PCS
Setting the standard
for securitisation

Prime Collateralised Securities
(PCS) EU SAS
4 place de l'Opera
Paris 75002

www.pcsmarket.org

Directorate-General for Financial Stability, Financial Services and Capital Markets Union
European Commission
Rue de Spa 2
Brussels, 1000

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Dear Sirs and Madams

Response to the consultation on the Securitisation Regulation

PCS would like to thank the Commission for the opportunity to respond to this consultation on a crucial component of the European Financial system.

It has been PCS' contention for a number of years that the Securitisation Regulation (including its recent amendment) and modifications to attendant legislative acts (primarily the CRR and Solvency II) were a great step forward in the road to reviving a strong, deep yet safe European securitisation market. The role of such market in the preservation of European banks' lending capacities and in the creation of the Capital Markets Union is widely recognized.

However, it is also our opinion, that the reforms begun with the Securitisation Regulation remain unfinished. A number of additional steps were required to give those reforms all their power to achieve their aims. Today, as we approach the review of the Securitisation Regulation and assess its impact, we are constrained to accept that it has not fulfilled its potential. But we can also see how, by finalising the final pieces of the reform of the European securitisation framework, the securitisation market can achieve the shared aims of the Commission, the Co-Legislators and market participants.

In the hope that we can assist, we set out PCS' response to the consultation that you have helpfully issued.

1. Effects of the regulation

Question 1.1. Has the Securitisation Regulation (SECR) been successful in achieving the following objectives:

	Fully agree	Somewhat agree	Neutral	Somewhat disagree	Fully disagree	No opinion
Improving access to credit for the real economy, in particular for SMEs					X	
Widening the investor base for securitisation products in the EU					X	
Widening the issuer base for securitisation products					X	
Providing a clear legal framework for the EU securitisation market	X					
Facilitating the monitoring of possible risks			X			

Providing a high level of investor protection		X				
Emergence of an integrated EU securitisation market			X			

Question 1.2. If you answered 'somewhat disagree' or 'fully disagree' to any of the objectives listed in the previous question, please specify the main obstacles you see to the achievement of that objective.

Improving access to credit for the real economy, in particular for SMEs

[A] State of the European securitisation market

One of the explicit purposes of the SECR was to lead to a strong and deep, yet safe, securitisation market able, amongst other things, to finance growth in Europe.

This has not occurred.

Between 2018 and 2019, European placed issuance fell 10% from €116bn to €108bn. In 2020 that fall just accelerated with issuance of €81.8, only just three quarter of the previous year[1]. Although 2021 looks marginally better, it is most unlikely that it will return to even the depressed numbers of 2019.

In the securitisation of prime residential mortgages – the backbone of any securitisation market – the numbers are even starker. In the EU27, placed issuance in 2019 fell to €6.8bn, to further fall in 2020 to €6.2bn. This is the lowest post-crisis issuance.

Comparisons with pre-crisis issuance can be questionable since issuance immediately before the Great Financial Crisis (GFC) contained certain products (like re-securitisations) which contributed to the catastrophe and which have since been, rightly, banned. Yet, the issuance immediately preceding the GFC of the type of securitisation which would today be issued as STS - the same securitisations whose exceptionally good credit performance through the crisis led the Commission (together with the EBA and ECB) to support the concept of STS in the first place - can be estimated

[1] These numbers include the UK, but the EU only trendline is the same with total 2020 issuance at €62bn

at around €450bn.[2]

There are several causes for this weakness and accurately working out the proportions in which each cause has contributed is simply not possible

First, the extremely accommodative monetary policy of central banks, first and foremost the ECB, has made comparatively expensive funding sources such as securitisation unattractive to banks.

Secondly, there was the impact of COVID. Especially in the first months of the pandemic, uncertainty as to the likely severity of its economic consequences led banks to shelve plans to lock in long term funding including through securitisations when it was unclear the funding, once raised, would be needed. Anecdotally, PCS can attest that a not unsubstantial number of our clients informed us, pre-COVID, of securitisation issuance that was subsequently cancelled due to this uncertainty.

But, notwithstanding those two causes, one cannot underestimate the impact not so much of the introduction of the SECR as that the reforms it embodies were never completed. Our response will deal later and on a more technical level with the steps necessary to finalise these reforms. But the still inaccurate capital calibrations for banks and insurance companies holding securitisations, the illogical treatment of securisations in the liquidity coverage ratios, the uneven playing field which imposes disproportionate disclosure and due diligence requirements *when compared to other asset-based investments* have all made the re-emergence of a broad, safe STS securitisation market extremely challenging.

This can be illustrated by comparisons with other jurisdictions that also had to battle the pandemic and deployed similarly accommodative monetary policies.

In 2020, US non-agency issuance was €491bn compared to EU issuance of €62bn. The US, even without taking into account any of the staggering €2859bn of agency issuance, had eight time the European issuance level.[3]

Lest it be argued that the United States is somehow a special case, Australia saw A$31.1bn of placed securitisation issuance in 2020. To put this in context, this represents 1.69% of Australian GDP. At €62bn, the European number represents only 0.48% of EU GDP or 3.5 times less than Australia. Put in a different way, if the EU issued as much securitisation as Australia for its GDP,

[2] This must always be a rough estimate since comparing past transactions to a standard that did not exist at the time and assessing how close they were to that standard is not only extremely time consuming but also subjective. However, to give an order of magnitude, we believe this number is both broadly correct and informative.
[3] As cited by AFME – AFME Securitisation Report – European Structured Finance

2020 EU issuance would have been €217bn.[4]

From these data, it is quite clear that COVID and monetary policy cannot be expected to shoulder the blame for the lack of a stronger securitisation market in Europe. Something is not working with the regulatory structure.

So, in direct response to the question, it is self-evident that a market that has not increased since the passage of the SECR cannot have improved access to finance for the real economy and especially SMEs.

[B] The potential of securitisation to increase access to funding

Although these arguments are neither new nor controversial, having been the basis for the drafting and passing of the SECR, it is important quickly to remind ourselves of the two key ways in which securitisation can increase access to funding[5].

First, securitisation not only allows banks to raise funds, but also – when properly structured – to remove assets from their regulatory balance sheet. Other than whole loan sales, a limited market, it is the only financial instrument that can do so (either in a "true sale" format or synthetically). To achieve this, the securitisation must meet strict prudential criteria for "significant risk transfer" (SRT).

This means that the amount of finance available to the economy, including SMEs, need not be artificially constrained by the amount of capital banks possess or can raise. In a time of plentiful capital, this may be a merely theoretical benefit. But with the coming implementation of the Basel rules, including their output floors, European banks' additional capital requirements are estimated at between €170bn and €230bn[6]. Absent a reborn European securitisation market able to absorb large amounts of assets quickly, the Basel implementation is likely to lead to a constriction of the banks' lending envelope. This is without even considering the ambitious European Green Plan. The Commission itself estimated, in its Sustainable Finance Action Plan[7], that, in addition to public money, there is a yearly €180bn investment gap to achieve EU climate and energy targets by 2030. The Commission also cited the EIB's estimate of an overall yearly investment gap in transport, energy, and resource management infrastructure of €270 bn. In an economic zone where over three quarters of all financing still comes from banking institutions, the collision of this gap and the forthcoming Basel capital requirements could well call into question

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[4] Numbers from National Australia Bank cited by the Australian Securitization Forum - ASF Year in Review 2020, GDP from World Bank, all currencies converted at September 2021 rates

[5] This focuses solely as per the question on access to credit and does not seek to address any of the additional ways securitisation can help the European economy in the context of the Capital Markets Union eg creating high quality investable assets for pension funds.

[6] "EU implementation of the final Basel iii standard" – Copenhagen Economics (June 2021)

[7] "Action Plan: Financing Sustainable Growth" (March 2018)

the achievability of most of the continent's ambitions when it comes to sustainability.

To gauge the importance of securitisation to navigate these coming difficulties, it is only necessary to look across the Atlantic. Arguably, it is not a surprise that the United States is relaxed about the introduction of the new Basel rules with their output floors. The existence of a securitisation powered state guaranteed mechanism able to remove nearly 3 trillion dollars of assets from regulatory bank balance sheets a year in an extremely flexible and scalable way allows the US to face the new standards with equanimity.

Secondly, if constraints on bank capital limit available finance, one could place one's hope in non-bank lenders to supplement the banks. But again, securitisation is a key to the creation and growth of non-bank lenders. The last few years has seen a growth in the number of such non-bank financial institutions. However, as new entrants, these institutions find it extremely challenging to raise cash in the corporate bond market for lack of a track record and/or size and certainly cannot raise it at rates that make economic sense. To create this track record and achieve the requisite size they need to lend. For this, they need financing. This can therefore only come from banks or from securitisation – insofar as these new lenders create good quality securitisable assets. If the funding comes from banks, Europe will not escape the constraints imposed by a shortage of bank capital. The non-bank lenders will become mere conduits for bank lending and their access to finance will be limited by the same bank capital issues. Only securitisation can allow these non-bank lenders to take off and grow independently of the banking sector and any of its woes.

