

December 4, 2024

VIA ELECTRONIC SUBMISSION

To: John Berrigan, Director-General of DG FISMA

From: Apollo Global Management, Inc.

Re: E.U. Securitisation – Structural Barriers to Supply-Side Capital Formation

### **Executive Summary**

#### **The Opportunity**

- The true sale securitisation market constitutes a significant capital formation opportunity, offering the ability to finance an extensive array of assets in a safe, regulated, and efficient manner
- True sale securitisation has been underutilized in the E.U. since the Global Financial Crisis (“GFC”), contributing to a current ~€12.7T gap vs. the U.S. in private capital formation
- Reinvigorating the E.U. true sale securitisation market can unlock €1T+ in incremental financing for the E.U. real economy

#### **The “Gap”: True Sale Securitisation and the E.U. Life Sector**

- Placed true sale securitisation democratizes credit markets, allowing a broad array of global investors to finance real economic demand and growth
- However, the E.U. currently lags the U.S. by a factor of ~6.5x (~€440B vs. ~€2.8T) in placed true sale securitisation outstanding
- Life insurers are particularly well-suited to finance the E.U.’s strategic, long-dated capital needs, but the European life sector currently holds only 0.33% of investment assets in securitisations (vs. ~17% for U.S. life insurers despite similar industry sizes)
- This is largely driven by Solvency II capital charges, even though investment grade securitisations have equal or safer credit risk than equivalently rated corporate credit
- The missing life insurer ‘bid’ dampens the broader E.U. securitisation market, reducing supply and demand at all points in offered securitisation tranches

#### **Key Drivers and Other Bid-Side Financing Issues**

- Solvency II capital charges for securitisations do not reflect their economic risk
- Current STS designation criteria are complex and narrow in scope
- Broad and uncertain scope of the ‘securitisation’ definition and what constitutes an ‘exposure’ under the Securitisation Regulation materially hinder E.U. financing activity

#### **Proposed Updates**

- Update Solvency II capital charges so that they reflect the economic risk of all asset classes in a consistent manner, including securitisations
- Simplify and clarify STS criteria, and consider including managed securitisations (e.g., CLOs)
- Clarify the regulatory and policy intention as to what is intended to be in scope of a “securitisation,” and consider carving out more asset classes as exempt

## Discussion

Apollo Global Management, Inc. (Apollo) appreciates the opportunity to submit comments to the European Commission regarding the E.U. securitisation framework. Apollo is a global investor specializing in retirement services and investment grade private credit, with approximately \$733B in assets under management as of September 30, 2024. In Athene, our retirement services business, we are deeply committed to helping our policyholders achieve safe, long-term retirement income. In our credit business, we provide financing to numerous constituents by efficiently accessing global institutional and savings capital and tailoring our credit products to financing needs.<sup>1</sup> Notably, Apollo is grateful to count 100+ insurance companies from around the world as partners through asset management and/or investment grade credit origination relationships. Taken together, our businesses are centered around (i) the consistent origination of safe, investment grade credit, supported by broad access to global capital sources, and (ii) providing consistent and safe incremental yield per unit of risk to our clients and policyholders.

Drawing on our extensive investment and capital raising experience across global markets, we are grateful to share our perspectives on the E.U. securitisation market which, in our view, constitutes a vast capital formation opportunity. As with any large, complex economy, the ability of European governments and businesses to access suitable financing is dependent on several economic and regulatory interdependencies. The effectiveness of this so-called ‘plumbing’ is central to the ability of supply-side capital to find and meet demand-side financing needs. Securitisation democratizes access to credit markets for borrowers and institutional investors, helping to pair diverse sources of funding with the needs of the real economy. However, notwithstanding this significant native ability, securitisation within the E.U. has been underutilized since the GFC, particularly when compared to the U.S.

Through our direct observations as a market participant and in reviewing recent reports<sup>2</sup> from Messrs. Draghi, Noyer and Letta, we recognize that there are many ‘plumbing issues’ that must be addressed to materially improve E.U. financing markets, including securitisation. However, we believe that the materiality of the demand-side issues for private financing and securitisation (or the ‘E.U. bid’) may not be fully addressed as part of the ongoing E.U. dialogue. Even if many of the technical areas being discussed are reformed (e.g., transparency, due diligence, ‘public’ versus ‘private’ securitisations, etc.) – which we agree are necessary to improve functioning of E.U. securitisation markets – the material capital formation sought by the Commission may not be realized without also addressing critical ‘bid’ side dynamics.

Since the GFC, the U.S. has experienced a significant expansion of its credit ecosystem, collectively embracing and leveraging the strengths of banks, insurance companies, and asset managers. The U.S. market is supported by matching long-term private capital sources to long-term financing needs. These developments in the U.S. market have contributed to its continued economic growth and resiliency, even during periods of stress following the GFC (e.g., COVID, interest rate volatility, etc.). The ability of E.U. institutions to access sources of private capital for long-term financing is among the most material gaps that we observe. Therefore, addressing ‘bid’ side dynamics impacting private capital participation is also among the largest opportunities

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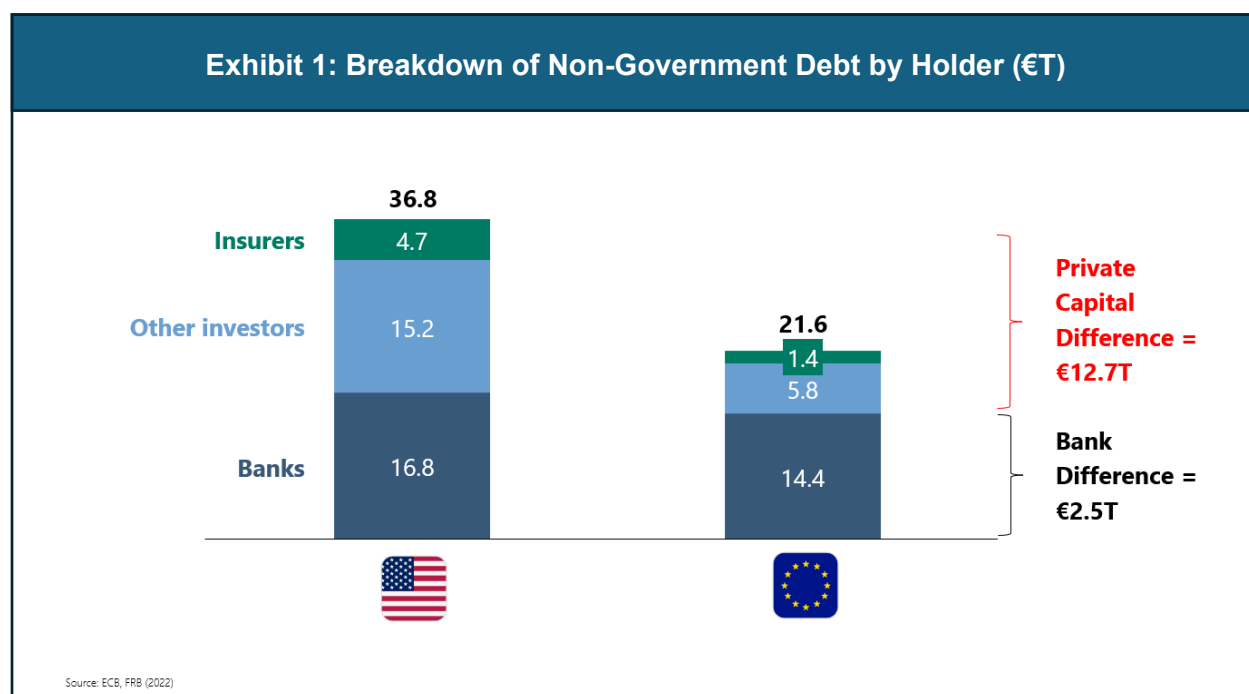
<sup>1</sup> Athene’s balance sheet is comprised of approximately 95% fixed income or cash; 97% of Athene’s balance sheet is IG as of September 30, 2024. Apollo has originated approximately \$154B of credit YTD as of September 30, 2024, ~80% of which is IG.

