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Paris EUROPLACE's response to the European Commission's targeted consultation on the functioning of the EU securitisation framework

Paris EUROPLACE -which represents Paris International Financial Centre's market players, international corporates, investors, banks, financial intermediaries and other financial services providers- welcomes the opportunity to contribute to the debates regarding the functioning of the EU securitisation framework.

CONSULTATION QUESTIONS

1. Effects of the regulation

Question 1.1.

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

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

Widening the investor base for securitisation products in the EU: Fully disagree

Widening the issuer base for securitisation products: Somewhat disagree

Providing a clear legal framework for the EU securitisation market: Somewhat disagree

Facilitating the monitoring of possible risks: Neutral

Providing a high level of investor protection: Somewhat agree

Emergence of an integrated EU securitisation market: Neutral

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.

Paris EUROPLACE supports a renewed securitisation framework which is much needed to urgently contribute to efficiently support bank capital relief and in particular the five following goals:

- Financing investment, notably in SMEs, and a transition towards a more sustainable economy in the post-COVID environment, which needs to ease the banking credit facility constraints and respond to investor appetite, so as to allow market players to make illiquid assets more liquid, the emergence of a more balanced model between bank and market fundings, while enlarging the issuer and investor base;
- Compensate in some way, and at least try to anticipate at best, the possible changes to be expected in the ECB (European Central Bank) monetary policy in the near term. As the US Federal Reserve seems already contemplating a less accommodative monetary policy, it is key for the European regulation to enable the financial sector to make any future reorientation in the ECB monetary policy as neutral as possible for the appropriate funding of the real economy; otherwise, i.e. with no risk-sharing process facilitated by a more ambitious securitisation framework, any changes in the monetary policy could be damaging for investment and employment over the next years.
- A renewed securitisation framework will by itself, i.e. without any new regulatory constraints or templates, naturally contribute to the adaptation and the mitigation of the climate change, through a green (or a sustainable) securitisation of bank loans (for example to the car industry);
- A radically new approach is needed to consider the securitisation framework as a tool which has completely changed since the 2008-2009 crisis and with very limited losses in recent years. Huge changes in both the regulation (which is currently decorrelated from actual risks) and the strategy of financial actors should also make the securitisation framework a positive means to serve commonly shared goals;
- European financial players generally have a cross-border, worldwide activity: the securitisation framework has therefore to be equivalent and comparable among jurisdictions. We think that this is currently absolutely not the case: a large part of the US prominent role in the securitisation market is artificially and simply due to a much more favourable regulation in the US than that prevailing in the EU.

All together, we deeply regret that the current regulation, as well as the limited changes we expect concerning the next regulatory adaptation to come over the next years, drastically reduce the scope made available to financial firms to correctly finance the economic recovery, but also to support employment and address the climate change. Consequently, it is urgent to offer more flexibility in the regulatory framework to enable the financial sector to properly fulfil economic and social objectives.

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.

One of the main cost impact from the SECR relates to the risk-retention requirement for asset management companies when issuing CLOs.

For managed CLOs, the asset managers do not transfer assets to the CLO but buys loans in the open market and manages them on the best interest of the investors in the CLO - similarly to a loan or High Yield fund. As such, the retention obligation should not apply as it is not providing lower risks to investors nor driving any best practices into the CLO management.

2. Private securitisations

Question 2.2.

What are the reasons for this development?

A clear distinction has to be made between private and public securitisation issuances. We basically consider that the number of private transactions (via ABCP or balance sheet warehousing) has been artificially inflated by the way such operations are reported to the ESMA. Also, private issuances are often an adequate, facilitating process to fuel possible public securitisations (especially for FinTech), although the opposite is not observed.

Regarding private securitisations, it is key to provide investors and public authorities with a proportionate and targeted level of information. But we see current transparency requirements as costly and not calibrated in accordance to the investor profile.

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

No

No opinion

The information provided in the standard templates is very complete and detailed. While some of it may not be directly of use in certain transactions, it is positive that such complete information is made available to investors.

That being said, the risk assessment process carried out by financial players at regular period to report standardised information to supervisory authorities has also become an increasingly sensitive and resource-consuming task, mobilizing large teams (IT, business, legal and prudential resources) to meet regulatory requirements in a transparent and exhaustive manner.

Paris EUROPLACE considers that the format and the content of the ESMA templates have been changing too rapidly in recent years, impeding financial market players to work in a stabilised and secured environment. Indeed, frequent modifications in the regulation present some evident drawbacks and increase not only the regulatory burden, but also the risk of non-compliance.

3. Due diligence

Question 3.2.

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

Investors need information on the portfolio of assets securitised, on the structural features of the transaction and on the counterparties involved.