Currently, a meaningful part of securitisation issuance including STS is indeed coming from such non-bank lenders. Of the 2021 verification mandates received by PCS so far for public deals, a little over one third came from non-bank lenders.[8]

But without a deep securitisation market with a strong investor base able to fund these non-bank lenders, the capacity of such new entrant to improve access to credit for the real economy will be limited by the capacity of banks to fund them.

[C] SMEs

The importance of SMEs to the European economy is well-established. However, one should dispel the notion that the best way for securitisation to help SMEs access to finance is to have a large volume of SME securitisations.

[8] Some of the entities defined by PCS as "non-bank lenders" may for legal or other reasons have a banking licence. But they are not traditional banks. They take no deposits, have no branches and do not engage in a variety of lending activities nor offer traditional banking services to their customers. They are single purpose companies funding themselves in the wholesale markets. This means that even if they, in some cases, are Basel compliant, constraints they face on capital raising are fundamentally different from those of traditional banks

Securitisation of SME loans is usually more arduous and costly than of assets such as mortgages or auto loans. One of the reasons is that securitisation is most efficient with assets that are extremely homogeneous and are smaller in size so that they may be securitised in large pools. Such assets have, when pooled, risk profiles better suited to statistical analysis of historical data. More heterogeneous and granular asset pools such as most SME lending usually require higher levels of credit due diligence to ascertain any idiosyncratic characteristics that may lurk in the securitised pool. Since the possibility of unperceived risks and asymmetric knowledge is commensurately higher, rating agencies and investors usually require higher levels of protection, even at objectively similar levels of credit risk. This makes many SME securitisations more expensive than equivalent auto or mortgage deals. [9]

The key help securitisation can provide to SMEs seeking access to credit is by allowing banks to remove assets easier and cheaper to securitise, such as auto loans and mortgages, off their regulatory balance sheet to free capital which can be made available to SME lending.

Conclusion

The only way the SECR could have improved access to credit for the real economy is if it had led to an increase in the size of the securitisation market. This has not occurred.

Arguably, in current circumstances of near free central bank funding of banks, this has not had an obvious negative impact on access to credit for European borrowers. But if we wait until access is constrained (by the Basel implementation and a tightening of central bank policy) to complete the SECR reforms, it will be too late. A deep securitisation market will not return overnight. The comparisons with the United States and Australia clearly show that the regulatory issues and not only COVID and central bank policy are a problem in need of fixing.

Widening the investor base for securitisation products in the EU

As the volume of securitisations is stagnant, definitionally the investor base by volume is not wider. Is it wider by category or number? Is the same pie divided either amongst investors coming from a greater variety of backgrounds and/or more of them?

The answer is no.

Most importantly, through the amendments made in 2019 to Solvency II, it was the hope expressed by the Commission that insurance companies would return as investors to the securitisation market. Here the data are nothing short of

[9] They are other technical reasons that make SME securitisations challenging including amongst others contractual terms, confidentiality obligations, the complexity of relationship pricing, the need flexibly to be able to amend facilities.

catastrophic. The Joint Committee of the ESA's report[10], revealed not only that securitisation represented only 2.3% of the overall investment portfolios of European insurers but that STS securitisation, the asset class policy makers explicitly wished to find its way there, was only 2% of that small number, in other words, ***a staggering 0.046% only of total investment.***

PCS is in contact with many investors. It would be fair to say that the investor community we communicate with is composed of the same organisations and types of organisations today as it was in 2018 or, for that matter, 2012.

Widening the issuer base for securitisation products

Again, little to no progress has been discernible in the SECR's ability to widen the issuer base for securitisation products.

Only 3% of all the verification mandates received by PCS in 2020 were from first time issuers.

It is true that a few new issuers have entered the European securitisation market. They are new non-bank lenders, especially in The Netherlands. But it should be noted that these are not existing financial institutions that funded themselves previously via other channels and have, following the SECR, opted to turn to securitisation. They are almost invariably institutions set up from the outset to fund themselves in the securitisation market. Their appearance reflects the (comparatively small) rise of fintech in Europe rather than a securitisation driven development.

The fact that, as mentioned above, they represent a larger part of the market also unfortunately reflects the reduction in universal bank issuance so that, as a percentage of the market, these non-bank lenders (old and new) have a greater proportional presence.

Question 1.3. What has been the impact of the SECR on the cost of issuing / investing in securitisation products (both STS and non-STS)? Can you identify the biggest drivers of the cost change? Please be specific.

PCS has little knowledge of the internal cost calculations of issuers and investors and none of that is quantitative.

Anecdotally, we hear both issuers and investors state that securitisations are much more expensive to issue or invest in that any other capital market instrument. Nearly all, if not all, the comments focus on the data aspects of the SECR. Gathering the data in the prescriptive formats published by the ESMA under article 7 of the SECR for issuers. For investors, it is the cost not only of analysing the data at the outset and for the life of the transaction, in

[10] Joint Committee report on the implementation and functioning of the securitisation regulation (article 44) (May 2021)

conformity with article 5 of the SECR, but also of setting up compliance systems to demonstrate that this has been done.

Question 2.1. Are you issuing more private securitisations since the entering into application of the EU securitisation framework?

PCS does not issue securitisations.

Question 2.2. What are the reasons for this development (please explain your answer)?

Although PCS does not issue securitisations, we are aware of the discussions that have arisen over the apparent increase in the size of private transactions within the STS category, as evidenced by the number of notifications to ESMA. PCS is also aware of a concern in certain quarters that this supposed increase reflects market participants exiting the public, transparent market to a more opaque market segment with potentially greater hidden risks.

This is wrong.

As we set out in our 2020 end of year review[11], the apparent proportional increase of private transactions in STS is an artefact of the regulatory structure and not a real phenomenon.

Most of these STS notified private transactions are not new and many are double counted.

First, most of these notified transactions are ABCP conduit transactions. ABCP transactions traditionally are reviewed and brought up to date on a yearly or two-yearly cycle. The vast majority of ABCP transactions verified by PCS are transactions predating 2019 (sometimes literally by decades). As part of their yearly/two-yearly update, the participants in the transaction make the necessary amendments to make the transaction compatible with STS and then notify it. These transactions are therefore in no way new transactions that, before the SECR, would have been public. They are old transactions that have always been private and are catching up with the new standard.

Secondly, the SECR requires that each ABCP conduit sponsor notify the transaction separately for its conduit. But many ABCP securitisations are multi-conduit. One originator enters into one financing transaction with four, five or six conduit lenders. Under the SECR each one of those conduits must notify that same transaction separately resulting in multiple notifications for a single lending arrangement. Since the ABCP securitisations are private, no details are provided on ESMA's website. It is therefore not possible for outside observers to know how many ABCP notifications are multiples.

[11] PCS Newsletter (December 2020) at https://pcsmarket.org/newsletter-dec2020/

We note, however, that ESMA does have that information and we would urge ESMA to publish that data on an anonymized basis.

One analysis made by a market participant and communicated privately to PCS concluded that the number of STS ABCP notifications (the bulk of STS private notifications) should be divided by 2.5 to obtain the true number of actual transactions.

Question 2.3. Do the current rules enable supervisors to get the necessary information to carry out their supervisory duties for the private securitisation market?

Yes

There is more disclosure available to regulators for all securitisations, including private ones, than for any other capital market or banking instrument.

One key reason for the failure of the European securitisation market to grow is the absence of a level playing field between securitisation and any other asset-based lending instrument.

Should the regulatory community indicate that they wish for additional information, PCS believes that it is incumbent on it to explain not only why it feels it needs such information but also why it is satisfied not to have this information in respect of other financial instruments bearing similar risks.

For example, should the insurance regulators indicate a need for more granular information on private RMBS securitisations held by insurance companies, we believe that it also behooves them to indicate why such information does not appear to be required when insurance companies purchase whole mortgage pools. The risks of the latter to insurance undertakings, absent credit enhancement available in a securitisation, are of the same nature and greater in quantum than for the former.

Or if bank regulators feel the need for more granular information on private mortgage securitisations, why would such information not be required of a bank lending to a small and weak banking institution via a covered bond and overwhelmingly on the strength of a cover pool on which almost no disclosure whatsoever is required.

PCS is unconvinced by the argument that this additional disclosure is motivated by the exceptional risks carried by securitisations and particularly STS securitisations. The SECR and the creation of the STS regime was explicitly based on the incontrovertible fact that European securitisations in what are now the STS asset classes performed extremely well during the GFC and as well as equivalent capital market instruments and better than, for example, corporate bonds. When it comes to STS securitisations, these alleged exceptional risks are simply not there and never were.