<sup>2</sup> Draghi, Mario, “The Future of European Competitiveness” ([Link](#)); Noyer, Christian, “Developing European Capital Markets to Finance the Future” ([Link](#)); Letta, Enrico, “Much More than a Market” ([Link](#))

capable of driving economic expansion within Europe. In particular with respect to the insurer 'bid,' we believe the Solvency II framework should be modified to ensure it treats securitisation consistently with other fixed income asset classes to reflect the actual risk.

### **The Backdrop: E.U. Economic Targets and Long-Dated Financing Needs**

Since the GFC, the GDP gap between the E.U. and U.S. has widened. While E.U. GDP and U.S. GDP were roughly equivalent in 2007, U.S. GDP is now ~1.5x greater.<sup>3</sup> While there are many contributors to this situation, as noted, a stark difference is with respect to private capital mobilization. We estimate that the aggregate value of non-government debt retained by European banks is only slightly below that held by U.S. banks (~€14.4T vs. ~€16.8T). However, the U.S. has accessed an incremental ~€12.7T in private capital to finance the real economy.



More broadly, the E.U. is more reliant on bank financing than the U.S. E.U. banking assets are ~€30T vs. U.S. banking assets of only ~€23.6T, despite a larger U.S. credit market.<sup>4</sup> For example, outstanding fixed income securities in the U.S. totaled ~€50.3T vs. ~€23.5T in the E.U.<sup>5</sup> It is clear that private capital formation presents a primary strategic opportunity that will support economic expansion within the E.U.

A vast amount of forward-looking E.U. financing demands are long-dated and will necessitate access to significant private capital. The Commission estimates that financing needs for the E.U.'s green and digital transitions alone will exceed €800B annually.<sup>6</sup> The ECB estimates that ~80% of this financing will need to come from outside of the public sector.<sup>7</sup>

<sup>3</sup> World Bank Open Data ([Link](#))

<sup>4</sup> ECB, "Understanding the Profitability Gap Between Euro Area and U.S. Global Systemically Important Banks" ([Link](#))

<sup>5</sup> SIFMA, "2024 Capital Markets Factbook" ([Link](#))

<sup>6</sup> European Commission, "Strategic Foresight Report 2023" ([Link](#))

<sup>7</sup> ECB, "Mind the gap: Europe's strategic investment needs and how to support them" ([Link](#))

While the complete inventory of issues affecting E.U. financing markets will be identified in detail by responses from other market participants, we believe that addressing ‘bid’ side dynamics may constitute an effective prerequisite to achieving the goals of the Commission and the Capital Markets Union. In this context, we have focused this letter on three critical E.U. ‘bid’-side financing issues:

1. Availability of funded, or true sale, securitisation placed with investors (“placed true sale”) and the role of the life insurance sector;
2. STS designation criteria, which as currently conceived constrains securitisation growth; and
3. Impaired financing activity that would not be commonly thought of as ‘securitisation’ by market participants, but nonetheless is being constrained by the broad and uncertain scope of the ‘securitisation’ definition<sup>8</sup>.

By addressing these issues, as well as those identified by other commentators, we believe that the E.U. can unlock **over €1T+ in incremental financing** (See **Appendix Exhibit A1**).

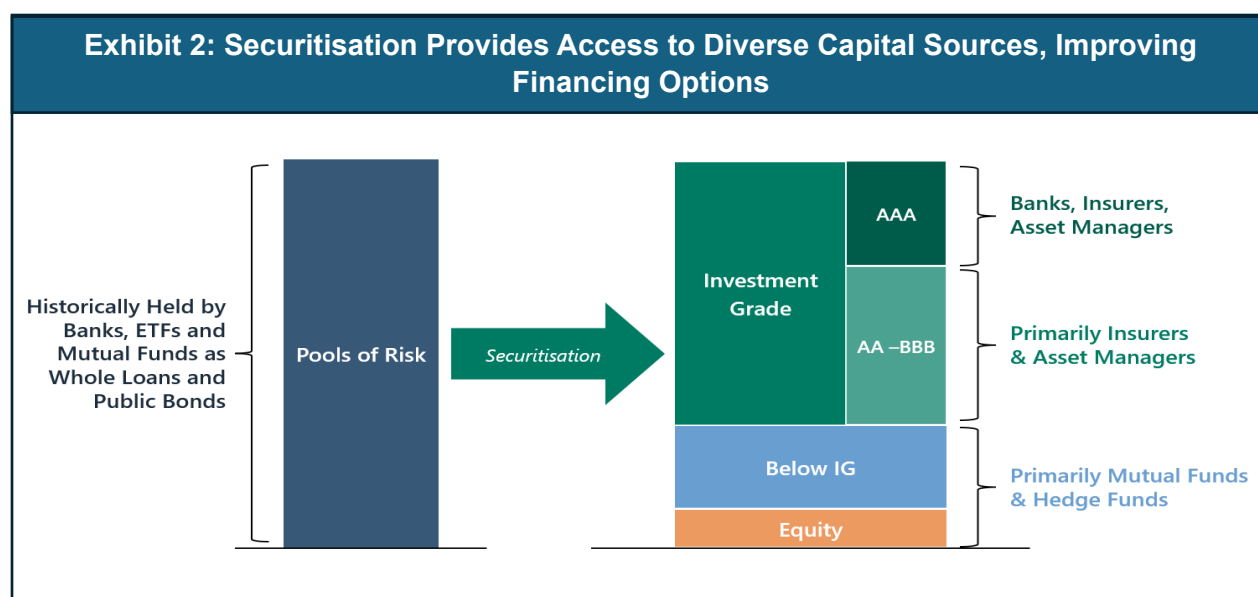
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## I. Two Interrelated Gaps: True Sale Securitisation and the Role of the Life Sector

### A. The First Gap: True Sale Securitisation

#### *Identifying the Gap*

Broadly, securitisation offers a means for the E.U. to raise private capital by democratizing credit markets, providing access to a broad set of global institutional investors with different risk and return appetites. In turn, securitisation markets allow banks and other lenders to manage capital positions to ensure that origination capital is available to meet economic demand and remains available through credit cycles.



