27 September 2021

[GCA_Ref]

GCA response to the European Commission's Targeted consultation on the functioning of the EU securitisation framework

Focus on questions 1.1, 1.2, 3.1, 14.1

1. **Effects of the regulation**

Question 1.1:

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

	1 (Fully agree)	2 (Somewhat agree)	3 (Neutral)	4 (Somewhat disagree)	5 (Fully Disagree)	6 (NA)
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				X		

securitisation market						

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.

In general, the GCA considers that the regulatory framework could be improved in a number of aspects to accomplish the objectives detailed below. The proposals to accomplish this have for example been reiterated by the High-level forum on the Capital Markets Union and the GCA expects that implementing those proposals would have a positive impact on all those objectives that have not been met. For example, adjusting the capital non-neutrality factor (as proposed by the CMU HLF) would provide further incentives to securitise and lower regulatory costs for both issuers and investors, thereby increasing overall volume of issuances, in turn improving access to credit in Europe and contributing to the emergence of a solid EU securitisation market. Similarly, upgrading the HQLA eligibility criteria of securitisations, having more targeted disclosures at least for private securitisations, and making the significant risk transfer (SRT) process more efficient would have a similar positive effect. Importantly the GCA believes that building an integrated securitisation market necessarily requires an incentive system. If the regulatory framework does not set the right incentives, banks will not engage in securitisations and the framework will miss its purpose. Furthermore, the discussion about the review of the securitisation framework comes at the same time as the implementation of the Finalisation of Basel III. Considering that the output floor is calibrated based on the standardised approach that is over-calibrated and not risk-sensitive enough for securitisation, further attention should be paid to this particular topic to avoid that the reform efforts in the area of securitisation are not undermined.

More specific comments are the following:

<u>Improving access to credit: </u>so far the securitisation market has not shown any meaningful growth since the introduction of the SECR. While admittedly Covid-19 and monetary policy have played an important role in this development, it is hard to argue that the SECR improved access to credit as yet. Reasons (in addition to what has been mentioned above) for that may be the following:

- Costs and governance required for securitisation remains too high for some issuers, particularly disclosure requirements;
- SMEs traditionally finance themselves via private warehouse transactions with banks when using securitisation, before targeting a capital markets exit – punitive capital charges for bank financers often makes securitisation a more costly option when compared to other available alternatives

<u>Widening the investor base:</u>

The SECR has missed the opportunity to widen the investor base since small institutional investors are deterred from investing in ABS, given the fixed costs associated with due diligence. Not directly related to the SECR, the capital treatment for insurers under Solvency II is overly punitive and should be reviewed in this context

The differences in attitudes of investors to, for example, ABCP between the EU and the US is remarkable and instructive on this point. This situation is linked to the relative attractiveness of the products in the two jurisdictions, which derives largely from their regulatory treatment in each jurisdiction – including the eligibility of ABCP for central bank liquidity operations, where unfortunately the post-GFC stigma associated with securitisation remains. This is despite the widening of such schemes recently to much more risky investments such as Additional Credit Claims.

Widening the issuer base: We have seen new issuers entering the market, especially start-ups, finance companies, fintechs and other players without access to central bank money and/or the bond market. However, this trend already existed before 2019. The SECR should have reopened the market for traditional issuers (larger banks) by offering a competitive product, but even with the limited benefits of STS, European securitisation is still not at a level playing field with other wholesale funding products. There is potential for new issuers using securitisation for capital purposes, but thanks to the recent synthetic STS amendments,a better workable SRT regime is still in the development phase, so it is not yet possible the see a trend.

Providing a clear legal framework for the EU securitisation market
In this respect the SECR has been a partial success. The harmonisation of rules among different classes of market participants (previously provided for separately and slightly differently in the CRD, Solvency II and AIFMD regimes) is helpful in that it creates consistency and more of a level playing field. Many of the requirements are relatively clear, including the broad thrust of the disclosure, risk retention and due diligence requirements, and the STS framework. The devil, however, appears in the details. Significant legal questions remain unresolved and unclear or in a state of uncertainty even now. By way of example, these include:

- The due diligence requirements on institutional investors under Article 5(1)(e) when investing in non-EU securitisations.
- Whether non-MiFID-regulated investment firms are permitted to act as sponsors.
- Article 9 in general is difficult to apply (despite recent useful amendments as part of the Capital Markets Recovery Package) and comply with, especially in relation to acquired portfolios, future-flow transactions and transactions with a sponsor.
- Over two years after the SECR began to apply we still do not have final risk retention RTS, and the transitional rule in Article 43(6) does not provide grandfathering for any transactions done or updated on or after 1 January 2019.
- Various technical standards and guidance that fully implement on-balance sheet STS framework introduced in April 2021 remain outstanding.