The due diligence is generally based on the information provided by the originator/ seller during the marketing phase of a transaction. The information includes amongst other: a prospectus, an investor presentation, a datapack (displaying stratification tables and/or loan-by-loan datatape, and historical performance of the book) and a cash flow model – which analysis is mainly performed using Intex tool (or proprietary cash flow tools when appropriate).

The analysis is generally complemented by a meeting with the issuer either in person or through digital means.

The marketing data pack to investors is fairly standardised in the public securitisation space although it may vary per asset class. The information displayed during the marketing phase is generally sufficient to perform the due diligence of the investment. Depending on the nature of the assets, the risk contemplated for the investment, the granularity of the portfolio, some further clarification can be asked to the arrangers and on-site visit may be organised.

This said, the mandatory "due diligence" actions issuers and investors are required to do are disproportionate and excessive. While appropriate due diligence is vital, the current requirements are not linked to the risk and complexity of the securitization and are very onerous, creating further disincentives.

So, due diligence requirements should be simplified and allow for proportionality. The outcome should be that the requirements should be similar to that required for other instruments such as covered bonds.

Question 3.3.

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

Yes – please specify (multiple choice accepted)

X Auto-loans/leases

X Residential mortgages (RMBS)

X SME loans

X Corporate loans

X Leases

While loan-by-loan information is useful, it may be less critical to have on very granular asset classes where "bucket" analysis could be sufficient.

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?

Yes

No

No opinion

While investment in any tranche of a securitization requires a detailed due diligence, the scope of this due diligence and the analysis done may be different when investing in senior tranches and junior tranches of securitisations. As an example, the analysis of an investment in a senior tranche will focus more on the structural features of the transaction ensuring the seniority of the tranche (credit enhancement, waterfall etc.), while the analysis of an investment in a junior tranche will require a very detailed analysis of the underlying pool of assets. As it is, our view is that we have sufficient information available to analyse and invest in both junior and senior tranches of securitizations.

Question 3.8.

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

Yes

No

No opinion

Please explain your answer.

Please see our answer to the question 2.5 above.

4. Jurisdictional scope

Question 4.1.

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

Yes

No

No opinion

Please explain your answer.

Please see below our response (question 4.2).

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?

Yes

No

No opinion

Please explain your answer.

European players are very much interested in maintaining strong business relationships with both the US and the UK markets. Considering the provisions required by the regulation framework at article 5(1)(e), we think that obligations for these European players need to be significantly eased in non-EU countries. In particular, due diligence and the ESMA templates should be reviewed to limit the administrative and regulatory burden for the local (US or UK) entities.

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:

When it comes to a situation where “one, but not all entities”, is located in the EU, additional complexities arise for financial firms. This echoes the difficult interpretation of the article 5(1)(e) of the Regulation (EC) 2017/2402 and the question of non-EU based securitisation. Thus, we call for a clear and precise EU regulation with no extraterritorial provisions. Indeed, the latter may open the door to legal risks and consequently dampen cross-border opportunities.

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?

Yes

No

No opinion

Article 5(1)(e) should be clarified to limit the verification requirement in relation to the reporting requirements of Article 7 to EU securitisations only (i.e. securitisations with an originator, sponsor or SSPE in the EU).

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?

Yes

No

No opinion

Non-EU AIFM should only be subject to Article 5 Securitisation Regulation in respect of those funds which it managed or market in the EU and not as regards those funds which it does not. The existing definition of institutional investor in the Securitisation Regulation could be interpreted in broader way and should thus be amended to reflect this intent.

6. Sustainability disclosure

Question 6.1.

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

Yes

No

No opinion

It should be clarified that SFDR should not apply to securitizations. Indeed, investors in multi-credit funds including securitisation and non-securitisation exposures find themselves in a situation where they cannot assess the sustainability risk/SFDR of their investment and it should be clarified that securitisations are outside the scope.

Question 6.2.

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

Yes, but exclusively based on the information of the underlying assets, with a transitional period to ensure the availability of information.

Yes, with a grandfathering arrangement for existing deals.

Question 6.3.

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

Yes

No

No opinion

Question 6.4.

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

This topic is not directly linked to the securitisation reform and must be discussed within the scope of the relevant legislations.

Question 6.7.

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?

Yes

No

No opinion

The EuGB should be adjusted to get the commitment on the use of proceeds at the originator level (and not at the SPV level). There is no need for a separate sustainable securitisation standard.

7. …. A system of limited-licensed banks to perform the functions of SSPEs

Question 7.1.

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

Yes

No

No opinion

In our view, the introduction of a mandatory banking license to enter the securitisation market would further limit and even reduce the interest of these operations. Indeed, the questions would be raised to know who would own these SSPEs and whether the risks' reduction usually permitted via securitisation would still exist at some point. In addition, statistical requirements already prevail in France for some SSPEs (the so-called *Fonds Communs de Titrisation* and *Organismes de Titrisation*). All in all, we consider that regulatory provisions should not be strengthened in that aera.