<sup>8</sup> Article 2(1) of Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation ([Link](#))

There are two primary ways by which originators securitise credit in the E.U. and the U.S.:

- 1) Synthetic Securitisation (e.g., “SRTs”, or “CRTs” in the U.S.)
- 2) True Sale Securitisation (i.e., legal transfer of assets into a special-purpose vehicle)

Synthetic securitisation provides deposit banks with access to capital from third-party investors, who provide subordinate capital on specified pools of credit in exchange for a higher return. This subordinated ‘risk transfer’ to investors frees up bank capital, which can then be used for other corporate purposes. In theory, given the presence of third-party capital, synthetic securitisations should have the effect of causing banks to extend additional credit to the market and therefore facilitate incremental economic expansion. However, in practice, synthetic securitisations are often used for income management and so called ‘back-book optimization’, both designed to support the applicable bank’s equity valuation.<sup>9</sup> Therefore, the connection between synthetic securitisations and the expansion of credit (or new origination) in the economy has generally been relatively tenuous.<sup>10</sup> In addition, because synthetic securitisations do not result in the full movement of credit off of bank balance sheets, residual, interconnected credit risk must continue to be overseen and managed by sponsoring banks.

On the other hand, true sale has a more direct impact on credit availability in the economy. Placed true sale securitisation is an effective means of mobilizing private capital to fund the real economy by allowing long-term investors to directly finance long-term economic needs at all points in the securitisation credit tranches.<sup>11</sup> At the same time, this mechanism reduces interconnected risk to the banking system by fully transferring underlying credit assets (subject to any related risk retention requirements).

Following the GFC, the U.S. true sale securitisation market has expanded to finance the full breadth of the real economy, providing access to diverse capital sources and improving financing options for borrowers. The gap in this area between the E.U. and the U.S. is quite stark: we estimate that the E.U. lags the U.S. ~€440B vs. ~€2.8T in placed true sale securitisation outstanding, a difference of ~6.5x (excluding agency/GSE issuance in the U.S.).

### *Securitisation Safety – The Market Today*

As we examine the utility of placed true sale securitisation, we must acknowledge, of course, the role that securitisation had as a contributor to the GFC. Following the GFC, global policymakers adopted broad regulations to improve securitisation market safety and resilience and implemented several reforms to improve transparency and address conflicts of interest inherent in the ‘originate to distribute’ business models.

These key regulatory measures (both in the E.U. and the U.S.), including the ban on re-securitisations and certain rating methodologies, and the adoption of risk retention

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<sup>9</sup> Synthetic SRTs are predominately used for capital management purposes. The reason is that the full capital structure is not funded, and loans are not transferred which results in a risk transfer based on a guarantee with three credit events and the requirement by the bank to call the guarantee.

<sup>10</sup> Synthetic programs either do not implement at all (e.g. warehouse structures) or use less (e.g. replenishment) features compared to true securitisations which are required for a direct impact on increasing lending volumes. In addition, synthetic programs are often managed by finance and risk management of the bank but with no integration in front office pricing and origination. Materiality has been observed only for large and long-standing programs directly linked to the front office units and in the context of not reducing the lending or exiting this business line.

<sup>11</sup> True securitisation can also be sponsored by a broader set of market participants, thus allowing other lenders to more efficiently supplement bank credit offerings.

requirements, have resulted in significant structural improvements within the market. With respect to non-agency RMBS, S&P notes that bonds “are no longer backed by the type of subprime and Alt-A collateral that was widespread prior to the crisis”<sup>12</sup> (See **Appendix Exhibits A2 and A3** for further detail on structural improvements). Broadly speaking, these reforms have collectively had the desired effect of improving global securitisation market resilience, as noted by both regulators and market observers.<sup>13</sup>

In addition, many of the investment grade securitisation products that the market considers “core” today, such as CLOs, performed well through the crisis *before* these reforms were implemented. And the picture has only since improved, with the performance of post-crisis U.S. securitisations with investment-grade tranches outperforming comparably rated corporate bonds.

Exhibit 3: Market Losses by Asset Class (2001-2023)			
Rating	Corporates	CLO	Other ABS
Pre-Crisis (2001-2010)			
AAA	0.00%	0.00%	0.00%
AA	0.05%	0.00%	0.03%
A	0.11%	0.02%	0.17%
BBB	0.32%	0.18%	0.62%
BB	0.85%	0.31%	2.54%
B	2.97%	1.41%	9.72%
Post-Crisis (2011-2023)			
AAA	0.00%	0.00%	0.00%
AA	0.01%	0.00%	0.00%
A	0.03%	0.00%	0.00%
BBB	0.13%	0.00%	0.00%
BB	0.54%	0.03%	0.07%
B	1.54%	0.29%	1.06%

Represents the average default rate of U.S. products for all categories, except CLOs. CLOs represent the average of US CLO trailing 12-month impairment rate. 2001 - 2010 includes a discounted buyback of a pre-GFC CLO tranche (current CLO documents prohibit such activity); the related CLO transaction performed as expected and repaid all of its debt at par with no underlying impairment. Source: Moody's Annual Default Study (February 2023), S&P Annual Global Structured Finance Default and Rating Transition Study (March 2024), Moody's Impairment and loss rates of Global CLOs (June 2024).

The point of these comments *is not* that policymakers should reduce macroprudential risk surveillance regarding securitisation safety or that the U.S. approach to securitisation regulation should be adopted wholesale, but that when properly constructed, placed true sale securitisation is a crucial, highly effective, and safe mechanism for the capital formation necessary to fund the long-term needs of the real economy. Simply put, effective prudential

<sup>12</sup> S&P, “How U.S. Structured Finance Has Changed Since The Credit Crisis” ([Link](#))