PCS is always in favour of more disclosure. But the concerning lack of equivalence in disclosure does not lie between public and private securitisations but between securitisations generally and all other financial instruments. The Commission is correct to be concerned that some market participants may well gravitate to lower disclosure instruments. We believe this is already occurring. But those lower disclosure instruments are not private securitisations but non-securitisation lending. This is not healthy from a regulatory point of view but also further undermines the opportunities for growth of the securitisation market.

Question 2.4. Do investors in private securitisations get sufficient information to fulfil their due diligence requirements?

Yes

PCS verifies private as well as public securitisations. Based on our experience, the notion that investors in private securitisations get less information than in public ones is a myth. More often than not, they obtain more.

Investors in private securitisations get all the Article 7 information. But, in most private securitisations the lender or lenders are sophisticated institutions negotiating directly with the originator over an often-lengthy period of time. This allows them to perform deeper due diligence as they have additional time. Through this deeper due diligence, they often request and obtain more information (or more relevant information) than the already extremely dense information provided via Article 7 SECR.

Question 2.5. Do you find useful to have information provided in standard templates, as it is currently necessary according to the transparency requirements of Article 7 and the associated regulatory and implementing technical standards?

Yes, but in a more appropriate manner.

The templates are good at creating standardisation. This standardisation is key to the long-term success of STS.

The templates are also important for public transactions where there are no or very limited negotiations between capital market investors and originators. They can prevent, especially during times of market effervescence, a steady decline of information available to investors and potential investors.

However, this does not mean that the current templates and the structure of the disclosure regime is fit for purpose. See our response to Question 3.1.

Question 2.6. Does the definition of private securitisation need adjustments?

Yes.

PCS believes that disclosure standards for private securitisations should be as high as for public securitisations but differently set. This is set out in our response to Question 3.1. However, to avoid abuse, this should also come with a new, more restrictive but also more appropriate definition of "private securitisation".

The problem arises from the interaction of an overbroad definition in the SECR of "securitisation" and an inappropriate definition of "private". Securitisation is defined broadly as any lending which is limited recourse to assets and involves credit tranching. "Private" is defined as any transaction that does not require a prospectus under the Prospectus Directive.

The post-GFC legislation on securitisation (including the SECR) was primarily targeting capital market instruments widely distributed to capital market investors of the type that had caused so much trouble during the crisis.

However, the broad definition[12] of securitisation catches traditional bank lending occurring within an everyday banking relationship and with clients well known to their lenders. These bank securitisations are directly negotiated between banks and usually large and sophisticated clients in the same way as other banking facilities provided to those clients. As part of these negotiations taking place over weeks and months, the bank is able to due diligence the assets and request all information it requires. In the case of any other type of bank lending, the borrower would only have to provide the information the bank, as a sophisticated lender, thought was relevant and there would be no complex mandatory templates to fill. This *modus operandi* is accepted by prudential regulators and overseen by them as part of their general oversight of a bank's competency and systems (Pillar 3).

It is therefore only an accident of the broad definition of "securitisation", created for the purposes of protecting capital market investors, that a traditional banking activity becomes burdened with complex and inflexible mandatory rules of disclosure and due diligence.

Would it not therefore be better if the disclosure and due diligence rules did not apply to "private" transactions? After all, aren't these no different from bank relationship lending that is not subject to such onerous requirements? This is indeed superficially attractive. But with the current definition of "private

[12] Currently in Article 2.(1) of the SECR

securitisation" this would be very dangerous.

Because the definition of "private securitisation" covers any securitisation that does not require a prospectus, it covers – as we have seen – traditional banking relationship lending. But it can also cover exactly the type of distributed capital market instrument that is the target of the SECR's disclosure and due diligence rules.

Indeed, if the rules on disclosure and due diligence were to be relaxed for "private securitisations" it could well result in precisely the behaviour that public authorities are rightly concerned about: issuers would structure their capital market securitisations to fall outside of the Prospectus Directive to avoid disclosure requirements.

Unless an amendment is made to the definition of "private securitisation", the SECR is caught between requiring unnecessarily constraining disclosure within the context of normal banking relationships or allowing market participants to move large chunks of the public market into the private sphere to avoid disclosure.

PCS would therefore suggest an amendment to the approach to "private securitisation" to capture traditional banking whilst excluding what are rightly capital market instruments. We do not believe there is a simple definition though that can solve this conundrum. However, an innovative approach to the problem has been submitted to us by a market participant which we believe can provide the right balance. It is not unlike the approach set out in the current RTS on homogeneity in its reliance on "factors".

Like many things, the "real private bank securitisation" is easy for market participants to recognize but difficult to define simply. However, it usually shares several characteristics:

- The investor is a bank or non-bank lender that has a primary lending business (rather than an investment business).
- The transaction is booked in that lender's "lending business" and not in its treasury or investment arm or a trading book or a fund open to outside investors
- The originator is an existing client of the lender.
- The securitisation is not underwritten and/or syndicated by an arranger.
- The securitisation is not evidenced by a negotiable instrument (bond or note).
- The securitisation is not listed on an exchange.

- The securitisation does not require a prospectus.
- There are no more than small number of lenders.
- There is no ISIN for the securitisation.

These are just suggestions and may well not be the appropriate factors. But a “private securitisation” would be a securitisation that met at least a set number of these factors.

PCS would invite the Commission to issue a call for advice to the EBA and ESMA on the possibility of such an approach that would ensure “private securitisations” can benefit from certain easing without creating prudential concerns or allowing market participants to circumvent the spirit and purpose of the SECR.

Question 3.1. Do you consider the current due diligence and transparency regime proportionate?

No.

[A] Level playing field issues

As PCS pointed out in a recent article[13], issuing a securitisation for a financial institution or purchasing one for an investor is never an absolute decision but a relative one. Both almost always have the option of different instruments and will judge the benefits of choosing one – securitisation – against the other options.

As a result of the GFC and despite vast amounts of data showing the resilience, safety and quality of European STS securitisations, securitisation legislation imposes the heaviest burdens on both securitisation issuers in terms of disclosure and investors in terms of due diligence.

As an example, we agree that if investors are going to place key credit reliance on assets such as mortgages, they should have thorough disclosure of all the key aspects of those mortgages on a loan-by-loan basis and posted in a regulated repository. However, PCS cannot reconcile, on the one hand, the statement that covered bonds are exceptionally high-quality instruments because of the ***dual*** recourse to the issuer and mortgage assets (from which it follows a key consideration of any investor in a covered bond is reliance on the mortgages), and, on the other hand, the statement that the information to be provided on those mortgages as part of a covered bond cover pool are a small fraction of the information to be provided to an investor relying on these same mortgages in the form of a AAA senior tranche of a securitisation.

[13] EUROFI – Regulatory Update (Sept. 2021) - https://www.eurofi.net/wp-content/uploads/2021/09/regulatory-update_ljubljana_september-2021.pdf

The same considerations apply to due diligence requirements placed on investors. An investor can purchase a pool of SME loans or lend to a special purpose corporate in reliance purely on the security provided by that corporate over its real estate assets with, if it wishes, minimal or no due diligence. But if the same investor purchases a securitisation backed by exactly the same SME or real estate pool, it is required by law not only to perform mandatory and complex due diligence but to create and maintain compliance systems to record this due diligence.

So long as the legally required levels of disclosure and due diligence for the same risks are grossly uneven between securitisations and all other capital market financing sources, securitisation will struggle. Additionally, this creates systemic distortions within the European financial landscape. Such distortions undermine long-term financial stability by pushing market participants to the lowest regulatory level where the greatest systemic risks reside.

This is not the place to define what level of disclosure or due diligence should be required by law. PCS, not being an investor or issuer, is also not particularly well placed to provide an opinion.

However, we strongly encourage the Commission to ask the Joint Committee of the ESAs for advice on the appropriate level of disclosure and due diligence ***across capital market instruments on a holistic and horizontal basis***. This will allow a consistent approach to risk across the capital markets rather than the current uneven siloed structure.

[B] Templates

Although other respondents to this consultation have greater expertise and will provide specific examples, PCS is aware that it appears to be the universal opinion of both the sell side and the buy side that the current templates are too complex, too inflexible and do not reflect what sophisticated yet conservative investors need or are looking for.

The extensive and mandatory disclosure requirements of the SECR are clearly a barrier to entry in the securitisation market for many medium and smaller sized financial institutions.

We strongly encourage the Commission to mandate ESMA to enter into a deep and detailed debate with issuers, investors and data repositories with a view to determining what disclosure should be mandatory and what disclosure can be made optional resulting in a revision of the templates. This debate will have the benefit of two or more years of experience which will have brought to light many aspects of disclosure that may not have been apparent when the templates were first conceived.

[C] Private securitisations

PCS is not in favour of removing all current mandatory disclosure and due diligence requirements for "private securitisations". It appears to us that a minimum level should be maintained and that the current template approach is a good vector to do this.

