

Position Paper

January 2017

Securitisation STS and CRR proposals: Position Paper for Trilogue discussions

Introduction

The European Parliament and Council texts on the STS and CRR proposals include a number of improvements to the original proposals. We welcome in particular (among other points):

- The broad alignment of views between the co-legislators on the CRR hierarchy of approaches – though we stress the importance of our comments below on conditions of feasibility for use of SEC-IRBA and determination of Kirb;
- The support in principle for the introduction of a regime for third country STS securitisations (European Parliament);
- Changes to the maturity caps on underlying assets of the ABCP programme (Council).

However, several new proposals introduced during the debate, together with some unaddressed issues, which we discuss below, run counter to the objective to revive securitisation markets. Our members – investors and issuers - are deeply concerned that if certain provisions are not corrected in Trilogues then all securitisation – not just STS securitisation - could become prohibitively burdensome in Europe.

For the new STS securitisation framework to succeed, it is vital that the provisions are carefully designed to ensure securitisation remains not only possible but also sufficiently attractive for both issuers and investors. It is important to look at the package of initiatives that impact on securitisation as a whole: a disproportionate or punitive requirement in one area will not be compensated by more flexibility in other areas. Picking apart individual components without considering their effect more generally will negatively impact the ability of both issuers and investors to restore the market.

Our comments below focus on priority issues identified by AFME members.

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 retail investors. (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 evidence has been produced or impact assessment 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 a Prospectus Directive requirements) 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 a European Securitisation Data Repository (ESDR). 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 will further stigmatise securitisation compared with other asset classes, and drive investors away.

Further, the provision for ESMA's transparency overview (Art. 5(2a)) as well as the information required under Article 5(1a) (i.e. the investor name give-up information) suggest that the information would still need to be disclosed to ESMA and the ESDR. Here we question the practical

feasibility of such requirement for investors in the secondary market; by definition these investors are unknown to the issuer and the originator, or for the ABCP.

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 as grandfathering provisions, would cause many problems. These transactions, established before the publication of the STS proposals, 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 outstanding¹. The exclusion of a large section of the market 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.

A number of provisions need to be adjusted to accommodate existing/legacy transactions and grandfathering. AFME will be pleased to share more detailed feedback.

- **Third country issues**

We support the introduction of the regime for third country STS securitisation, however the lack of clear provisions on the access of third country entities to the EU market remains problematic. We further note that the list of equivalent countries accepted should not be restrictive and should include all countries that have investors in European ABS, be they sovereign wealth funds or institutional investors.

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’ and companies’ access to third-country issued securitisations thereby reducing activity in the EU. 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 have addressed these concerns in more detail in separate comments.

¹ As of late 2015.

- **ABCP maturity limitations**

Particularly in light of the reduced limit of 1 year (instead of 2 years as originally proposed by the Commission) for the WAL of assets in each ABCP transaction, the adjusted requirement proposed by the Parliament in Article 12 for auto loans, auto leases and equipment leases should also be extended to consumer loans, credit cards and SME loans. This would be a natural extension and would allow ABCP conduits to continue supporting the real funding needs of consumers and SMEs.

- **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 Amendment 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 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”.

- **Senior positions in SME Securitisation (Art. 270)**

Unfortunately, the European Parliament did not adopt an amendment to Article 270, paragraph 1 letter (e) introduced during Parliament’s discussions which allowed banks to use the same regulatory capital treatment of STS securitisation for the senior tranche of their SME securitisations even where the guarantee was provided by private investors through cash collateral. This is extremely penalising since the vast majority of SMEs securitisations in Europe are guaranteed in this way.

- **Significant risk transfer and implicit support**

We oppose the Parliament's changes to the definitions of significant risk transfer and other operational conditions as well as changes proposed in relation to implicit support. We believe that the definition of mezzanine securitisation for purposes of the significant risk transfer test has been settled for some time and should not be changed except to the extent necessary to adapt to other changes in the securitisation framework. We support the Council's provisions in this area.

Conclusion

With issuance in Europe as low as EUR40.2bn in Q3 2016, of which only EUR16bn was placed with investors, the European securitisation market remains moribund – largely because of the lack of a level playing field with similar fixed income products created by punitive regulation which does not recognise the strong performance of European securitisation through and since the financial crisis. With regulatory costs for holding securitisation paper several times higher than other similarly-rated products, participants continue to leave the market. Securitisation is already one of the most – if not the most – heavily regulated of fixed income products/financial tools, with the most conservative calibrations.

The STS framework represents a unique opportunity to design a framework that benefits the economy and incorporates lessons from the financial crisis. In its proposal “laying down common rules on securitisation and creating a European framework for STS securitisation” the European Commission states:

The development of a simple, transparent and standardized securitisation market constitutes a building block of the CMU and contributes to the Commission's priority objective to support job creation and a return to sustainable growth. A high quality framework for EU securitisation can promote integration of EU financial markets, help diversify funding sources and unlock capital, making it easier for credit institutions and lenders to lend to households and businesses.

We urge policymakers to consider amendments against these policy objectives. Provisions should be evaluated against their propensity to make a successful STS regime and a revived European securitisation market more, rather than less, likely.

Association for Financial Markets in Europe

Level 39

25 Canada Square

Canary Wharf

London

E14 5LQ

020 3828 2700

www.afme.eu