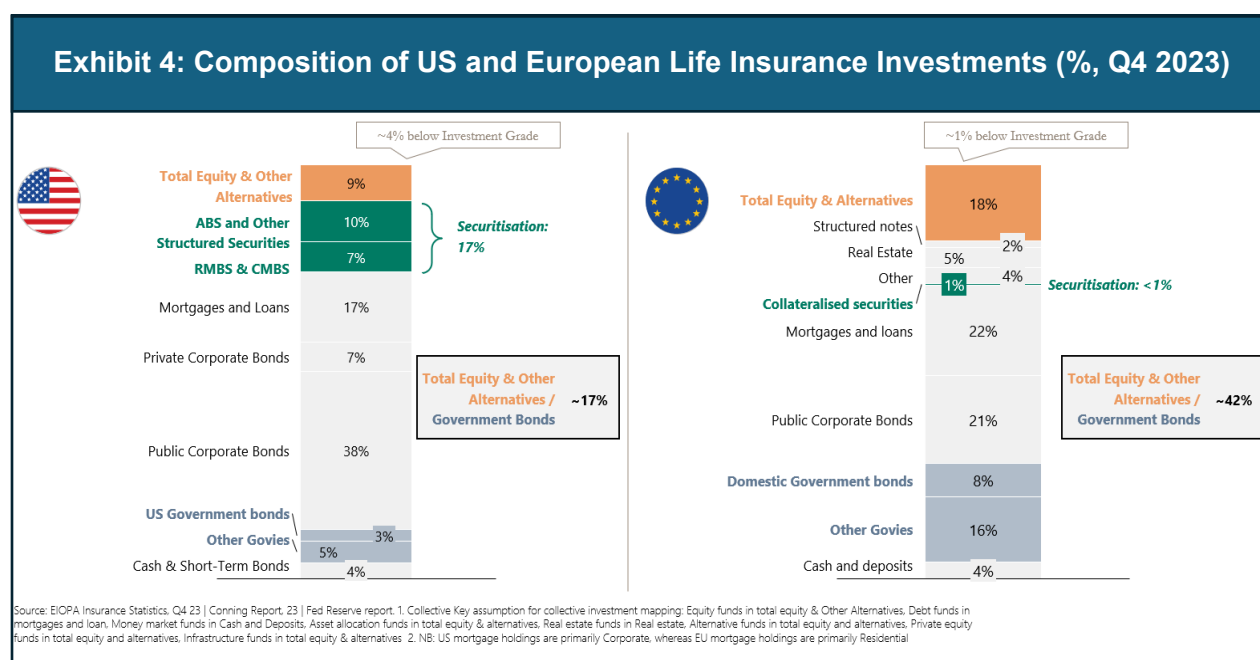
<sup>13</sup> FSB, “Evaluation of the Effects of the G20 Financial Regulatory Reforms on Securitisation” ([Link](#)) “The available literature suggests that risk retention and prudential requirements have generally enhanced the resilience of securitisation markets ... Default rates of structured finance products have declined in recent years, reflecting in part higher collateral quality, while subordination has increased. Many defaults following the GFC were concentrated in subprime RMBS and complex structured products, reflecting riskier loans that were originated and securitisation deals that were issued prior to the GFC”; S&P, “How U.S. Structured Finance Has Changed Since The Credit Crisis” ([Link](#)) “Regulatory changes, especially the Dodd-Frank Act, have for the most part better aligned issuer and investor incentives. This has helped make the structured finance market more transparent...for many structured products, there has been an increase in credit enhancement, making the senior tranches less risky.”

oversight of securitisation and reforms to enhance their contributions to the real economy are not mutually exclusive; the experience in the U.S. since the GFC demonstrates this.

## B. The Second Gap: Life Insurers – the Missing E.U. Lender

### *Identifying the Gap*

At a portfolio level, European life insurers have higher allocations to sovereign obligations and equities than U.S. life insurers (~42% vs. ~17%), which are invested in predominantly public and private investment-grade credit.<sup>14</sup> Drilling down another level, securitisation holdings are vastly lower within the European life sector relative to the U.S., with only 0.33% of their investment assets in securitisations (vs. ~17% in the U.S.).<sup>15</sup>



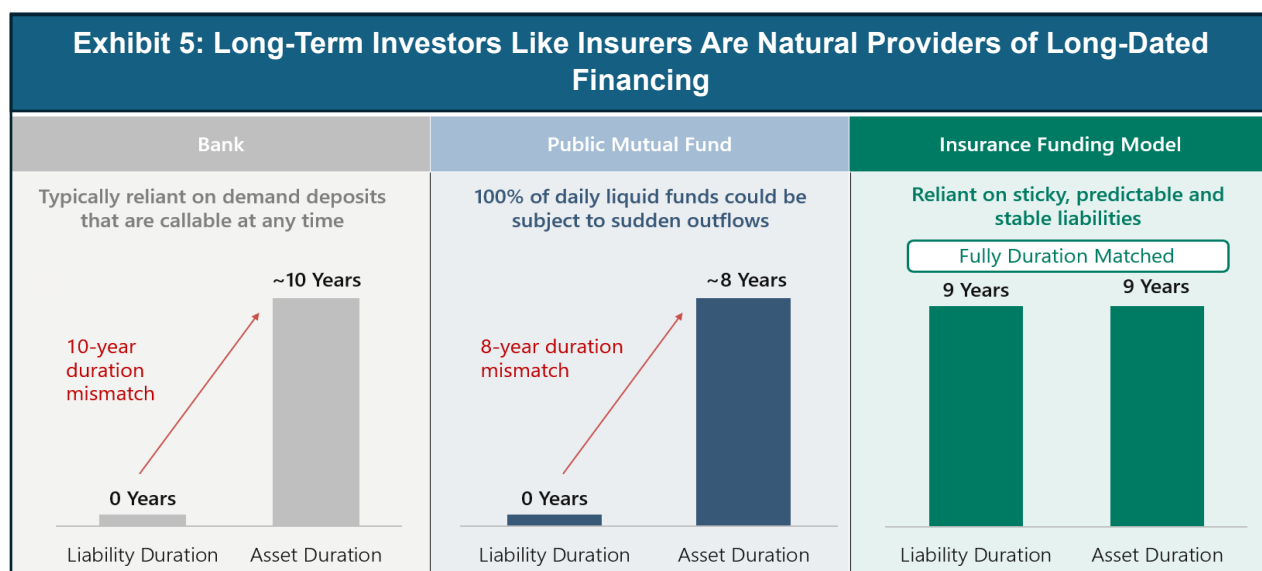
Insurers are particularly well-suited to access long-term savings capital from retirement populations via long-dated liabilities. In turn, life insurers can match-fund these liabilities by holding longer term credit investments. At its foundation, this core strength creates a compelling economic symbiosis: (i) access by retirees to incremental, safe yield overseen by professional managers in support of retirement income and (ii) long-term capital that can be tailored to the financing needs of the real economy.<sup>16</sup> This symbiosis empowers the financial services sector to contribute to resolving two critical policy priorities – addressing the retirement/savings gap and financing long-term economic needs.

<sup>14</sup> EIOPA Insurance Statistics (Q4 2023), Conning Report (2023); Federal Reserve. Includes ~0.5% real estate equity for E.U. life insurers.

<sup>15</sup> Joint Committee on the Review of the Securitisation Prudential Framework (Insurance) (December 2022) ([Link](#))

<sup>16</sup> See Coppola, "In Safe Hands: The Financial and Real Impact of Investor Composition Over the Credit Cycle" ([Link](#)); Chodorow-Reich, Ghent, Haddad, "Asset Insulators" ([Link](#)); Knox, Sorensen, "Insurers' Investments and Insurance Prices" ([Link](#))





We believe that the insurance sector’s ability to issue long-term liabilities paired with long-term financing is currently under-utilized within the E.U. The impact of this choice can be quite substantial considering sovereign debt and equity investments are less direct in converting long-term capital and savings to long-term financing for real economy demands. The difference in insurer securitisation investment contributes to the significant difference in insurer private capital mobilization noted in **Exhibit 1** (~€1.4T in the E.U., vs. ~€4.7T in the U.S.) despite similar industry sizes (~€6.3T in E.U. life insurer liabilities, vs. ~€7.5T in the U.S., see **Exhibit 8**).

Of course, the overall liability product design and needs of each country driving asset portfolio selection is quite complicated, as well as diverse, within the European ecosystem. However, there is one consistency – incentives resulting from the calibration of Solvency II regarding spread duration and securitisation capital charges.