However, ***but only based on a change to the definition of "private securitisation" discussed in our response to Question 2.6***, it seems appropriate that bank (and bank-type) lenders should be able to exercise traditional banking skills in the selection of the information they need. PCS would therefore suggest that, in the review of the templates referred to in paragraph [B], ESMA also be requested to provide much greater allowances in the use of ND fields for "private securitisations" and only leave as mandatory disclosure a bare minimum solely for the purpose of avoiding a catastrophic decline in information provided to lenders as can sometime occur in a market that is overheated.

Question 3.2. What information do investors need? How do investors carry out due diligence before taking up a securitisation position?

We believe that this is a question best answered by investors.

One suggestion that we have heard is to amend Article 5.(3)(c) so that only investors who intend to derive a regulatory benefit from an STS securitisation need due diligence whether the securitisation meets the relevant requirements. We think this would be a mistake as it would undermine one of the main purposes of the STS regime. The STS regime was set up with the intention of creating a new, safe and universally recognised capital market asset class. This recognition is important for liquidity and for highly rated STS securitisations to become a new safe asset. But, an amendment to Article 5.(3)(c) allowing many (if not most) capital market investors to ignore entirely the STS nature of a securitisation in their analysis is likely to result in STS status not creating a new asset class but only in becoming a highly technical feature of the CRR (and Solvency II) relevant only to a narrow sub-set of investors. In turn, this would drive Europe yet further away from its hope of a deep, liquid yet safe "plain vanilla" securitisation market based on its superior, legally defined standard.

Question 3.3. Is loan-by-loan information disclosure useful for all asset classes?

Loan-by-loan information is not, in our opinion, useful for all asset classes.

Three considerations weigh on the usefulness of loan-by-loan data:

- Homogeneity: how homogeneous the loans in their terms, maturities, nature of the borrowers, etc…? How closely does every loan in the pool resemble every other? Are there any abnormally large loans?

- Granularity of the pool: How many loans are in the securitised pool and what is their average size as a proportion of the total?

- Maturities: how long are the maturities of the pool? How long is the data provided useful?

The more homogeneous and granular the pool the less useful loan-by-loan data. The same is true of the shorter the maturities, although it is fair to say that the usefulness of loan-by-loan does not drop unless you reach very short maturities.

There is no scientific rule that provides an objective cut-off point. In PCS' estimation, loan-by-loan would be invariably important if not essential for mortgages and auto-loans/leases and all but the most granular corporate loans (excepting, possibly short dated micro-SME loans that are undistinguishable from small consumer loans).

Equally, loan-by-loan seems of little to no usefulness for trade receivables and credit cards.

For consumer loans and leases, it would depend on homogeneity and granularity. One could for example set limits to those two factors to determine whether loan-by-loan should be required.

As an aside though, PCS would like to point out that even if loan-by-loan data is necessary in our opinion, this does not imply that the current templates where this information is to be provided are adequate. This appears to be especially the case for SMEs and corporates, where the templates appear to be based on mortgage templates.

Question 3.4. Is loan-by-loan information disclosure useful for all maturities?

See our answer to Question 3.3.

Question 3.5. Does the level of due diligence and, consequently, the type of information needed depend on the tranche the investor is investing in?

The level of due diligence does depend on the tranche the investor is investing in. It would be extremely strange if an investor in a AAA senior tranche with credit enhancement of 15 times the worse historical loss had to perform the same detailed loan-by-loan analysis as an investor taking the B- junior first loss tranche where defaults are inevitable, and a thorough analysis of the recovery process alone can determine the likelihood of loss.

Whether this drives a difference in the information needed (as distinguished from a difference in the amount of modelling of that same information, for example) is difficult to answer in the abstract. It really depends on the securitisation's structure, the securitised assets and sometimes the jurisdiction.

Question 3.6. Does the level of due diligence and, consequently, the type of information needed depend on whether the securitisation is a synthetic or a true-sale one?

No

Question 3.7. Are disclosures under Article 7 sufficient for investors?

Yes.

PCS is not an investor but in all our interaction with investors since the passage of the SECR we have never heard an investor indicate that there was insufficient information disclosed under Article 7.

Question 3.8. Do you find that there are any unnecessary elements in the information that is disclosed?

See our response to Question 3.1, paragraph [B].

Question 3.9. Can you identify data fields in the current disclosure templates that are not useful? Please explain your answer.

See our response to Question 3.1, paragraph [B].

Question 3.10. Can the disclosure regime be simplified without endangering the objective of protecting EU institutional investors and of facilitating supervision of the market in the public interest?

Yes.

Assuming, as we believe to be the case, that conservative and experienced investors can form a consensus as to what disclosures are unnecessary to assess risk, it seems self-evident that they will not be examining this unnecessary data. It is equally self-evident, they will not be protected by data they do not examine. It therefore follows that the only impact of requiring this type of data to be disclosed is to burden originators with pointless costs.

If the information is not believed by conservative and experienced investors to be useful in assessing the risks of a securitisation, then it is unclear how such data would be useful in the supervision of those markets.

It is arguably theoretically possible that some data could prove of use in supervision even if not examined by investors or deemed useful to assess risk. However, PCS would point out that disclosure has a cost and is a burden, especially in a situation where this burden falls disproportionately on securitisation[14]. We would therefore respectfully request supervisors to explain what precise use any specific datum would be put to, as there is, in some quarters, a suspicion that some supervisory authorities are prone to ask for inordinate amounts of data that effectively go unexamined on the grounds that "they may come in handy at some point in the future". Just like the proposition that there can never be any harm in asking for a bank to raise more capital, the idea that there can never be any harm in asking for more data is a deceptively inaccurate summation of complex facts.

Question 4.1. Have you experienced problems related to a lack of clarity of the Securitisation Regulation pertaining to its jurisdictional scope?

No. As a third-party verification agent though it is unlikely that we would.

Question 4.2. Where non-EU entities are involved, should additional requirements (such as EU establishment/presence) for those entities be introduced to facilitate the supervision of the transaction?

No

PCS is very sympathetic to the view that a regulatory benefit should not be provided without regulatory oversight. We also are very sympathetic to the view expressed by the Commission that it is not appropriate for the European Union to have to rely on the goodwill of third country governments or regulators to look after European interests in times of crisis because key activities on which Europe relies are carried out entirely extra-territorially.

It is therefore very important in PCS' view that securitisations benefiting from the STS status have an EU nexus. That nexus could be either a party within the EU that is subject to supervision and sanctions or a party outside the EU subject to regulations deemed equivalent and where an appropriate MOU exists between EU regulators and local regulators providing comfort that the rules will be followed and infractions sanctioned.

It does not follow though that ***every*** party involved in a securitisation must have an EU presence, merely that there should be one party – with real substance – who can be held responsible.

Question 4.3. In transactions where at least one, but not all sell-side entities (original lender, originator, sponsor or SSPE), is established in the EU:

[14] See our response to Question 3.1, paragraph [A]

A. Should only entities established in the EU be eligible (or solely responsible) to fulfil the risk retention requirement under Article 6?

No

We need to go back to the purpose of the retention rules: to ensure that the party who “originates” the securitised assets and takes the benefit of the cycle of origination-securitisation has “skin-in-the game”. Therefore, it is more important that the correct entity hold the retention than some EU entity be artificially shoehorned into being the “retention-holder”.

Identifying the correct entity though is fairly easy in practice but challenging to capture in legislative drafting. The entity that should be required to maintain “skin-in the game” is the entity that elects to put together the securitisation, selects the assets to be securitised and extracts (in whatever form) the equity value not necessarily from the securitisation itself but from the entirety of the economic cycle which is ultimately funded by that securitisation. It is therefore important that the universe of possible retention holders is as large as possible so that retention does not end up in the hands of the wrong entity merely because that entity is the only one meeting a narrow definition of “originator”. Together with a wide definition of potential retention holders, there should be clear rules as to which entity from all those that meet the definition should be legally required to hold it. These rules would be designed to prevent those who benefit from the full economic cycle financed by the securitisation to identify a third party meeting the definition of originator or sponsor and saddling them with the burden of retention whilst avoiding themselves having any “skin-in-the game”.

For example, if you have a securitisation of corporate loans where the loans are selected by a hedge fund which procures their sale to an SSPE and extracts fees and profits from excess spread, it makes no sense to identify the original lender who sold these loans to the SSPE as the retention holder even if it meets the definition of “originator”.

Equally, if a bank sets up a fintech business in such a way as to determine the underwriting criteria used to generate assets and then receives, directly or indirectly, the bulk of the equity returns, it should not be able to insert into the structure some undercapitalised company to meet the technical definition of “originator” and park the retention there having ensured that it held no real “skin-in-the game”.

In line with our answer to Question 4.2 though, an EU based entity of substance should be accountable (in the absence of an equivalence regime) for ensuring the correct party holds the correct retention and holds it consistently with EU rules. If this is the case, possibly through some endorsement regime, then it should not be necessary for that retention holder to be located within the Union.