Question 7.2.

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

We do not see any advantage of such “limited license bank”. This additional agreement can keep out of the market potential issuers as it implies new administrative costs and makes the regulation equivalence more complex and so the European market less attractive.

In addition to the SECR specific reportings and notifications, we wish to remind to the members of the European Commission that the ECB collects, via Eurozone national central banks, quarterly and annual statistic reporting by transaction. Such statistics equivalent exists in all country members and warrants a centralization of the data already monitored.

9. Assessment of non-neutrality correction factors impact

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?

Yes

No

No opinion

Among the main critics that can be made regarding the current securitisation framework, we think that the prudential aspect is far from contributing to a satisfactory financing of the real economy. For example, we see the capital requirements as considerably higher after securitisation than the capital requirements of the assets pool before securitisation. Such a **non-neutrality** in the EU regulation reflects an unacceptable discrimination or a stigma towards securitisation, while a totally different landscape prevails for the same financial companies established in the US. This regulatory gap obviously leads to arbitrage and to welfare losses at the expense of the EU firms and citizens.

Far from being what a “simple and transparent” securitisation framework should be, the impact of the output floor on securitized exposures is indeed highly negative. Whether this is an unintended effect or not, the current regulatory regime is, in our view, largely inadequate and inefficient to help finance the real economy. We think a deep recalibration of the technical elements embedded in the transposition of Basel III rules is urgently needed. We thus call for a RW floor of 7% for both STS and non-STS senior tranches.

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?

Yes

No

No opinion

Please explain your answer.

As indicated for question 9.1.a above, the regulatory regime of securitized assets is strongly damaging the profitability of financial players, as the cost in terms of capital is higher after securitisation than it is for the loans pool before. Through such a non-neutrality, value added is being destroyed with no justification at all. As a consequence, a more sophisticated prudential treatment has to be designed, to correctly assess where credit risks are, and then very rapidly implemented.

11. Treatment of STS securitisations and asset-backed commercial papers (ABCPs) for the liquidity coverage ratio (LCR)

Question 11.1 a)

Should STS securitisations be upgraded to level 2A for LCR purposes?

Yes

No

No opinion

Please explain your answer.

The concept of STS may be definition prove helpful for the EU financial sector, giving financial actors more reasons to properly finance the real economy. However, considering the LCR Delegated Act, the prudential regime of senior STS tranches of securitisation has not been improved at all: indeed, these tranches are subject to a significant discount, contrary to what is applied to covered bonds (considered as “extremely high quality” assets, being included as HQLA level 1 assets, as in the “high quality” category of level 2a). This strongly contributes to lower the demand from bank treasury desks.

We therefore suggest that AA-rated (or more) STS senior tranches could be included in Level 1 (for residential and auto loans for example, as they are very liquid) or Level 2a assets (SME loans and other consumer loans) under the LCR regime, while non-STS securitisations should be admitted in Level 2b with similar haircuts as those applied to covered bonds.

Question 13.4

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

Yes

No

No opinion

Please explain your answer.

In order to avoid any conflict of objectives between the different tasks of the ECB, regarding monetary policy and banking supervision in particular, we would like to emphasize the need for the supervisory authorities to avoid any overly conservative interpretation of SRT assessments. Actually, based on various anecdotal evidence, it seems to us that the ECB has too frequently (actually, in a very large number of cases) been assuming that a structural features review was necessary. Accordingly, we hope a much more simplified, not restrictive and above all predictable process could be envisaged, for example with safeguards and clearer rules, before deciding whether a transaction really needs or not to a structural review. Also, the SRT assessments should be much more transparent and disclose clear criteria to shorten the time needed by the ECB to approve and not the submitted transactions. For standardised and regularly proposed transactions, a "fast track" process should also be envisaged to maintain the attractiveness of securitisation, instead of lengthening the whole process through unclear criteria.

13. SRT assessment process

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?

We think regulatory provisions have to be justified and proportionate. Regarding the asymmetry of information between issuers and investors and the so-called associated agency risk, it exists when the due diligence process is poorly satisfied, which is not the case with the current regulatory framework. Therefore, the regulation framework must be eased, and the regulatory capital reduced, when transactions remain private, in particular when they stay within the investors' portfolio.

15. Solvency II

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)?

Yes

No

No opinion

Insurance companies will look for an appropriate profitability of their investments. This needs a good level of revenue and a reasonable level of required own funds. However, capital charges for securitisation in Solvency II appear already very high, notably in comparison with equally rated corporate or covered bonds. If this level of capital is corrected, insurers will be able to look for the securitisation investments with returns commensurate to their risk appetite.