### *The Impact of Spread Duration*

Within Solvency II, on a relative basis, life insurers are clearly incentivized to hold sovereigns, equities and shorter duration credit relative to longer dated credit given the nature of various features of the solvency calculation.<sup>17</sup> This is the major driver for why we believe there is such a large gap in long duration financing capabilities when comparing the U.S. and the E.U. life sectors. To be clear, this is not an assertion of the superiority of one solvency model over another, but rather to identify why, within Solvency II environments, we tend to observe this allocation preference. While beyond the scope of this letter, we believe a future consultation

<sup>17</sup> Under Solvency II, insurers that invest in public and private credit instruments are required to hold capital for a 99.5<sup>th</sup> percentile credit spread widening event over a one-year horizon. This means that market value losses and capital requirements are strictly increasing with the duration of these assets. For insurers using the Standard Formula, there is no mechanism to take credit for the fact that if assets back long term, stable insurance liabilities, such insurers are unlikely to become forced sellers (i.e., would be highly unlikely to realise the depressed market value in such spread stress event). Such an adjustment is only available for internal model insurers through modelling the dynamics of the volatility adjustment in stress and requires a complex and resource intensive regulatory approval process. By contrast, under Standard Formula EEA government bonds are treated as risk free, and certain types of equity investments receive preferential capital treatment reflecting their long-term nature. For instance, long term equity investments receive a 22% capital charge (provided the insurer can, among other requirements, demonstrate it can avoid forced sales in stress), compared to a 20% capital charge for a 10-year BBB corporate bond. This clearly incentivises investments into government bonds, short-dated credit, or certain types of equity over long-dated credit.



may be fruitful as we believe rebalancing the solvency incentives in a manner designed to increase insurer capabilities to issue long-term retirement products, match-funded with long-duration credit, would allow the E.U. to benefit from a material efficiency in a manner similar to that which exists in the U.S. market.

### *Securitisation Calibration*

As a credit asset, securitisation is affected by the impact of spread duration described above. However, spread duration is not the primary binding constraint that limits securitisation holdings by E.U. life insurers. Solvency II's calibration disproportionately penalizes securitisations vs. other asset classes, leading to distortions which impact the asset choices of European insurers. The result reflects design decisions made in the calibration for securitisations that effectively result in a punitive outcome, and one that is inconsistent with approaches taken for other assets. For example:

1. For non-STS securitisation, the calibration period considers only a six-year window spanning the GFC (2007-2013)<sup>18</sup>; this period represents high market stress and is inconsistent with the longer period (1999-2010)<sup>19</sup> used in the calibration for corporate bonds.
2. The underlying assets used in the calibration represent only a narrow segment of the potential universe of non-STS securitisations. Non-STS securitisations inherit a calibration based on "Type B" assets (that is, those assets that do not meet criteria to be considered lower risk assets), which is heavily concentrated on two asset types – CMBS and UK Non-Conforming RMBS. These types reflect neither the distribution nor breadth of current securitisations, and also ignore many asset classes considered lower risk.
3. For STS securitisation, the required capital does not appear to be linked directly to a quantitative analysis of the impacted assets. Solvency II capital charges for non-Senior STS securitisations have been identified as "quite high for short durations (0-5 years)."<sup>20</sup>

The combined effects of these decisions significantly constrain the ability of European insurers to provide financing through securitisation. The adverse calibration also results in significant differences in the capital requirements for similar assets depending on the form in which they are held. Even the highest-rated securitised tranches can have capital requirements far exceeding the requirements associated with the aggregate underlying assets, if held directly. For example: for a hypothetical portfolio of residential mortgages would carry a ~3% charge. If held in a RMBS, the highest-rated tranches could incur a capital charge of 5% (Senior STS), notwithstanding the structural subordination/credit enhancement that results in such a tranche becoming safer than the underlying; and, if the securitisation did not fully meet the STS criteria, which could occur due to either characteristics of the underlying loans or failure to comply with operational and documentation requirements, the capital requirements would increase to 62.5% – **~20x the underlying portfolio.**

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<sup>18</sup> EIOPA, Technical Report on Standard Formula Design and Calibration for Certain Long-Term Investments.

<sup>19</sup> EIOPA, The underlying assumptions in the Standard Formula for the Solvency Capital Requirement calculation (2014).

<sup>20</sup> EIOPA, Consultation Paper on the advice on the review of the securitisation prudential framework in Solvency II.

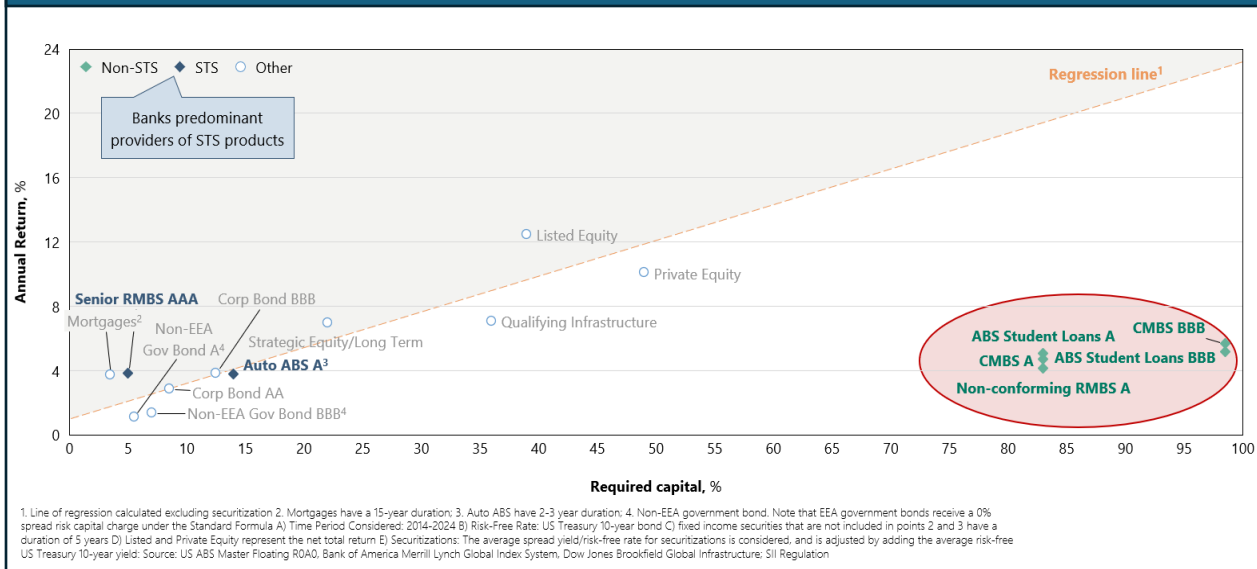
## Exhibit 6: Capital Charges Significantly Higher for Securitisations vs. Loans

5 Year Duration	CQS0 (AAA)	CQS1 (AA)	CQS2 (A)	CQS3 (BBB)	CQS4 (BB)	CQS5 & 6 (B & lower)	Unrated
<b>Residential Mortgage</b>							
Whole Loan Portfolio	-3.0% <sup>1</sup> (varies largely based on the LTV of the loan)						
RMBS - Senior STS (securitisation of above portfolio)	5.0%	6.0%	8.0%	14.0%	28.0%	47.0%	23.0%
<b>Leveraged Loan / Middle-Market</b>							
Leveraged Loan Portfolio	15% (for unrated loans)						
Collateralised Loan Obligation (securitisation of above portfolio)	62.5%	67.0%	83.0%	98.5%	100.0%	100.0%	100.0%
<b>European Infrastructure</b>							
Qualifying infrastructure (debt)	4.2%	3.9%	5.0%	8.4%	22.5%	37.5%	15.0%
Infrastructure held by SPV and financed by tranching debt (i.e., a securitisation)	62.5%	67.0%	83.0%	98.5%	100.0%	100.0%	100.0%

1. For example, portfolio consisting of all first lien Dutch residential mortgages, vintages 2003 – 2020, original tenor 5-40 years, both fixed and floating rate, original LTV mostly 60-80% (max 90%);

The significant capital charges for non-STs securitisations under the Standard Formula make them substantial outliers vs. other asset classes and render them impractical as investments for most E.U. insurers.