Facilitating the monitoring of possible risks:

For public STS transactions, which were actually the ones targeted by the new transparency requirements under the new regime, disclosure is more standardised and consistent across issuers. While the ESMA templates have been broadly adopted by the issuers of these transactions, investors and rating agencies still require investor reports in the format that was used before the regulation went into force – especially for frequent issuers -, as it is easier to review and compare over time.

In respect of synthetic securitisation, we do not think the "one size fits all" approach to disclosure and reporting has been helpful. The reality is that investors investing in the senior tranches of a traditional cash securitisation have different needs from the highly sophisticated firms investing in the junior/riskier tranches of a synthetic securitisation, and apply their own due diligence, monitoring and reporting requirements, which standard ESMA templates do not cover (as not designed for that purpose). The overly prescriptive approach to disclosure evidenced in the ESMA templates impose significant additional cost and operational burdens on originators without providing any meaningful additional information to investors in synthetic securitisations, as evidenced by the fact that no investors have shown any interest in those reports since they were introduced, but continue to require bespoke reporting agreed on a deal-by-deal basis with the originator.

While the principles set out in Article 7 of the SECR are sensible, at least for private securitisations, it should be for originators and investors to agree on what is required to meet those requirements rather than requiring all transactions to comply with a set of standardised reporting templates.

Integrated EU securitisation market: Although the SECR wishes to contribute to the integration of EU securitisation, the absence of any investor base widening through the current SECR prevents from any actual integration of the EU securitisation market.

Besides, other elements of the CMU action plan (like harmonisation of insolvency legislation) have to be completed before market integration can actually take off. It is also important to note that even if the already achieved harmonisation has been helpful in reducing complexity, compliance costs due to prescriptive requirements as a result of an overly conservative interpretation of the regulation (i.e. requirements for private securitisations as part of the ESMA templates) remain very high. More guidance, consistency and clarity could be useful.

3. Transparency and Due diligence

The transparency regime in the SECR requires that the originator, sponsor and SSPE of a securitisation make a range of information available to the holders of the position, to competent authorities and, upon request, to potential investors. The information is provided via templates and is intended to enhance the transparency of the securitisation market as well as to facilitate investors' due diligence and the supervision of the market. The following questions aim to find out whether the information that is currently provided to investors is appropriate, sufficient and proportionate for their due diligence purposes and whether any improvements can be made.

Question 3.1:

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

-Yes

-**No**

-Don't know/No opinion/not applicable

Explanation:

The regime is not proportionate with the regimes applicable to any other capital markets product. We would not suggest that other products should be subject to the same due diligence and transparency as securitisation, but we would support a more level playing field.

We consider that it is unclear if providing such a large volume of information gives more clarity or ends up taking out the focus from the relevant data. Feedback from investors tells us that they prefer a more focused regime for securitisation, with more emphasis on information that is really useful and less on huge quantities of data (with many ND's) that do not provide any insight but still have to be subjected to due-diligence by investors.

In our view, the goal of the review of the securitisation framework should be to improve investor information from a qualitative standpoint. To improve the added value of the disclosures, it could be useful to reflect to what extent an alignment with the disclosure requirements in the covered bond framework could be a meaningful remedy. In the same vein, it would make sense to apply an exemption to transactions where the investor is directly involved in deciding the information format and the data that are reported by the originator, which will already guarantee that the investor is responsible and has all the relevant information to perform due diligence. This is the case for private transactions in particular. Moreover, an exemption for private transactions without a third-party investor, as also suggested by the ESAs in their "Joint Committee report on the implementation and functioning of the securitisation regulation (Article 44)", would eliminate a reporting requirement that is not useful. The recommendation of the ESAs report to register all private securitisation in a securitisation repository should be reconsidered, since all private securitisations would have to comply with the ESMA templates, which is incompatible with the bespoke reporting that is used in bilateral transactions. Also, it should be considered that in those transactions, investors and competent authorities already receive this information. Therefore, the added value may be limited considering the significant additional operational burden.

We would propose that the European Commission clarifies that the extensive disclosure and due diligence requirements imposed on securitisation are actually to be met only for public transactions, and more specifically: (a) differentiate disclosure requirements for publicly distributed securitisations and for other cash (including ABCP) or synthetic securitisations; (b) establish the principle of proportionality in the application of disclosure and due diligence requirements; and (c) allow permanently for long–term use of ND (no data available) fields. Such flexibility may be achieved through issuing an interpretative communication specifying that the disclosure requirements developed under Articles 7.3 and 7.4 of of Regulation (EU) 2017/2402 will apply only to securitisations with a prospectus drawn up in compliance with Directive 2003/71/EC. The originator, sponsor and SSPE of a securitisation without a prospectus drawn up in compliance with Directive 2003/71/EC shall provide information under Article 7 (1) (a) of Regulation (EU) 2017/2402 required by the investor(s) or the sponsor in such securitisation and deemed by them sufficient to perform due diligence on the securitisation exposures proportionate with its risk profile.