B. Should the main obligation of making disclosures under Article 7 be carried out by one of the sell-side parties in the EU? In this case, should the sell-side party(ies) located in a third country be subject to explicit obligations under the securitisation contractual arrangements to provide the necessary information and documents to the party responsible for making disclosures?

No.

The same principles as outlined in our response to Questions 4.2 and 4.3 apply.

(This response is without prejudice to our views as to whether the whole Article 7 disclosure should be provided by third country originators. We do not think so)

C. Should the party or parties located in the EU be solely responsible for ensuring that the "exposures to be securitised" apply the same credit-granting criteria and are subject to the same processes for approving and renewing credits as non-securitised exposures in accordance with Article 9?

See our responses to Questions 4.2 and 4.3.

D. Should a reference to sponsors located in a third country be included in the due diligence requirements Article 5(1)(b) of the SECR? How could their adequate supervision be ensured?

Sponsors (especially in the context of ABCP conduits) do not grant credit. Even a CDO manager does not, in its capacity as sponsor, grant credit. So, we are not clear what type of sponsor would be targeted by such a change.

Question 4.4. Should the current verification duty for institutional investors laid out in Article 5(1)(e) of the SECR be revised to add more flexibility the framework?

No

(This response is without prejudice to our views as to whether the Article 7 disclosure should be simplified.)

Question 4.5. Should the SECR and the Alternative Investment Fund Managers Directive (AIFMD) be amended to clarify that non-EU AIFMs should comply with the due diligence obligations set out in Article 17 of the AIFMD and Article 5 of the SECR with respect to those AIFs that they manage and/or market in the Union?

No opinion

Question 4.6. Should the SECR be amended to clarify that sub-thresholds AIFMs1 fall within the definition of institutional investor thereby requiring them to comply with the due diligence requirements under Article 5 of the SECR?

No opinion

Question 5.1. Has the lack of recognition of non-EU STS securitisation impacted your company?

Yes. A mandate for STS verification from a UK originator was withdrawn when it was realized that the sole investor was an EU entity unable to take any benefit from the STS status of the securitisation.

Question 5.2. Should non-EU entities be allowed to issue an STS securitisation?

Yes. See our response to Question 5.3 below.

Question 5.3. Should securitisations issued by non-EU entities be able to acquire the STS label under EU law?

Free flowing (but safe) global capital markets are a positive good. They provide good investments for European savers and allow diversification which can mitigate risk. So, in principle, PCS is supportive of non-EU entities issuing EU STS securitisations.

The two key conditions for the treatment of a securitisation issued by a non-EU entity to be treated as STS under EU law are:

- Full compliance with EU STS criteria (including EU interpretations)
- Presence in the EU of an entity that is responsible toward EU supervisors or equivalence.

The aim of the STS regime is the creation of a new class of simple, transparent and standardised capital market instruments which create confidence by the strength of the criteria and the regulatory infrastructure backing those criteria (sanctions regime, supervisory authorities, regulated third-party verification agents and data repositories). A key aspect of this construction is that STS should be a unique category which can be bought and traded as such. This type of standardisation is one of the keys to the possible growth of this safe asset.

Therefore, whatever the solution reached it should not allow securitisations that do not meet all the EU STS criteria – as interpreted by EU regulators – to be treated as STS in the hands of EU investors. To do otherwise would fragment the STS regime with an EU STS, a UK STS, an Australian STS, a Japanese STS…each one different from the other. From a single simple trusted category, STS will become a complex architecture of different standards bearing different risks and requiring different analytical tool to be deployed by investors.

Furthermore, to the extent that EU issuers are required to comply with the EU version of STS, they will be at a disadvantage if third county issuers can get the same benefits with a watered-down version such as the much weaker and looser STC standard.

Therefore, any equivalence decision should be based on an absolute identity of STS standards. In addition, the risk of divergent interpretation of the STS criteria is very real. In over two years of STS verification PCS can attest that the interpretation challenges are not trivial. Certainly, equivalence on the Basel STC standard would not be appropriate.

The endorsement approach where an EU based entity of real substance is responsible for STS compliance could work well. We stress that the endorsing entity should be a regulated institution of substance and could never be a special purpose vehicle.

As criteria interpretation is also extremely important and in the absence of a supervisory relationship between the non-EU originator and an EU supervisor responsible for interpreting the criteria, third-party verification agents could play a key role in ensuring compliance of non-EU securitisations with not only the Level 1 STS criteria but also their interpretation (both regulatory and market standard). This could create comfort amongst investors that the singular simple standard enshrined in STS was being respected. Although we are aware of the self-serving nature of this comment, making the use of third-party verification agents mandatory for non-EU STS would not be a bad idea.

Question 5.4. Which considerations could be relevant to introducing any of the above mechanisms (e.g. equivalence/recognition/endorsement/other) and which could be the conditions attached to such mechanisms?

See our response to Question 5.3

Question 6.1. Are there sufficiently clear parameters to assess the environmental performance of assets other than auto loans or mortgages?

This is an evolving field but currently the answer, at an EU level, appears to be negative.

Question 6.2. Should publishing information on the environmental performance of the assets financed by residential loans and auto loans and leases be mandatory?

PCS is strongly in favour of disclosure of environmental performance. However, this should take into account some crucial points.

[A] Issues of level playing field

Securitisation is already the most regulated capital market instrument in the world. PCS has already mentioned in its response to Question 3.1, paragraph [A] that a return of securitisation is hampered not by the amount of regulation (most of which PCS supports) but the fact that ***only*** securitisation is subject to this amount of regulation whilst equivalently risky (or riskier) instruments are not. To support securitisation, the playing field must be levelled.

Therefore, PCS would support mandatory environmental information to be provided for securitisation generally and residential loans and auto loans only if these requirements were equally extended to other market instruments such as covered, secured and unsecured bonds of corporations whose sole assets or activities were real estate lending or auto-lending or manufacture.

[B] Issues of availability

There are very good reasons for requiring financial institutions to obtain and maintain records of the environmental impact of their lending and PCS strongly supports such actions. But the securitisation regulations are the wrong place to seek to compel or incentivise financial institutions to obtain or disclose this information.

In the current state of the market, mandatorily requiring environmental impact information that a financial institution may not possess as a condition to issuing a securitisation (but not other instruments) will merely result in a further contraction of the European securitisation market, not an increase in the generation of such information.

If the Commission or regulators wish to compel or incentivise the acquisition of environmental impact information by financial players, they have other tools to do so. Therefore, the disclosure of environmental impact information in the context of a securitisation should be limited to situation where the originator possesses this information.

Question 6.3. As an investor, do you find the information on environmental performance of assets valuable?

PCS is not an investor.

Question 6.4. Do you think it is more useful to publish information on environmental performance or on adverse impact and why?

No opinion

Question 6.5. a) Do you agree that these asset specific disclosures should become part of a general sustainability disclosures regime as EBA is developing?

See our response to Question 6.2, paragraph [B]

Question 6.5. b) Should ESG disclosures be mandatory for (multiple choice accepted):

[A] Securitisation that complies with the EU green bond standard

In our response to Question 6.6, PCS supports securitisations defined as green by virtue of the use of proceeds.

For those securitisations, ESG disclosures should focus on the use of proceeds. Otherwise, one will simply reduce available funding for the transition to a sustainable economy. (See response to Question 6.2, paragraph [B])

Securitisations that meet the EU green bond standard by virtue of the securitised assets have no choice but to disclose the ESG data for those assets. In such a case, disclosure should be mandatory. This does leave open though the much more difficult issue of what disclosure should be mandatory. For example, in a mortgage securitisation where lending goes to insulation of dwellings but where the originator does not possess EPC data for all the homes, should it be a requirement to have EPC ratings for all the loans before the securitisation is labelled “ESG compliant”?

The guiding principles, in PCS’ view, should be (a) maximizing financing for the transition to a sustainable economy and (b) preventing “greenwashing”. It is therefore important that rules are not put in place that, by their inflexibility or complexity, reduce legitimate green finance opportunities in their zeal to eliminate “greenwashing”.

[B] RMBS/Auto loans/leases

See our response to Question 6.2

[C] ABS

It should be recognised that although the disclosure of environmental impact information can be useful in the context of mortgage loans or car loans, it is meaningless in the context of credit card debt and impossible to obtain for trade receivables.

The requirements should therefore be made on an asset-class by asset-class basis based on a common-sense approach as to both the availability and usefulness of the information.

In this respect, PCS notes that the EBA is preparing a report and we have provided our views to the EBA in this matter.

Question 6.6. Have you issued or invested in a green or sustainable securitisation? If yes, how was the green/sustainability dimension reflected in the securitisation? (multiple choice accepted)

PCS is neither issuer nor investor.

Question 6.6. According to the Commission proposal for a European green bond standard, a securitisation bond may qualify as EU green bond if the proceeds of the securitisation are used by the issuing special purpose vehicle to purchase the underlying portfolio of Taxonomy-aligned assets. Is there a need to adjust this EuGB approach to better accommodate sustainable securitisations or is there a need for a separate sustainable securitisation standard?