## Exhibit 7: Securitisation Calibration Results in Outliers on Return vs. Capital Ratio

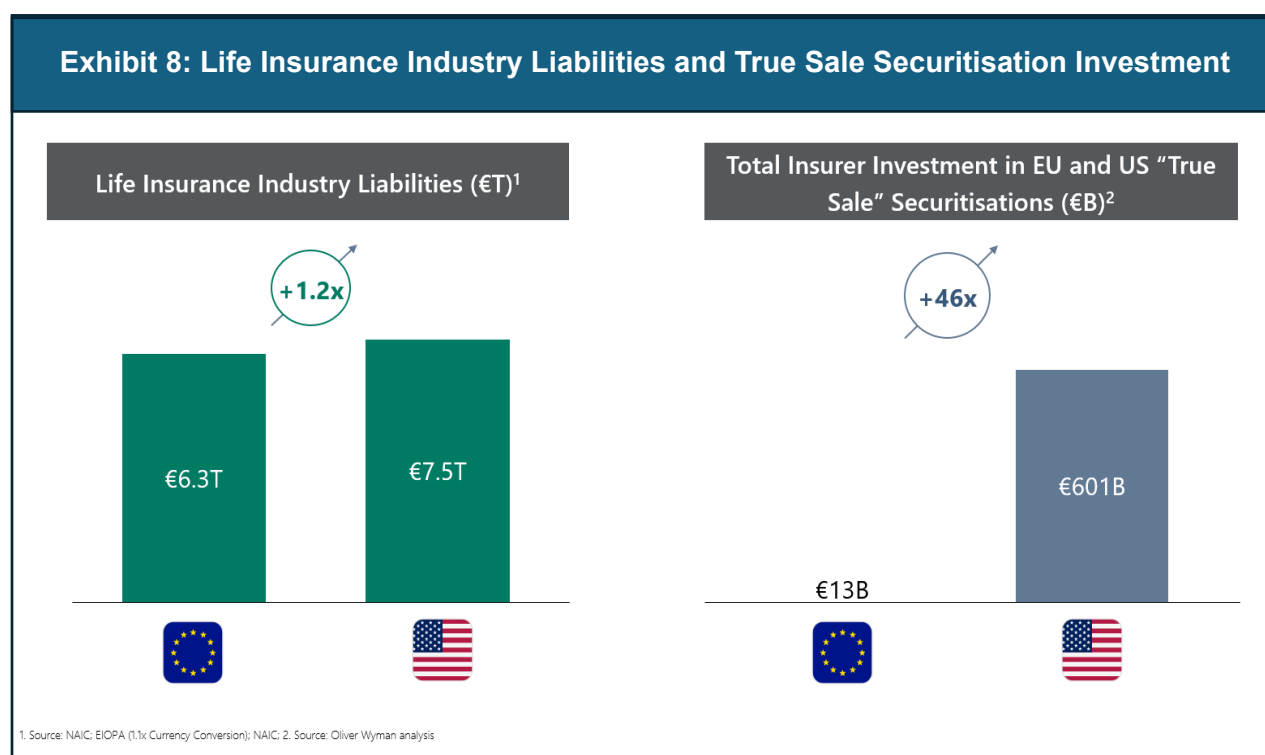


In addition to the securitisation risk capital calibration within the Standard Formula, we observe that the relative unlevel access to the benefits from approved internal models also contributes to the structural issues in E.U. securitisation. A relatively select few insurers (the 'haves') partially mitigate substantial capital charges on securitisation through relief granted under internal

models; however, such models are costly (> double digit €MM implementation cost) and have long implementation timelines (up to 5 years). As a result, this asymmetric solution, typically unavailable to small and medium insurance companies (the 'have nots'), hinders such firms' ability to invest, creating a structural advantage for larger firms and the absence of a properly functioning market. Thus, it is our view that the recalibration of charges within the Standard Formula should be reviewed to incent accretive capital formation, which, in our view, can and should be done whilst still adhering to strict standards of risk-based regulation.

### C. Taken Together: The Missing E.U. Lender

We estimate that U.S. insurers have **~46x greater** U.S. / E.U. true sale securitisation holdings than E.U. insurers (with the vast majority at the investment grade level), despite similar industry sizes (U.S. life insurance industry is only ~1.2x larger).



The U.S. true sale securitisation market relies on bids from banks, insurers and investors to support issuance across securitisation credit tranches. In particular, insurers form a very significant portion of the *investment grade* 'bid' across many securitisation types.<sup>21</sup> A missing 'bid' from one of these investors results in a knock-on effect in the broader securitisation market by increasing costs at all points in the securitisation tranches. This phenomenon ultimately becomes a self-fulfilling barrier to capital formation objectives.

While it is impossible to perfectly quantify the impact on overall availability of financing in the E.U., it is clearly quite significant. By comparison, we estimate that the U.S. has ~10x more domestic investment in domestic securitisation overall vs. the E.U., despite a GDP difference of

<sup>21</sup> We estimate that U.S. insurers hold ~40% of outstanding AA-BBB U.S. true sale securitisation tranches (excluding agency-backed), while E.U. insurers hold ~3% of AA-BBB E.U. tranches, a difference of ~13x.

only ~1.5x.<sup>22</sup> For a healthy securitisation market to develop, focus should be provided to addressing this domestic funding gap.

#### **D. Recommendations**

Regulation and market practice have further bolstered the risk profile of securitised products, making it prudent to take stock of whether insurance capital regimes consistently and dispassionately reflect economic risk or whether they inhibit the necessary flow of private capital to fund real economy investment.

Solvency II should be reexamined to ensure a level playing field for true sale securitisation, with capital charges that reflect the economic risks of each asset class. See Conclusion for our detailed recommendations.

### **II. STS Criteria – Too Complex and Restrictive**

#### **A. STS Label**

The STS label was implemented approximately five years ago as a means of bolstering the E.U. securitisation market. Securitisations that fit the simple, transparent and standardized criteria benefit from lower capital charges for banks and insurers. In practice, the label has had a limited impact on true sale securitisation issuance<sup>23</sup> and has artificially bifurcated the securitisation market into asset classes that benefit from more efficient capital sources than others despite otherwise equivalent economic risk.

