by the national financial supervision authority. **France** stated that the origination or purchase of non-matured receivables as regular business practice is regarded under French law as a credit activity and thus requires licensing as a credit institution in France (or the use of a European passport). SPVs subject to French law are allowed to acquire these non-mature receivables to conduct business without having to apply for a licence.

**d) In terms of harmonisation, are there any other initiatives in your country that would deserve a specific attention?**

**Germany** referred to the TSI initiative discussed in its reply under question 3b. **Romania** noted that amendments aimed at strengthening the regulation of prudential supervision of the quality of debts portfolio used to back-up the issued financial instruments and the issuance activity, are currently in progress. The **United Kingdom** indicated that while there are no initiatives, there is a degree of harmonisation of the business models and securitisation programmes of the major securitisation issuers brought about by market pressure and market discipline. In addition to that, common standards have been introduced at the underlying assets level. Finally, the introduction of transparency criteria by the Bank of England and the ECB, has led to greater standardisation between issuers.

**e) Regarding infrastructures (for example trading/issuing venues) related to securitisation, are there any initiatives in your country that would deserve specific attention? If specific infrastructures have been developed, please describe them and specify their importance (for example share of total transactions being traded/issued on each venue).**

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<sup>32</sup> Originate to distribute securitisations are explicitly excluded from the potential scope of application of these standards

<sup>33</sup> The transfer would have to comply with the requirements set forth by general laws.

<sup>34</sup> However the transfer of certain types of receivable may give rise to additional requirements, for example a transferee of consumer receivables requires a license from the UK consumer credit regulator, whereas a buyer of residential mortgage loans may require authorisation from the FCA.

Ten respondents (Austria, Croatia, Germany, Greece, Latvia, Lithuania, the Netherlands, Romania, Spain and the United Kingdom) indicated that there are no initiatives related to securitisation infrastructure that deserve specific attention. **France** stated that a scheme has been developed for securitising loans to SMEs but no other specific infrastructure has been developed; **Spain** noted that securitisations can be traded both in regulated markets and multilateral trading facilities (Mercado Alternativo de Renta Fija).

### C. SME securitisations

#### Question 3:

What is the current situation as regards SME securitisation in your country?

Ten respondents (Austria, Bulgaria, Croatia, Czech Republic, Estonia, Finland, Greece, Latvia, Lithuania, and Romania) indicated that there is no SME securitisation activity within their jurisdiction at the moment. Four respondents (France, the Netherlands, Portugal and the United Kingdom) noted that while there is some activity, SME securitisation never developed widely within their territory, with volumes being subdued. **Spain** stated that there is an operation in place that involves the securitisation of SMEs trade receivables. This operation takes place in the Spanish multilateral trading facility for fixed income.

Please describe your national schemes (if any) and/private sector initiatives for SME securitisation.

Four respondents (France, Germany, Italy and the United Kingdom) indicated that there have been initiatives for SME securitisation.

In **France** the main French banks, with the support of the Banque de France, have created the Euro Secured Notes Issuer (ESNI). This vehicle issues secured notes backed by bank loans to SMEs meeting the eligibility criteria for Eurosystem refinancing operations, measured by the Banque de France rating (FIBEN). Private loans transferred as part of a collateral arrangement in favor of ESNI shall nonetheless remain managed by the banking groups that granted them (each credit institution participating in ESNI has its own independent compartment) and the securities are not issued in tranches. These issues will provide a liquidity value to financing granted to SMEs and mid-tier companies and allow capital market participants to benefit from high quality collateral. The financial instruments issued may be used as collateral between capital market participants and as a new investment asset class for investors.

Another initiative is currently being developed by the Banque Publique d'Investissement (BPI France). In this structure, banks could sell a portion of their SME loans to a SPV (in order to allow for a correct alignment of interests, banks must keep between 60 and 80% of each loan), and BPI France would then guarantee the portion of the loans in the SPV. This would allow banks to deconsolidate their loans, while maintaining a commercial relationship with their clients. For BPI France, the structure ensures that its interventions focusing on addressing identified market failure in SMEs access to credit can be implemented without imposing constraints on the funding model of the banks.

In **Germany** the KfW PROMISE platform for synthetic securitisations of SME loans is structured as follows: a bank transfers the credit risk of a reference portfolio of SME loans to KfW via a credit default swap. The credit risk of the reference portfolio is then being tranching and KfW receives credit protection for the super senior tranche by a credit default swap with an investment bank acting as protection provider. The remaining risk of the reference portfolio is then first transferred

to a German SPV via a certificate of indebtedness or a credit default swap which is then finally transferring the credit risk to securitisation investors by issuing various credit linked notes. The proceeds from issuing the credit linked notes are then used to collateralise KfW's claims towards the issuing SPV resulting from the credit default swap. Main benefits of the PROMISE programme are its standardised structure and documentation and the reduction in capital requirements achieved by the originator due to KfW's favourable risk weight.