PCS is somewhat puzzled by the formulation of this question as it seems to imply that, under the Commission's proposed European green bond standard, only securitisations where the assets being securitised (and therefore purchased by the SSPE) are themselves "green" would qualify as ESG. The green bond standard principles clearly indicate that a green financial instrument is an instrument raising funds that are used to further Europe's sustainability ambitions and assist in the transition of the European economy. The "proceeds of a securitisation", by universal agreement, are the proceeds received by the originator. This is how all market participants, including regulators, understand that expression. It follows that PCS reads the proposed green bond standard as encompassing securitisations where the money raised by that securitisation is used by the *originator* to assist in the transition toward a sustainable economy. This is consistent with the drafting but also with the ambitions of the Commission to maximise the number of financing channels able to provide resources to the European Green Plan.

If our understanding of the green bond standard as including all financing instruments raising funds for the transition is correct, then we do not believe that there is any need to adjust the EUGB approach.

The alternative approach would be one where only securitisation of "green assets" would be treated as meeting the EUGB standard. Such an approach would undermine Europe's green ambitions but also be logically incoherent with the whole approach and philosophy of the EUGB standard.

The aim of the European green financing strategy is to fund the ***transition*** to a green economy, not to sustain an existing green economy. A frustration repeatedly voiced by green investors is the dearth of green investable assets. This is equally true of the assets currently on the balance sheet of financial institutions and, therefore, the universe of securitisable assets.

Therefore, a regime that allowed only securitisations of sustainable assets to be defined as sustainable would likely reduce issuance in "sustainable securitisations" to a mere trickle. This would result in the disappearance of funds otherwise available to finance the European Green Plan.

A requirement that only securitisations backed entirely by sustainable assets be defined as "sustainable" also faces a number of conceptual challenges and would result in an approach that is both illogical and inconsistent with the essence of the proposed standard.

a. If Europe were to wait for the emergence of a sufficient quantity of sustainable assets before creating a vibrant sustainable securitisation market this would effectively amount to waiting until the European economy had already transitioned to a broadly green economy before allowing securitisation to help with that transition.

b. The basic proposition of the EUGB standard is that, to finance the transition of the European economy to a sustainable footing, market participants may raise finance in the capital markets to fund future green projects that implement that transition. This is the rationale behind defining the use of proceeds as an identifier of "sustainability" in finance.

   To disallow a market participant from financing the green transition merely because the proceeds that are going to fund those transitional projects have been raised via a securitisation (rather than say a secured corporate bond) would be inexplicable and irrational. It would limit the amount of financing of Europe's green transition for no discernible policy benefit.

   This can be seen via a simple example.

   Company A is an energy producer with 100% brown assets and activities.

   Company A issues a five-year corporate bond the proceeds of which are to be used to finance a six-year project to build a geo-thermal power plant.

   Every payment of interest and the final repayment of the bond's principal will be coming from Company A's brown carbon intensive activities since its only green asset – the new geo-thermal plant – will not come online until after the redemption of the bond.

   But the financing results in the construction of a geo-thermal plant.

> There is no doubt that this bond meets the EUGB standard.
>
> Now, Company A does not have a good rating so instead of a corporate bond it issues a securitisation of its brown assets. The proceeds of that securitisation are dedicated to building the same geo-thermal plant.
>
> These are the exact same brown assets that would have generated the cash flow that would have paid the interest and the principal on the green corporate bond. In other words, the investors are getting paid interest and principal on the securitisation from exactly the same brown euros they would have been paid from had they invested in the green corporate bond. The only difference is that now those brown euros are owned by an SSPE.
>
> The same geothermal plant is constructed as a result of the securitisation financing.
>
> Under a “green asset” only approach to green securitisation, the corporate bond would meet the EUGB standard, but the securitisation would not.
>
> Not only is this not logical, but if Company A really cannot issue a corporate bond and cannot place a non-green securitisation (at least not at a commercially feasible price), then the geo-thermal plant is never built.

Another problem with a separate sustainable regime is that of the level-playing field. We have already mentioned that securitisation is the most regulated capital market instrument in the world. Despite all the benefits that would accrue to the European economy and the Capital Markets Union from a deep and liquid, yet safe, securitisation market, such a market has not materialized in part because of the regulatory burdens and hurdles that are unique to it and not imposed on other instruments with similar characteristics. A specific regime for securitisation around sustainability with different and more complex disclosure requirements, special and unique rules would only generate yet more headwinds in the market’s attempts to achieve any kind of volume.

Whatever is special about securitisation – and the data shows that it is much less than is often assumed – it has nothing to do with sustainability. Therefore, securitisation should be subject to the same rules, burdens, and restrictions as any other sustainable capital market instruments. In particular, PCS would caution against the gravitational pull of existing legislative frameworks. Because we already have a Securitisation Regulation but may not have similar regulatory pieces of legislation for other capital market instruments, it becomes tempting to aim for what may appear as “low hanging fruit” and design a new sustainable regime only and specifically for securitisation since amending existing rules is less burdensome that passing a whole new set of rules. This approach though would have meaningful negative consequences and would undermine the greater strategic aims of creating a CMU.

Question 7.1. Would developing a system of limited-licensed banks to perform the functions of SSPEs bring added value to the securitisation framework?

No.

In PCS' opinion, this is a solution in search of a problem. To our knowledge, in the 33 years of securitisation issuance in Europe, no SSPE has caused the failing of a securitisation. In addition, even in the case an SSPE suffers collapse, this would only affect a single transaction. To replace the current set-up with a system of LLBs is to create a systemic risk where none existed before. Undoubtedly, this systemic risk could be managed via legislation, capitalisation, regulatory supervision or, more likely, a combination of the above but at a cost and for, as we have seen, no discernible benefit.

Question 7.2. If you answered 'yes' to question 7.1, please specify what elements should such a system include?

N/A

Question 8.1. Are emerging supervisory practices for securitisation adequate?

As far as PCS is aware, there does not appear to be much coordination between regulators or, in most cases, much supervisory involvement. This seems also to be reflected in the comments appearing in the Joint Committee's report. We would point out though that much of such coordination, when it takes place, takes place in confidence and away from the eyes of market participants, including PCS. Therefore, we are cautious here as absence of evidence may not, in this case, be evidence of absence.

However, one area where PCS has concerns are the Q&A processes. In particular, we are most involved with the EBA Q&A process around the interpretation of STS criteria. We are aware that supervisors are disappointed with the lack of usage made by market participants of the Q&A facility. This is indeed a process that has great potential to clarify and standardize practices around STS. The problem is that the EBA has informed the market that a delay of 6 to 12 months should be expected before an answer is provided. In practice, the answer can take more than 12 months. These timeframes are not consistent with the good functioning of capital markets. In cases where the matter is serious – which one would expect if it has made it to a Q&A – the lack of a response could close down an entire asset class or type of securitisation for the time it took for the answer to be published. Any public securitisation involving the subject matter of the Q&A would have to disclose that a Q&A has been sent and that the answer had not been received. The prospectus would have to further disclose than until the answer was provided by the EBA, the STS status of the securitisation could not be vouched for. Effectively, this securitisation is likely to be unsaleable and would never be issued. We believe that the Q&A process can only fulfill its potential and will only be used by market participants if a commitment can be given to the market of a much shorter time before an answer is provided.

Question 8.2. Have you observed any divergences in supervisory practices for securitisation?

Yes

Question 8.3. If you answered 'yes' to question 8.2, please explain your answer.

As an STS third party verification agent, we are primarily aware of supervisory practices for STS.

We are aware that two securities regulators in Europe check the STS status of securitisations, *ex ante* (the Spanish CNMV and the Portuguese CMVM). Both have made comments to originators and arrangers and challenged some aspects of transactions. One regulator (the Dutch DnB) has publicly stated that it would do *ex post* (but not *ex ante*) checks on some securitisations and we are aware that this has indeed occurred. We are not aware of any other European regulator doing checks either *ex ante* or *ex post*, although this does not mean that none do.

Question 8.4. Should the Joint Committee develop detailed guidance (guidelines or regulatory technical standards) for competent authorities on the supervision of any of the following areas.

A. **the due diligence requirements for institutional investors (Art 5)**

Yes

B. **risk retention requirements (Art 6)**

No opinion

C. **transparency requirements (Art 7)**

No

Transparency requirements are already subject to extensive guidance from ESMA. We are not sure that much, if anything, would be gained by handing this responsibility to the Joint Committee.

D. **credit granting standards (Art 9)**

No

PCS is not aware that this article has ever caused any confusion or is in need of guidance (detailed or otherwise).

E. **private securitisations**

See our answers to Question 2.6.

