

European securitisation and the STS securitisation framework

10 March 2017

Roberto Gualtieri MEP, Chairman of the Economic and Monetary Affairs Committee
Prof. Edward Scicluna, Minister for Finance, Malta
Vice-President Valdis Dombrovskis, European Commission

Dear Chairman Gualtieri
Dear Minister Scicluna
Dear Vice-President Dombrovskis

As you know, for many years AFME has supported the need to restore high-quality securitisation to help support funding for economic growth in Europe. We fully agree with President Draghi's comments to the European Parliament last year that the framework for Simple Transparent and Standardised (STS) securitisation is a tangible example of how EU legislation can broaden financing opportunities for EU companies, foster cross-border investment and ultimately have a positive impact on the EU investment outlook.

With the Trilogues process underway, the need for sound provisions and compromises to establish the STS framework is critical. The securitisation market in Europe remains moribund: key players, including underwriters, issuers and investors, continue to exit the market as its critical mass shrinks to a level which cannot support the staff, infrastructure and other fixed costs necessary to continue to participate. The harsh and disproportionate treatment of securitisation in EU legislation is discouraging the recovery of the market.

While the STS concept is strongly supported by AFME, today I am writing to convey the deep concerns of a wide range of our issuer, arranger and investor members – including AFME's Board.

Several omissions and new provisions introduced without proper assessment will (if not remedied) firstly put the success of the STS framework in jeopardy, and secondly put at significant risk the existing functionality of the market, and so restrict the ability of the securitisation market to contribute to the objectives of the Capital Markets Union.

It is vital that the STS framework is designed to ensure securitisation remains not only possible but also attractive for both issuers and investors. Securitisation should be treated on a level playing field with competing fixed income products. A sufficiently large portion of the existing market – securitisations that have performed very well in Europe through and since the financial crisis – must be eligible for the STS designation to ensure liquidity and stability for investors.

A number of proposals under consideration run counter to these objectives. The following areas concern the STS framework specifically:

- The lack of provision for an adjusted standard for existing legacy transactions which have performed well but which cannot meet every single STS requirement, often for purely technical reasons; and
- Draconian, "strict liability" standards for mistakes made in complying with the highly detailed STS requirements, with no distinction made or defense available for honest mistakes made in good faith

(compared with intentional breach) , will dissuade originators and their executives from undertaking securitisation. In order to avoid this undesirable outcome, the penalties provided should apply only in the case of negligence or deliberate misconduct, rather than using the strict liability standard currently contemplated in Article 17.

Troubling aspects of the proposals affecting the entire European securitisation market (not just STS) include:

- Major proposals to increase significantly the risk retention requirement from its current level of 5% without an impact assessment – this will undermine years of regulatory work and send a very strong negative signal on securitisation in general, in addition to significantly reducing its efficiency as a tool for funding and for bringing new non-bank risk capital to the EU economy;
- Restrictions on permitted market participants: restricting the market to only certain types of issuers and investors will limit issuance, concentrate risk and reduce diversification;
- A failure to provide for an appropriate principles-based disclosure regime for private transactions would deal a severe blow to the market. The current regime provided for under Article 409 of the CRR functions sensibly and we would urge that it be replicated under the STS Regulation for private transactions only;
- In order to achieve a level playing field globally, EU bank investors in Europe need to be able to use the SEC-IRBA to calculate their capital charges. To be able to do so in respect of a sufficient range of investments, they need to be able to use a “top down” aggregate analysis of performance, complemented by data from similar pools (which we refer to as a “purchased receivables approach” - US banks already use this approach). In order to achieve this, we would urge the co-legislators to give the EBA a mandate to provide the guidance necessary to use this approach; and
- Harsh capital calibration revisions proposed for the CRR: we believe that the approach developed at international level does not adequately reflect the performance of European securitisations or the higher quality of future EU STS securitisations. Other trade associations may communicate further on this matter.