Regarding the specific due diligence requirements in Article 5 (1), we would like to point out the following two points:

- Regarding the due diligence requirement in Article 5 (1) (d), to check that "if established in a third country, the originator, sponsor or original lender retains on an ongoing basis a material net economic interest which, in any event, shall not be less than 5 %, determined in accordance with Article 6": a good solution would be to introduce an equivalence regime, where an EU-regulated investor will be able to hold a securitisation position in a third-country securitisation compliant with the local regulation on risk retention.
- Regarding the due diligence requirement of Article 5(1)(e), to check that "the originator, sponsor or SSPE has, where applicable, made available the information required by Article 7 in accordance with the frequency and modalities provided for in that Article", the recent ESA opinion seemed to imply that it is necessary for if an EU-regulated investor in third-country securitisations to receive the same information as required by the ESMA template to meet the requirements to carry out their due diligence obligation proportionate to the risk profile of the securitization exposure, without having necessarily received the ESMA Templates. However, this is an issue for the EU banks entering into third country securitisations. While the investors do receive asset-level data in some form, those third country sell-side parties are unlikely to be willing to provide additional information which is not produced or used by that originator in its business or that is not required from investors outside the EU. Therefore, this represents an existential issue for the non-EU securitisation lending businesses of EU lenders. If

the requirement for detailed reporting in the form of the EU templates, or provision of information in relation to all the data fields in those templates, this will clearly put EU lenders at a competitive disadvantage, including for the non-EU transactions of their EU clients.

14. SRT Amendments to CRR

Section 6 of the EBA report on SRT recommended a set of amendments of the CRR to simplify and improve the current SRT tests.

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?

-Yes

-No

-Don’t know/No opinion/not applicable

Explanation:

One change which is proposed (see Paragraph 211 of the EBA report) is to replace the existing first loss and mezzanine mechanistic tests with the PBA test. We would generally be in favour of this change, although only where, as indicated above, for the purpose of calculating the PBA test, the exposure value of any synthetic excess spread and retained first loss tranche which is assigned a 1250% risk-weight or is deducted from capital is treated as having been transferred. We do not, however, agree with the suggestion in Paragraph 212 of the EBA report that the tranches be weighted for this purpose in a similar manner to how the mezzanine mechanistic test currently works. In our view this would add complexity and raise the risk of anomalies arising in the outcome the test. Further, given that this recommendation recognises that the existing mechanistic tests can lead to certain anomalies, if the mechanistic tests are retained, it should be clarified that where the mechanistic tests are not satisfied, but the PBA is are satisfied, this is a basis on which a CA could exercise its discretion under Articles 244(3) and 245(3) to recognise SRT.

In a similar vein, and as also noted in Section 4.4, we support the proposal set out in the High Level Forum report on Capital Markets Union that the commensurate risk transfer requirements should be disapplied in the case of a securitisation which satisfies one of the mechanistic tests in Articles 244(2) and 245(2).

We do not agree with the proposal in Paragraph 215 of the EBA report for securitisations positions which attach below KIRB/SA and detach above KIRB/SA to be treated as two separate tranches for the purposes of the SRT assessment. Where there would be a benefit for the originator from being able to net the SCRAs against the exposure value of a first loss tranche which has a risk-weight lower than 1250%, it is always open to the originator divide the capital structure into separate tranches to facilitate that.

As noted above, the proposal in Paragraph 216 of the EBA report for synthetic excess spread to be considered a retained position in the case of synthetic securitisations has already been included in the CRR, although the industry is still awaiting the regulatory technical standards setting out how to calculate the exposure value of that retained position. We remain of the view that synthetic excess spread should be treated the same way as excess spread in traditional securitisations, and thus not attract a capital charge. Excess spread represents unrealised income expected to be generated by the underlying exposures, which has not yet been earned or reflected in the originator's profit and loss accounts, and against which it is not required to hold any capital if those exposures are not securitised. Unless the amount of synthetic excess spread is greater than the income expected to be generated by the portfolio, it is therefore both inappropriate and inconsistent for there to be any requirement for the originator to hold capital against this excess spread. Synthetic excess spread is not a widely-used feature in most synthetic SRT securitisations at present, with the notable but systemically important exception of transactions where the European Investment Fund acts as the protection provider. However, in those transactions where it is used, it is essential in order to make the transaction economically viable. We remain of the view that the benefits for the originator (and, therefore indirectly, the financial system more broadly) of de-risking through synthetic securitisation involving the use of synthetic excess spread, significantly outweighs any concerns about the commitment of synthetic excess spread weighing on the future profit and loss account of the originator. If the new text in Article 248(1)(e) of the CRR is applied literally, and the exposure value of the synthetic excess spread is calculated as being equal to maximum remaining future amount of synthetic excess spread that will be available, that will render the use of synthetic excess spread economically unviable in virtually all cases. If that is the regulatory intent (which we do not think is the case), then a prohibition on the use of synthetic excess spread would be more straightforward. However, on the basis that the rules do not prohibit the use of synthetic excess spread, it should also not be the intention for that to be the de facto outcome of the requirement to hold capital against synthetic excess spread. We therefore urge the regulators to approach the calculation of the exposure value for synthetic excess spread in the regulatory technical standards in a way which does not have this effect.