F. **STS requirements (Articles 18 – 26e)**

No

The regulation provides that the EBA is to issue detailed guidance on the STS criteria. The EBA has indeed done so most usefully and continues to have the powers necessary to add to that guidance or amend existing guidance. We are not sure that much, if anything, would be gained by handing this responsibility to the Joint Committee.

Question 8.5. Are any additional measures necessary to make sure that competent authorities are sufficiently equipped to supervise the market?

No opinion.

We are not privy to the internal arrangements of supervisory authorities and so cannot speculate as to what additional measures should be necessary.

Question 8.6. Do supervisors consider the disclosure requirements (both the content and format) for public securitisations sufficiently useful?

N/A

Question 8.6. Do supervisors consider the disclosure requirements (both the content and format) for private securitisations sufficiently useful? If not, how could they be improved?

N/A

Question 9.1 a) In your view, is the capital impact of the current levels of the (p) factor proportionate, having regard to the relative riskiness of

each of the tranches in the waterfall, and adequate to capture securitisations' agency and modelling risks?

No

It is important to note some key elements of this debate.

First, the current calibrations (and floors) for securitisations and particularly STS securitisations do not reflect historical performance of European securitisations. As a headline, we note that during the whole GFC (including the sovereign crisis that followed in 2011) not a single euro of credit loss was suffered by any investor in any securitisation tranche rated AAA all the way down to BBB that today would be STS. Objectively, the current calibrations are not based on data.

PCS is happy to provide the Commission with any additional data it requires in this respect, but we believe that other market participants have already done so.

Secondly, the *p* factor was not derived, so far are we are aware, from any scientific or mathematical analysis. It is effectively an invented number designed to capture on a subjective basis the real potential agency and modelling risks.

So, a starting point of any discussion on the proportionality of the current levels of capital required by the CRR ought to be the acknowledgement that existing levels have no anchor or justification in data.

We are aware that much is made of Basel as an international standard designed to create a global level playing field. But we also note that Basel's rules allow a *p* factor anywhere between 0.5 and 1.00. The United State has elected for SEC-SA a *p* factor of 0.5 whereas Europe has elected one of 1.00 for non-STS transactions.

This is particularly odd since one of the major identified agency risks is poor origination or very loose underwriting criteria leading to the origination then securitisation of highly risky financial obligations. One of the main reasons that securitisations in Europe did not suffer credit losses is that the assets securitised by European originators were not "sub-prime" assets. Lending standards in Europe continue to be more restrictive that in the US, as well as the subject matter of legislative oversights (e.g. Mortgage Directive).

Therefore, there is no Basel level playing field and comity justification for the current level of European p factor.

Problems with modelling, centered primarily on an inappropriate use of Gaussian cupolas and a misunderstanding of correlation risks, were at the heart of a large part of the catastrophic defaults of some (mainly US) securitisations during the GFC. PCS drew attention to this problem in our 2013 White Paper[15] where we identified it as one of the four “fatal flaws” with the securitisations that had failed during the GFC.[16]

However, this problem only occurred in relation to re-securitisations which are now banned. Modelling problems did not occur in respect of any traditional European securitisations. Indeed, several STS criteria further reduce the risk either of excessively complex models or of inconsistencies between those models and the real-life behaviour of securitisations.[17]

As a result, the modelling of STS securitisations is very simple and contains none of the risk identified post-GFC as having been problematic.

Agency risks which drive non-neutrality exist with securitisations. However, we note that the STS regime was specifically and deliberately created to remove all identified agency risks. There are 102 criteria to be met for a securitisation to be STS. So, the work of identification and removal was thorough.

Our recommendation is that if the regulatory community can identify any agency risk that is not covered by the 102 provisions of the STS regulation, they should notify the Commission and we would further recommend that the Commission then seek to amend the Level 1 text with a view to adding a 103rd (or 104th, 105th, etc…) criterion to remove such risk from the STS category.

However, if no such agency risk can be identified then a rational, fact-based approach to capital requirement would require that no factor solely inserted to meet agency risk should be inserted.

Put in a different way, we would recommend that the capital requirement for European STS securitisations held by banks should reflect their actual historical performance.

Question 9.1 b) If you would favour reassessing the current (p) factor levels, please explain why and what alternative levels for (p) you would suggest instead.

See our response to Question 9.1 a).

Based on our analysis, it seems that the *p* factor for STS securitisations – in the absence of any identified and uncovered agency risks – should objectively be set at zero.

15 “Europe in Transition – Bridging the Funding Gap” (March 2013)
16 PCS’ analysis of these four “fatal flaws” was kindly endorsed by the EBA in their 2014 paper on which STS standards were based.
17 Eg the requirement for homogeneous pools (art.20.8) and for generally used rates (art.21.3); prohibition on reversals of waterfalls and cash traps (art.21.4), triggers for non-sequential amortisation transactions (art.21.5)

However, we acknowledge the conservative nature of regulations and note that other market participants have suggested a *p* factor for STS securitisations of 0.25 (under SEC-SA). We would support this request.

For non-STS securitisations, PCS has considerably less experience. However, we would merely recommend that the *p* factor be set such that the capital requirements for non-STS European securitisations reflect the actual historical performance of these assets. We are aware that other market participants have suggested 0.5 (under SEC-SA) and, based on our limited knowledge, we find their arguments persuasive.

Question 9.2 Are current capital floor levels for the most senior tranches of STS and non-STS securitisations proportionate and adequate, taking into account the capital requirements of comparable capital instruments?

No

For the reasons set out in our response to Question 9.1, we believe the floor for STS securitisations is unjustified by the law and the data.

We endorse the calculations and approach of industry participants for a floor of 0.1 and a maximum of 0.3 for STS securitisations and 0.25 (with a maximum of 0.75) for non-STS

Question 9.3 Are there any alternative methods to the (p) factors and the capital floors to capture agency and modelling risk of securitisations that could be regarded as more proportionate?

See above.

Question 10.1. Do you think that the impact of the maturity of the tranche is adequate under the current framework?

No opinion

Question 10.2. Is there an alternative way of considering the maturity of the tranche within the securitisation framework?

No opinion

Question 11.1 a) Should STS securitisations be upgraded to level 2A for LCR purposes?

Yes and based on actual liquidity performance, level 1.

The 2018 amendment to the LCR Delegated Act did not provide any recognition of the strength of the new STS standard but simply inserted the new standard (STS) in place of the old, weaker eligibility standard.

Yet, the new STS standard is considerably more comprehensive than the old LCR eligibility standard– containing over 100 separate criteria. The new STS standard is backed by a sanctions' regime. The new standard is framed by new regulated market participants – third-party verification agents and data repositories – to reinforce its integrity and transparency. The new standard is an official designation enhancing its market liquidity. And yet, this new STS standard was granted no benefits whatsoever in the revised LCR rules.

Again, it is essential to complete the reforms of the securitisation framework begun with the creation of STS criteria and re-classify STS senior tranches to Level 1 or, at worse, 2A and restore the eligibility at a single-A rating level to recognise substantial improvement introduced by the STS standard.

Finally, securitisation is the only asset class that has a maturity cap at five years for LCR eligibility. This arbitrary cap does not appear to be backed by any empirical data and fits oddly with the possibility of including a twenty-year covered bond in the LCR pools. This maturity cap should also be removed.

The justification for this remains that the original quantitative work was flawed. It focused its liquidity stress test of 2007-2012 liquidity performance. But the 2007-2012 crisis (especially in the earliest phase) was a securitisation crisis. It was a crisis imported from the United States and triggered by the terrible performance of US securitisations. But this caused a contagion to European securitisations which saw large spread movements as a result. These turned out to be irrational as the ultimate credit performance of European securitisations demonstrated. Had the EBA looked at data only from 2011-2012, a sovereign crisis, it would have seen equal movements in sovereign debt. Unless one believes that, notwithstanding all the regulatory and legal changes made to the European securitisation regime and the actual demonstration of the credit resilience of European securitisation, securitisation liquidity remains uniquely fragile, the treatment of securitisation in the LCR rules feels like generals fighting the previous war rather than focusing on real future risks.

Expressed differently, 2007 to 2012 did not define in a scientifically objective way the immutable relative liquidity risks of all financial instruments in all types of crises but only the contingent and unique relative liquidity of instruments in a crisis bearing those specific characteristics. This does not mean that the data should be ignored. But it does mean that the limits of its predictive power should be acknowledged and understood. We outline below, in our response to Question 11.1 b) what we think should be the consequences of this analysis.

Question 11.1 b) If you answered 'yes' to question 11.1(a), should specific conditions apply to STS securitisations as Level 2A assets to mitigate a potential concentration risk of this type of assets in the liquidity buffer.

As mentioned above and as PCS argued back in 2014, when the new LCR rules were being discussed, all asset classes are at risk of liquidity shocks. This is why the concentration on the 2007-2012 movements in liquidity gave a dangerously misleading impression that securitisations were somehow uniquely fragile. The reality is that liquidity drains in all markets from the instruments that are perceived to be at risk from the idiosyncratic nature of the crisis. In 2007-2008 it was securitisation, in 2011-12 it was sovereign debt and next time it may well be corporate bonds.