We also note that accommodating third country participants is of benefit to EU markets because it allows investors a broader choice and helps reinforce the attractiveness of the EU as a market overall. It would also help to encourage depth and liquidity of markets, which are central aspects of the revival of EU securitisation and success of the STS regime.

If not remedied, the combination of the above shortcomings will undermine the main objectives of this piece of CMU legislation, and will further depress activity in the already moribund established market. We urge the EU institutions to do more to address these concerns and make a success of the STS framework. The note included in the annex below summarises important issues for consideration in the current debate.

Securitisation can clearly make a strong contribution to Europe's economic recovery and developing our capital markets. AFME will continue to work with the EU co-legislators to seek further improvements and more ambition in the STS legislation and accompanying capital requirements.



C.C.

-Paul Tang MEP

-Othmar Karas MEP

-Olivier Guersent, Director-General, DG FISMA

-Benoît Cœuré, Member of the ECB's Executive Board

Annex: Major issues for consideration

Our comments below focus on priority issues identified by AFME members for the Trilogue negotiations.

STS Regulation

- **Restrictions on permitted market participants (Art. 2a and Art. 2b in the European Parliament text)**

Art. 2a and Art. 2b in the European Parliament text are extremely problematic. Permitting only regulated entities to undertake securitisation will reduce rather than expand the use of this technique and exclude from the market many real economy corporates such as auto loan “captive” issuers leasing companies and other corporate groups undertaking trade receivable securitisation. Also, allowing only institutional investors to participate will concentrate, not diversify, risk – this runs counter to financial stability objectives. If restrictions are considered necessary at all, then a better approach would be to exclude direct investment by certain types of investors, for example MiFID II “retail clients”. (Such an exclusion should not apply to indirect investment via funds.)

The proposal in Art. 2a in the European Parliament’s text is problematic for a range of securitisations, for example it would prevent most ABCP conduits established in the EU from issuing US ABCP - unless the EU accepts that the US investor is subject to an equivalent regulatory regime, a process involving many uncertainties. Currently, access to the deep US ABCP market is essential for European ABCP conduits to function. Indeed, the ability of European issuers of ABCP to source funds from the US has been of critical importance during recent periods of market stress, when the US was the only market available. See further our comments below under third country issues.

- **Risk Retention**

Proposed changes to the risk retention regime in the European Parliament text affect all securitisations, not just STS. The changes will make it more inefficient for corporates such as auto loan manufacturers and leasing companies to fund themselves directly. Indirectly, they will make it more difficult for banks to transfer risk, thereby reducing their ability to lend to the real economy. We believe that the retention level should remain at 5% and the proposed changes should be abandoned since the existing regime has been reviewed many times over the years by many respected institutions, and has been shown to work well. No impact assessment has been undertaken to support a change to the current regime and deviation from the global 5% standard would create major challenges. We have addressed our concerns regarding risk retention in more detail in a separate paper.

- **Transparency provisions**

Standards of disclosure in European securitisation are already very good and much better than for other fixed income products. The market is not failing to revive because of shortcomings in disclosure. It is vital that any transparency regime for *public* transactions (i.e. those subject to an obligation to publish a prospectus under the Prospectus Directive) also allows for an appropriate, principles-based disclosure standard for *private* transactions, including adjustments to the application of the loan-level reporting requirement. This is now particularly important in the context of the proposed establishment of numerous

new repositories for data. In addition, while the European Parliament's Recital 13a refers to "non-public" securitisations it is important that appropriate provisions are included also to reflect confidentiality aspects relevant to them.

Proposals for public disclosure of information listing the names of investors in securitisation transactions, the characteristics of their investment and their ultimate beneficial owners are highly problematic. They are not practically possible to comply with, they are redundant with existing requirements for regulated investors to report to their supervisors and they would further stigmatise securitisation compared with other asset classes, and drive investors away.

Overall, we once again stress the importance of a level playing field with other fixed income products, where investor name give-up is not required.