In **Italy**, there is the Confidi initiative (Confidi is an Italian non-bank financial intermediary providing SMEs with credit guarantees) and the tranching cover system where credit protection is directly bought from investors, in the form of a financial guarantee backed by cash collateral or personal notes or tranching the underlying portfolio using the Supervisory Formula Approach (SFA). This structure can also cover the risk of a new origination portfolio, thus facilitating new securitisations, which in turn would provide substantial new lending to the real economy

In the **United Kingdom** the British Business Bank has undertaken two initiatives under the Enable programme: Enable Funding and Enable Guarantees.

**Enable funding.** Under this scheme, the BBB will "warehouse" newly-originated asset finance receivables from different originators, who are generally not large enough to issue securitisations on their own. Once a stock has been built up, the BBB will seek to refinance by issuing a securitisation. This initiative is aimed at improving the provision of asset and lease finance to smaller UK businesses, and enabling smaller asset finance providers to access capital markets.

**Enable guarantees.** Under this scheme, the BBB can provide a guarantee to cover a portion of a designated portfolio's net credit losses in excess of an agreed threshold. The first transaction of the enable guarantee programme was completed with Clydesdale and Yorkshire Banks in March 2015. While this scheme does not involve a public securitisation, securitisation technology is used in tranching the risk of the asset portfolio, and in assessing the credit risk of the portfolio.

## **D. Miscellaneous**

**Question 4: Are there any specific issues related to your national experience on securitisation you would like to highlight?**

**Lithuania** noted its support for a harmonised framework for securitisation in the EU; Portugal highlighted the negative impact the post-crisis regulatory changes and the behaviour of credit rating agencies has had on the issuance and sale of ABS. **The Netherlands** pointed out the regulatory uncertainty and the high prospective capital charges as the main reasons behind the lack of activity in the RMBS market. **France** also highlighted the high cost of securitisation as opposed to other funding options and the need for standardisation and innovation. **Italy** noted that certain synthetic securitisation transactions aimed at SMEs can be as clear and transparent as traditional securitisation and offer significant added value in the bank management of risk and capital. Therefore, they should not be excluded from the framework of STS securitisation. **The United Kingdom** finally indicated that the small number of large banking institutions, which have similar business models leads to economies of scale which benefit not only banks but also investors. In addition to that, the government's initiatives have enabled smaller banks to access the securitisation markets.

## Replies to the FSC questionnaire

	<b>Existence of specific legislative and regulatory provisions?</b>	<b>Impact of the existing legal framework on the market?</b>	<b>Would evolution of the existing national legal framework be needed to re-boot the market?</b>
Austria	No	N/A	N/A
Bulgaria	No	N/A	N/A
Croatia	No	N/A	N/A
Czech Republic	No	N/A	N/A
Estonia	No	N/A	N/A
France	Yes	Positive	No
Finland	No	N/A	N/A
Germany	No	Positive	No
Greece	Yes	N/A	
Italy	Yes	N/A	Yes
Latvia	Yes	N/A	Yes
Lithuania	No	N/A	Yes
Netherlands	No	N/A	N/A
Portugal	Yes	N/A	No
Romania	Yes	No impact on the market	Yes
Spain	Yes	Positive	Yes
United Kingdom	No	Positive	

## Harmonisation of securitisation structures

	<b>Existence of a specific legal framework for the structure of securitisation transactions</b>	<b>Obstacles for the transfer of pool of assets to SPVs outside the country's jurisdiction?</b>	<b>Initiatives in term of harmonisation?</b>	<b>Infrastructures related to securitisation?</b>
Austria	No	No	No	No
Bulgaria	No	N/A	No	No
Croatia	No	N/A	N/A	N/A
Czech Republic	No	No	N/A	N/A
Estonia	No	N/A	N/A	N/A
France	Yes	No		Yes
Finland	No	N/A	N/A	N/A
Germany	No	No	Yes	No
Greece	Yes	No	No	No
Italy	Yes	No	No	No
Latvia	No	No	N/A	N/A
Lithuania	No	No	No	No
Netherlands	No	No	Yes	No
Portugal	Yes		N/A	No
Romania	Yes		Yes	No
Spain	Yes	No		Yes
United Kingdom	No	No		No



**SME securitisation****National schemes/private initiatives for SME securitisation**

Austria	No SME securitisation activity	No
Bulgaria	No SME securitisation activity	N/A
Croatia	No SME securitisation activity	N/A
Czech Republic	No SME securitisation activity	N/A
Estonia	No SME securitisation activity	N/A
France	Subdued volumes of SME securitisation activity	Euro Secured Notes Issuer (ESNI)/ Initiative of the Banque Publique de Investissement
Finland	No SME securitisation activity	N/A
Germany	Subdued volumes of SME securitisation activity	KfW promise platform
Greece	No SME securitisation activity	
Italy	No SME securitisation activity	Confidi
Latvia	No SME securitisation activity	N/A
Lithuania	No SME securitisation activity	N/A
Netherlands	Subdued volumes of SME securitisation activity	N/A
Portugal	Subdued volumes of SME securitisation activity	
Romania	No SME securitisation activity	N/A
Spain	Yes	N/A
United Kingdom	Subdued volumes of SME securitisation activity	British Business Bank Initiatives (Enable funding/ guarantees)

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