We argued then, and argue now, that an approach to LCR pools that sought to be conservative by only selecting a narrow class of assets considered to be extremely liquid is in fact riskier than an approach that selected a wider class of assets but required LCR pools to be more diversified. Since it is not possible to predict where the next liquidity crisis will emerge, spreading your risk was a more conservative approach than trying to "pick winners".

In line with our argument made in respect of many of the questions in this consultation, one of the facts that makes it difficult for a safe but large securitisation market to grow in Europe is the greatly tilted playing field on which it must operate. We know, from the performance of European STS and STS-like securitisations (and for that matter, even European non-STS securitisations) that this unlevel playing field is not justified.

So, in line with our response to Question 11.1 a) and with our general approach, we would suggest that no special conditions should apply to these assets to mitigate a potential concentration of securitisation risk in the liquidity buffer. We do, however, strongly believe that general conditions should apply to all assets in the LCR pools to prevent potential concentration risks in any asset class.

Question 11.2 a) Should ABCPs qualify as level 2B assets for LCR purposes?

Yes, subject to conditions.

PCS has no information as to how or whether ABCP trades. However, we can provide an argument from first principles that does not require any knowledge of ABCP trading.

The LCR pools are designed explicitly to allow a bank to meet 30 days of obligations in the event of an incapacity to tap the funding markets.

ABCP with a maturity of less than 30 days will always meet the necessary liquidity conditions as it will pay out before the 30-day window which the LCR rules are seeking to cover. The only issue is the credit worthiness of the commercial paper. But, with some credit test, if the regulator is confident that the ABCP will generate cash within 30 days not from a sale but from maturity then it is hard to see how it should not be allowed it the LCR pools.

Question 11.2 b) Should specific conditions apply to ABCPs as level 2B assets for LCR purposes.

See our answer to Question 11.1 b).

Question 12.1. Do you agree with the allocation of the LTEL and UL to the tranches for the purposes of the SRT, CRT and PBA tests, as recommended in the EBA report?

No opinion

Question 12.2. What are your views on the application of Art. 252 of the CRR on maturity mismatches when a time call, or similar optional feature, is expected to happen during the life of the transaction?

No opinion

Question 13.1. What are your views on the EBA-recommended process for the assessment of SRT as fully set out in Section 5 of the EBA report on SRT?

The vital importance of securitisation to the European economy lies in its unique capacity to remove risk from the balance sheet of banks thus freeing capital that can be used for further lending.

Even if the reforms started with the 2017 Regulation are fully completed (CRR, Solvency II, LCR, disclosure, etc…), this will be of no avail unless there is a workable SRT process that allows financial institutions to use securitisation to its full potential.

Therefore, PCS considers the SRT process a central to delivering a meaningful securitisation market.

Having made this point, we do recognize that our expertise does not lie in this field and so, although we are familiar with the EBA's report, we would give way on this matter to banks and their advisers.

Question 13.2. Do you agree with the standardised list of documents that the EBA report on SRT recommended for submission to the competent authority for SRT assessment purposes?

See our response to Question 13.1

Question 12.3. Once it has been established that the regulatory quantitative and qualitative criteria are met and transactions are in line with standard market practices, should a systematic ex-ante review be necessary?

No

Notwithstanding our response to Question 13.1, we have sufficient experience of securitisation and prudential regulation to posit that systematic ex ante reviews for complex transactions meeting specified criteria are unnecessary and destructive to the capacity of any market to function efficiently

Question 12.4 Should the ex-ante assessment by the Competent Authority be limited to complex transactions?

No

Again, notwithstanding our response to Question 13.1, we would opine that the complexity of the transaction should not, as a matter of common-sense, be the determining factor. The novelty of a transaction should lead to an assessment. It is perfectly possible to cause great damage with a simple but flawed transaction. But to review a transaction repeatedly even when it has not changed in any way merely because it is complex does not seem reasonable.

Question 14.1 Do you agree with the recommendations on amendments of the CRR as fully laid out in Section 6 of the EBA report on SRT?

See our response to Question 13.1

Question 15.1. Is there an appetite from insurers to increase their investments in securitisation (whether a senior tranche, mezzanine tranche, or a junior tranche)?

No, but one should not draw erroneous conclusions from that fact.

The biggest issue is what we would refer to as the human problem. With the current calibrations under Solvency II and the small level of issuance since the GFC, most insurance companies have closed down their securitisation investment desks. It made no sense to pay expensive talent to purchase minuscule allocations of bonds that were not profitable because of how much capital they ate up. So today, even at very large insurance companies, you have no-one who knows what a securitisation is or what the market looks like. There is no-one advocating for a large allocation of funds or, for that matter, any allocation of funds. Of all the issues faced by insurance companies, securitisation is never one of them since they have no holdings. No-one's employment, success or bonus turns on securitisation.

Should a strategic planner at an insurance company think independently of maybe looking at the asset class, a quick back of an envelope calculation of capital-adjusted returns will tell him or her that this is not really worth it and the process will end there.

Sometime, an asset manager might convince an insurer to allocate a small amount to a securitisation fund but again, it is a hard sell considering the very poor capital adjusted returns

Until Solvency II capital requirements are fixed, insurers will not turn their eyes to the product.

But we would caution against the view that the silence of insurers is an indication that they would not play a large role in the securitisation market should the capital adjusted returns start to make sense once more.

The importance of a large securitisation market to the European economy has been stressed repeatedly, including by the Commission.

The reason for that importance is the capacity for the securitisation market to allow banks to free capital. For this to be successful, a meaningful part of the investor base for European securitisation cannot be made up of other European banks. (Currently, banks make up around 30% of the investor base). This means that it is essential to bring in insurance company and pension savings into this market in meaningful amounts.

Because of the human problem, public authorities cannot wait for insurance undertakings to ask for the necessary changes as this becomes a chicken-and-egg problem. It therefore follows that required changes to Solvency II must be effected whether the insurance community makes it a priority or not. For even if it is not a priority for the insurance community, it is a priority for the European economy.

Question 15.2. Is there anything preventing an increase in investments in securitisation by insurance companies?

Yes

Solvency II calibrations make low yielding but high-quality STS securitisations uneconomical on a capital-adjusted basis.

The heavy due-diligence requirements of Article 5 are also a disincentive but one that can be overcome by using experienced asset managers.

Question 15.3. Is the current calculation for standard formula capital requirements for spread risk on securitisation positions in Solvency II for the senior tranches of STS securitisations proportionate and commensurate with their risk, taking into account the capital requirements for assets with similar risk characteristics?

No

We are aware that other respondents will be providing the Commission with all the necessary data in this respect so we will limit ourselves to a simple consideration.

A capital adequacy regime that requires less capital to be allocated to the purchase by an insurance undertaking of a pool of whole mortgages with all attendant risks than to that of the AAA rated senior STS securitisation of the same mortgages with credit enhancement of twenty times the worse historical loss for that asset type and of the kind that suffered not one euro of loss during the worst economic crisis since the Thirties cannot be considered proportionate.

For the quantitative analysis, we have had the opportunity to review the data provided by AFME in their response and find it persuasive.

Question 15.4. Is the current calculation for standard formula capital requirements for spread risk on securitisation positions in Solvency II for the non-senior tranches of STS securitisations proportionate and commensurate with their risk, taking into account the capital requirements for assets with similar risk characteristics?

See our response to Question 15.3

Question 15.5. Is the current calculation for standard formula capital requirements for spread risk on securitisation positions in Solvency II for non-STS securitisations proportionate and commensurate with their risk, taking into account the capital requirements for assets with similar risk characteristics?

See our response to Question 15.3

Question 15.6. Should Solvency II standard formula capital requirements for spread risk differentiate between mezzanine and junior tranches of STS securitisations?

Yes.

Question 15.7. Should Solvency II standard formula capital requirements for spread risk differentiate between senior and non-

senior tranches of non-STS securitisations? Please explain your answer.

Yes

Senior tranches are invariably larger in size than non-senior tranches – both at the level of an individual transaction and in terms of general outstandings. It follows that one would expect more liquid and smoother trading in senior tranches.

Senior tranches are invariably easier to analyse from a credit standpoint than junior tranches. This means that the universe of potential investors for the harder to analyse junior tranches is smaller than for the very "plain vanilla" senior tranches (especially in the STS securitisations).

However, this answer only addresses the question of spread risk. It is therefore without prejudice to the wider issue of whether spread risk is the appropriate metric for the capital requirements of securitisations when these are almost always purchased by insurance undertakings as "buy-and-hold-to-maturity" instruments. In PCS' opinion, this is not the appropriate metric.

We hope these responses have been helpful and we stand ready to assist the Commission in any way we can on this important matter.

Ian Bell
Chief Executive Officer
Prime Collateralised Securities (PCS) EU sas