- **Existing/legacy transactions and grandfathering**

The lack of provision for an adjusted standard for existing/legacy transactions, as well grandfathering provisions, would cause many problems. Investor due diligence, risk retention and transparency rules affect the whole market and existing transactions have been structured on the basis of rules in place at the time they were concluded. It seems to us that the political intention is to allow these existing transactions to carry on as is, but the transitional provisions included in the proposals are insufficient to achieve this. It is very important that this technical area be addressed to ensure a smooth transition to the new rules. AFME has prepared detailed drafting suggestions in this respect which we would be pleased to provide if they would be of help.

Further, a large number of legacy transactions, established before the publication of the STS proposals but which are STS "in spirit", have performed well but cannot easily be "retro-fitted" to comply with the new rules. They comprise around €320 billion or 40% of all European RMBS / consumer / SME ABS outstanding. The exclusion of these transactions from the STS category would further damage investor confidence and liquidity in a market which is already fragile. It would risk a highly damaging impact on existing investor holdings as they would be subject to harsher capital requirements, LCR ineligibility, harsher NSFR treatment, and other disadvantages as compared with STS transactions. Far from encouraging new investors to enter the market, this adverse treatment would likely dry up any liquidity in the secondary market which in turn would further damage the primary market. AFME has also prepared a detailed analysis of the STS criteria and proposals for the treatment of legacy transactions that would balance the need to ensure the "STS" label remains meaningful with the need for continuity in the market and initial critical mass of potentially STS transactions.

- **Third country issues**

We are concerned by the introduction by Council of a provision that originator, sponsor and SSPE must *all* be established in the EU for a securitisation to be eligible for STS categorisation. Such limitations would be particularly problematic for ABCP programmes, which often involve multiple jurisdictions, as well as limiting EU investors' access to third-country issued securitisations thereby reducing activity in the EU and hampering the ability of EU investors to construct appropriately diversified portfolios to generate attractive yields and allow effective risk management. Excluding non-EU securitisation from STS recognition (and consequent reduced capital requirements) would also result in securitisation exposures with similar levels

of credit risk - which could otherwise be STS-compliant - being treated differently for regulatory capital purposes.

We suggest that third country entities be permitted to have access to the STS label provided that they can comply with the STS criteria and an appropriate, regulated institution agrees to take responsibility for the STS certification (including ongoing compliance) and be supervised by the competent authority of a relevant EU Member State. This would allow third country securitisations to continue to be available to EU investors on a sensible basis while ensuring an appropriate regulatory nexus to permit effective supervision.

We have addressed these concerns in more detail in separate comments.

- **Sanctions: negligence/omission standard should apply**

We believe that penalties should apply only in the case of negligence or deliberate misconduct. The provisions to which sanctions could apply are numerous, new, and unclear. Given the range of STS criteria and the potential for draconian sanctions if honest mistakes occur, market participants may decide that on balance it is not worth engaging in securitisation transactions. Participants are likely to restrict their use of securitisation or postpone the use of the STS label until there is more clarity on the interpretation of the rules. We stress again the importance of a level playing field with other fixed income products which do not feature an unduly harsh sanctions regime.

CRR Amendments

- **Conditions for use of SEC-IRBA and determination of Kirb (Art.255)**

A key objective of the CRR Amendments is to revive the securitisation market by broadening the use of the SEC-IRBA, which will only be possible once European banks will be allowed to apply the advanced "top down" securitisation approach where they have not originated the pool. In such situations, it would be unreasonable to expect that banks do a loan by loan analysis of the pool, especially for granular assets. Therefore, banks need permission to use a "top down" approach under which the performance of the pool is assessed at the aggregate level provided that there is sufficient historical data available on the pool. Banks can also complement such analysis by using data from similar pools. This is in fact very similar to what the CRR already allows for pools of purchased receivables under Article 179. Thus, we believe that it is essential that this CRR Amendment includes provisions for the EBA to develop RTS for the use of such data which should be more accurately described as a "purchased receivables approach".