Question 15.2.

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

Yes

No

No opinion

Please explain your answer.

We think the current drafting of the Solvency II regulation is largely too restrictive for EU insurance firms to invest in securitized assets. Conversely, non-EU insurance companies are very active on this market. Meanwhile, EU insurance firms have been proposing credit insurance solutions which receive a very limited attention from a bank prudential regulation perspective. Thus, we call for an urgent revision of the Solvency II regulatory regime.

Indeed, the Solvency Capital requirements (SCR) for securitisations under Solvency II remain too high relative to the real risk and relative to the yield that can be earned. As a result, the yield that can be earned by an insurer investing in securitisations is not usually high enough to cover both the risk and the additional capital that needs to be set aside by the insurer. This problem arises because the current SII framework ignores the actual risk involved in investing in securitisation which the risk of actual losses from extreme level of defaults and instead assesses risk and capital by assuming the insurer would sell all their securitisation after a huge change in market spreads.

A possible way forward is to allow insurers to apply the dynamic VA (DVA) to value liabilities. This recognises the fundamental SII principle that the extreme scenarios used to determine the SCR should be applied to assets AND liabilities. And in doing so would arrive at a more economically correct and appropriately lower level of capital requirements.

Other issues to be addressed:

- As well as the absolute level of capital being too high, the differences in capital requirements between senior and non-senior tranches of a securitisation remain too high – eg a senior 5-year AA STS securitisation has now capital charge of 6%, while the junior tranche with same AA rating has it at 17%.
- Non-STS securitisations remain significantly penalised, without this being justified by historical performance data.
- There is inconsistency in treatment between a whole mortgage loans pool versus RMBS, the latter being heavily penalised in terms of capital.

The scope of allowing a risk factor of 0%, which is currently limited to exposures to the European Investment Fund and the European Investment Bank, should be expanded to all types of government and RGLAs guarantees.

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?

Yes

No

No opinion

Please be specific in your reply and, where relevant, provide a comparison, including where appropriate with internal models and their relative impact on the share of securitisation investments.

We think that the stress factors which are applicable to senior tranches should be in line with those applied to corporate and covered bonds benefiting from the same rating. In addition, the stress factors regarding senior tranches should be consistent with their risk and lower than those applicable to the underlying exposure.

Also, the Solvency II capital requirements (SCR) represent an obstacle to investing in securitisation as they are unnecessarily punitive. There is a need for more risk-sensitive capital charges. For senior tranches, the calibration of SCR may benefit from a revision to align their credit spread shocks with those for bonds and loans for all credit rating levels.

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?

Yes

No

No opinion

The industry notes that the differences in capital requirements between senior and non-senior tranches of a securitisation remain high – eg a senior 5-year AA STS securitisation has now a capital charge of 6%, while the junior tranche with same AA rating has it at 17%. It considers that the rating is already encompassing the level of risk, whether the concerned tranche is senior or non-senior, so that a factor of 1 to 3 in the capital charge appears far too high.

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?

Yes

No

No opinion

Please be specific in your reply and, where relevant, provide a comparison, including where appropriate with internal models and their relative impact on the share of securitisation investments.

The industry notes that non-STS securitisations remain significantly penalised, without this being justified by historical performance data. While STS label brings some guarantees to the investors, non-STS tranches, when benefiting from an identical rating to STS tranches, should be treated in a similar way, and in any case should not have a capital charge more than 10 times higher.

The analysis of this problem should also investigate the reasons behind the limited number of new official STS securitisations notified to ESMA, as well as the treatment provided in the transitional regime for old securitisations (eg pre-2019 not-rated securitisations must be treated as non-STS without credit assessment and must be stressed at 100% like non-STS without credit assessment even if they could be considered STS due to their technical characteristics (not falling within the old type 1, at least investment grade).

In addition: there is inconsistency in treatment between a whole mortgage loans pool versus RMBS, the latter being heavily penalised in terms of capital. Last, the scope of allowing a risk factor of 0%, which is currently limited to exposures to the European Investment Fund and the European Investment Bank, should be expanded to all types of government and RGLAs guarantees.

Question 15.6.

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

Yes

No

No opinion

Regulation should avoid being too complex through the introduction of too many refinements. In the case of mezzanine versus junior tranches, the rating might *a priori* be enough to differentiate between different levels of risks.

Question 15.7

Should Solvency II standard formula capital requirements for spread risk differentiate between senior and non-senior tranches of non-STS securitisations?

Yes

No

No opinion

As mentioned in questions 15.4, 15.5 and 15.6, the rating of a securitisation could be enough to differentiate between different levels of risks, so that the differentiation between senior and non-senior tranches of non-STS securitisation does not appear a priori relevant.