In this regard, we note that, although the drafting of paragraphs (e)(ii)-(iv) of Article 248(1) of the CRR is not clear, if interpreted in a way which is consistent paragraph (e)(i) of that article, it does leave open the possibility that, if synthetic excess spread is structured to absorb losses only when and if the underlying assets have actually generated sufficient excess spread for the purpose (i.e., it is akin to "actual excess spread" as employed in traditional securitisations), and is hence not a commitment of the originator, this amount will not be subject to capital requirements (as is the case for traditional excess spread) until it has been recognised by the originator in its income statement. However, this approach is closed off by the EBA SRT report which recommends that synthetic excess spread should only be permitted in a synthetic SRT securitisation where it takes the form of a fixed nominal commitment, thus rendering paragraph (e)(i) of Article 248(1) redundant. (The same is the case for a synthetic STS securitisation, where Article 26(e)(7) also requires synthetic excess spread to take the form of a fixed nominal commitment.) In this, the EBA SRT report also proposes the creation of an un-level playing field between traditional and synthetic securitisations, without providing any justification for this discrimination.

Paragraph 217 of the EBA report notes the current inconsistency in the fact that transactions where the originator applies a 1250% risk weight to, or fully deducts, all the retained positions do not technically constitute SRT transactions, and are thus not subject to the supervisory assessment process set out in the report. This also means that the structural features discussed in the report are not technically applicable for full deduct transactions. This is despite the fact that full deduct transactions do need to comply with the basic requirements in Article 245(4) of the CRR which form the backdrop against which the structural features discussed in the EBA report are deployed in SRT transactions, and will also need to comply with the new requirement to hold capital against synthetic excess spread under Article 248(1)(e) of the CRR. Against this backdrop, the EBA recommended that full deduct transactions should be subject to the same requirements in relation to the structural features discussed in the EBA report, as well as the notification requirements in order to enable CAs to assess compliance with the requirements. AFME Members agree that the structural features should apply to full deduct transactions in the same way as to SRT transactions. However, any assessment process that applies for full deduct transactions should be limited to showing compliance with those features and should be more straightforward than is the case for SRT transactions. For example, because the originator is holding capital against the maximum loss it could suffer in respect of the securitisation, there should be no need for any detailed modelling showing the impact of amortisation provisions.

Although not mentioned in the EBA report, one additional change which could be very beneficial for securitisation markets. The impact of guarantees provided by Member States to EU banks to support the post-Covid 19 economic recovery is significantly reduced where guaranteed loans are securitised, due to the inability (in general) of securitisation investors to recognise the guarantees as direct credit risk mitigation against their securitisation positions (even where the guarantee maps, economically, to the securitisation position held). This is due to eligibility issues, under the CRR credit risk mitigation rules, relating to 'directness' and mismatch between the guaranteed exposure and the exposure in respect of which protection is sought. Such eligibility issues arise unless (as in the GACs and HAPs schemes) a guarantee has been expressly drafted to facilitate recognition as direct credit risk mitigation in the hands of a securitisation investor. Action to address this issue would significantly enhance the efficacy of support provided by Member States to support the post-Covid 19 economic recovery. It would enable EU banks to transfer the risk of guaranteed loans to market investors, and reduce their exposure to the sovereign guarantors of the loans, freeing the banks to lend further.

It is our understanding that the CRR already facilitates recognition via KIRB/SA of credit protection (including Member States' loan guarantees) provided to originators and or SSPEs. However, where recognised via KIRB/SA, the risk weight floors applicable to securitisation positions, and the non-neutrality of securitisation risk weighting in general, greatly reduce the benefit that can be recognised. A 15% (non STS) or 10% (STS) risk weight floor is clearly disproportionate in the context of a portion of a pool that benefits from a guarantee from an EU Member State.