As previously noted, we believe the Solvency II framework should be examined holistically to ensure it treats securitisation consistently with other fixed income asset classes and all assets in a market consistent basis reflecting the actual, quantitative risk. Such a change would have a much greater impact on the E.U. insurer ‘bid’ than changes to current STS criteria. However, recognizing the intensity and timeframe that such an amendment would require, addressing the STS criteria would offer incremental near-term economic benefits.

#### **B. Key Issues**

The STS label is onerous as currently constructed and is seemingly designed for a very narrow set of bank-dominated assets. Its “one-size-fits-all” approach to securitisation is often counter to the market-driven needs. Securitisation is not naturally homogenous and is diverse in terms of structures tailored to the myriad long-term assets capable of being financed. A highly prescriptive approach has resulted in many market participants not realizing a significant enough economic benefit to undertake the additional work to comply – the cost / benefit is a major disincentive for issuers.

Notably, STS is unavailable for managed transactions. The exclusion of securitisations (for example, CLOs) from being STS securitisations because they are actively managed is based on the assumption that actively managed portfolios are not “simple” and may present a greater risk than static portfolios. The historical performance of CLOs does not appear to support this

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<sup>22</sup> Domestic investment estimated using the following sources: Concept ABS, AFME, SIFMA (2023), Treasury International Capital (TIC) System U.S. Portfolio Holdings of Foreign Securities (2024), ESRB, ECB Securities Holdings Statistics, EIOPA JC-20222/67 Joint Committee Advice on Review of the Securitisation Prudential Framework, JPMorgan, Oliver Wyman.

<sup>23</sup> AFME Securitisation Data Report Q4 2023 and 2023 Full Year ([Link](#))

assumption. In fact, if this aspect of STS had resulted in the market moving toward static CLOs (i.e., without active management), such a trend would likely have had the effect of increasing risk by removing a major risk mitigant – their ability to take action in advance of and after contractual risk triggers are implicated.<sup>24</sup>

### **C. Recommendations**

Given the above and as further detailed in the Conclusion, we recommend that the criteria for the STS label be both broadened and simplified to maximize its ability to incent private capital formation and real economy investment. See Conclusion for our detailed recommendations.

## **III. Securitisation Regulation – a ‘Hidden Gap’**

### **A. Definitional Issues – ‘securitisation’ and ‘exposure’**

The definition of “securitisation”<sup>25</sup> within the Securitisation Regulation<sup>26</sup> is broad, and combined with the lack of definition for an “exposure”, is often the subject of significant market consternation and debate over their scope of application.<sup>27</sup>

Asset managers and related practitioners will quickly point out this is a significant qualitative barrier to capital formation. In our own experience, we have sponsored many financings to European businesses that (i) are not considered to be securitisations outside of Europe, but (ii) nonetheless restrict European investors from investing due to the broad nature of the definition of “securitisation” and uncertainty in regards as to what constitutes an “exposure”. These financings generally include provisions that prioritize lender obligations (i.e., tranching<sup>28</sup>) in an inter-creditor arrangement but that are not generally considered to be securitisation (outside of the E.U.) given either (i) the absence of self-liquidating assets (ii) the availability of an expressed exception to the relevant securitisation regime, and/or (iii) a market-wide safe harbor. We have observed a number of different market reactions and ‘solutions’ to these issues.<sup>29</sup>

If the ‘securitisation’ definition attaches to a transaction, various legal requirements under the Securitisation Regulation apply, including that “institutional investors” undertake legal due diligence under Article 5 prior to holding the relevant position and issuers produce prescriptive transparency reports under Article 7. In practice, a necessary prerequisite to a broad universe of

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<sup>24</sup> S&P, “CLO Spotlight: Managers Matter: Active Management Of U.S. BSL CLOs During Uncertain Times Shows Its Value” ([Link](#))

<sup>25</sup> Article 2(1).

<sup>26</sup> Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation ([Link](#))

<sup>27</sup> The rules, and policy intent, clearly include typical products that use securitisation techniques such as RMBS, CMBS, ABS and CLOs. However, due to its broad nature, the definition often intersects with, and therefore hinders, other financing transactions which the market would not ordinarily consider a ‘securitisation.’

<sup>28</sup> In the EU, under the Securitisation Regulation, ‘tranching’ is one of the key requirements that brings a financing transaction within scope of being a ‘securitisation’ despite this financing technique being used on transactions outside of the securitisation market where there is more than one source of capital; which consequently, then places a greater emphasis on what constitutes an ‘exposure’ to determine whether a transaction is a ‘securitisation’.

<sup>29</sup> For example, ranging from (a) over-structuring / complicating cross-border transactions to ensure they meet E.U. regulatory constructs e.g. third country asset managers which would be perfectly valid “sponsors” but must satisfy the “originator” requirements to be valid retention holders; (b) E.U. institutional investors withdrawing capital or forgoing investment opportunities e.g. withdrawing capital / not investing in multi-strategy funds supporting a wide range of E.U. assets because there is a ‘securitisation’ position in the fund and the concern of being sanctioned for holding an ‘indirect’ exposure; and (c) the widespread view that the Securitisation Regulation is in the “hard basket” resulting in third-country issuers not offering investments to E.U. institutional investors and thereby reducing the diversification and yield available to E.U. institutional investors such as insurers and pension funds.

financings in today's markets, where there are non-physical assets being financed directly or indirectly by more than one source of capital, is whether such financing is within or outside of the 'securitisation' definition despite not having the traditional hallmarks of a securitisation product.

Coupled with the broad scope of the rules, of particular concern is the (unclear) indirect application, and (potential) "look-through" analysis that E.U. institutional investors must apply before investing in certain financing transactions. Article 2(19) defines a "securitisation position" to be an "**exposure** to a securitisation". However, the term "exposure" is not defined but is interpreted broadly. If an institutional investor invests 'directly' in a securitisation, for example by purchasing notes issued in an RMBS transaction, this would clearly be considered to be an "exposure" and a "securitisation position". However, for many financing transactions and investments, issuers and E.U. institutional investors must also consider whether the rules (a) include 'indirect' exposures (for example, if an E.U. institutional investor invests in a fund which in turn holds a securitisation position, even if *de minimis* in value), and (b) if so, the scope of such indirect exposures.

Out of concern for significant (and understandable) penalties for non-compliance, these definitions are interpreted with exceptional conservatism. Therefore, market participants tend to cast a 'wide net' to 'securitisation' transactions; broader than those intended to be within the policy guardrails of the Securitisation Regulation. This blind spot, or 'hidden gap', is in turn creating an unquantifiable negative effect on real world financing throughout the European economy.

This lack of clarity unfortunately distorts the flow of private capital within and into the E.U. While it is difficult to accurately measure the impact of these distortions, in our experience they have had a significant impact on the E.U.'s ability to efficiently finance its real economy.

## B. Recommendations

We believe the Securitisation Regulation could be materially improved. We have set out our recommendations below.

### Conclusion

In sum, by taking the following actions and by addressing other issues with the regulation of securitisation in Europe that consultation respondents will raise, we estimate that the E.U. should be able to unlock €1T+ in incremental financing (See **Appendix Exhibit A1**).

Drivers	Proposed Actions
<b>Solvency II Calibration</b>	<ul style="list-style-type: none"> <li>• <b>Revise calibration assumptions by extending the underlying historical series</b> from the current 7 years to align with Corporate Fixed Income calibration standards</li> <li>• <b>Revise basket of indices to ensure it is fit-for-purpose</b> for the E.U. post-Brexit securitisation market</li> <li>• <b>Increase granularity of risk factors, considering the key characteristics of a securitised instrument</b>, including but not limited to the nature of the underlying assets (real assets/financial assets, etc.), collateralization, (non-) conforming status, and seniority</li> </ul>

Drivers	Proposed Actions
<b>Solvency II Calibration</b> (Continued)	<ul style="list-style-type: none"> <li>• <b>Increase granularity of securitisation treatment under the Standard Formula by segmenting the non-STS category into further sub-categories</b> (e.g., senior / junior and creating a new mezzanine STS tranche for securitisations)</li> </ul>
<b>STS Designation Criteria</b>	<ul style="list-style-type: none"> <li>• <b>Provide clearer guidance on compliance</b> and apply a proportionate and principles-based approach to the application of the rules</li> <li>• <b>Simplify STS criteria</b> so that sell-side parties can apply a more effective process of asset eligibility checking and investors can more easily review and verify compliance</li> <li>• <b>Allow managed securitisations.</b> The STS classification should be available to all securitisation asset classes which have shown consistent high levels of performance and low default rates regardless of whether they are actively managed or static</li> </ul>
<b>Overall Scope of Securitisation Regulation</b>	<ul style="list-style-type: none"> <li>• <b>Clarify the regulatory and policy intention as to what is intended to be in scope of a ‘securitisation’</b> by expressly defining an ‘exposure’<sup>30</sup> in a clear and targeted way that is understood by the market as falling within the scope of a ‘securitisation’ transaction<sup>31</sup></li> <li>• Clarify whether a ‘securitisation position’ is intended to capture <b>indirect exposures</b><sup>32</sup></li> <li>• If <b>indirect exposures</b> are in scope, set out guidelines and limits e.g. on the type of ‘indirect’ investments caught, their quantum and duration</li> <li>• <b>Carve out more asset classes</b><sup>33</sup> for example, those assets which are strategically important to long term economic growth, have a low default rate history, address asymmetry of information, an assessment of non-credit related risks and alignment of interests, and transactions solely between sophisticated parties which already address these risks and inbuilt protections. For example, open market CLOs, ABL facilities and private warehouse facilities</li> <li>• We believe it would be most helpful if there was market guidance from the E.U. by way of a <b>Q&amp;A on the definitions of ‘securitisation’ and ‘exposure’</b></li> </ul>

<sup>30</sup> As used in the definition of ‘securitisation.’

<sup>31</sup> For example, as any “self-liquidating financial asset including a loan, a lease, a mortgage, a secured or unsecured receivable [*include other asset classes considered to be in the policy scope of the Securitisation Regulation*].”

<sup>32</sup> Or only direct exposures when an E.U. institutional investor directly holds a tranchised security or debt instrument issued by a securitisation SSPE.

<sup>33</sup> By expanding the list of assets which are out of scope of the Securitisation Regulation in limb (c) of the definition of ‘securitisation.’



## Appendix

### Exhibit A1: E.U. Can Unlock €1T+ in Financing

Collateral		Underlying credit market in € bn	Size in % of GDP in % of GDP	Securitisation before Retention in € bn	Securitisation Share in % of underlying	Uplift in Securitisation in € bn	Including Add'l Market Uplift <sup>1</sup> in € bn
BSL / Middle Market (CLOs)	EU	623	~4	229	~37	~22	~232
	USA	1,715	~7	689	~40		
CRE (CMBS)	EU	1,414	~8	7	~<1	~150	~392
	USA	5,364	~21	597 <sup>1</sup>	~11		
Residential (RMBS)	EU	6,782	~39	423	~6	~237	~237 <sup>4</sup>
	USA	8,363 / 6,455 / 14,818	~25 / 58 <sup>2</sup>	628	~10		
Auto Loans & Leases	EU	653	~4	66	~10	~73	~162
	USA	1,605	~6	341	~21		
Credit Cards/Student Loans/Consumer Credit	EU	942	~5	82	~9	~0	~36
	USA	2,967	~12	176	~6		
Lease	EU	336	~2	11	~3	~29	~54
	USA	815	~3	98	~12		

1. Aggregated potential impact: Assumption of US securitisation shares for Europe and simultaneous market-share alignment (underlying market - GDP)
2. Before and after agency eligible underlying market
3. Includes additional EUR 16bn of US Data Centre ABS which are not classified as CMBS structures
4. Aggregated uplift based on increase in securitisation share

Source: AFME, SIFMA, Oliver Wyman analysis






### Exhibit A2: Securitisation Pre- and Post-Crisis

	PRE-CRISIS	POST-CRISIS
EXAMPLE	Pre-2008 Mortgage-Backed Securities (MBS)	Collateralized Loan Obligations (CLO 2.0/3.0)
Collateral	Subprime properties with de minimis value; 'synthetic' or 'derivatives' used rather than holding underlying bonds	Collateralized by first lien senior secured bank loans; always overcollateralized
Leverage on Leverage	Securitisations of securitisations (i.e., CDO <sup>2</sup> )	Predominantly (90%+) first lien, limited mezzanine
Event of Default Triggers	Market Value-based with limited buffer	Cash Flow or Par Value requiring significant impairment
Diversification	Concentrated, e.g., in highly cyclical residential real estate properties	Forced diversification, 10% max per industry, and 1-2% max per obligor
Market Participants / Investor Base	Leveraged investors, including structured investment vehicles (SIVs), Wall Street balance sheets, and hedge funds	Long-term asset managers, including insurance companies and pension funds (i.e., 'real-money')
Asset Liability Management	Long-term assets funded by short-term liabilities (e.g., commercial paper) creating roll risk	Funding sources matched to assets
Other	Relied on ratings agencies; relatively little direct diligence performed	Actively managed/diligenced by managers with real "skin in the game"

Non-agency RMBS outstanding in the US has declined from a peak of ~\$2T in 2006 to only ~\$630M in 2023

Source: Federal Reserve Stability Report

## Exhibit A3: CLO Structural Protections Pre- and Post-Crisis

CREDIT SUPPORT, BASED ON ASSETS	PRE-CRISIS ("CLO 1.0")		POST-CRISIS ("CLO 2.0")	CHANGE
AAA	25%		36%	+11%
AA	19%		25%	+6%
A	13%		18%	+5%
BBB	8%		13%	+5%
BB	6%		8%	+2%

COLLATERAL LIMITS		
First Lien Senior Secured Collateral	80-85%	90-98%
CLO bucket (e.g., debt of other CLOs)	5-10%	0-5% <sup>1</sup>
High-yield bucket	10%	0%
Emerging market debt	10%	0%

COLLATERAL LIMITS		
Reinvest period (years)	5-7	3-5
Non-call period (years)	3-5	1-2

1. Holding debt of other CLOs is prohibited in EU CLOs

Source: Wells Fargo Securities and Apollo Analysts