afme/ Finance for Europe

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[redacted]

By email to [redacted]

Mr Valdis Dombrovskis
Executive Vice-President for An Economy that Works for People
European Commission
1049 Brussels

By email to valdis.dombrovskis@ec.europa.eu

Dear [redacted] Dear Executive Vice President,

Urgent action required from ECB and Commission to support the European securitisation markets in light of the coronavirus emergency

As you know, the coronavirus has posed unexpected and severe challenges to all sectors of the financial markets: reducing liquidity, widening spreads and in some cases closing some sectors to new issuance entirely.

Considerable support has been provided to fixed income sectors such as government bonds, covered bonds and corporate bonds which benefit from long-established, easy to access repo and purchase programmes. However, equivalent support for securitisation remains slow and difficult to access. Indeed, we see a direct correlation between such support and the improved market conditions prevailing in those sectors. Yet support for European securitisations has remained in our view limited, and overly cautious, with the result that market conditions remain volatile and constrained in liquidity and ability to absorb new issues. Liquidity is the key challenge in today's markets; any credit concerns remain both contained and confined to certain defined sectors.

We note that in the United States the Federal Open Market Committee (FOMC) announced on 23rd March that it will purchase Treasury securities and agency mortgage-backed securities in the amounts needed to support smooth market functioning and effective transmission of monetary policy to broader financial conditions and the economy. [1]

In addition, the Federal Reserve Board established a Commercial Paper Funding Facility (CPFF) on 17th March 2020, which will support asset-backed commercial paper (ABCP) as well as unsecured CP, subject to minimum ratings, which are met by most US ABCP conduits. The CPFF will provide a liquidity backstop to US issuers of commercial paper through a special purpose vehicle (SPV) that will purchase both unsecured commercial paper and ABCP rated A1/P1/F1 directly from eligible companies.

The United States is also providing wide support for "private label" securitisations[2] (those not guaranteed by a Government Supported Enterprise or GSE) by reinstating the TALF or Term Asset-Backed Securities Loan Facility which played a crucially important and helpful role in restoring the US securitisation market after the global financial crisis. Through the TALF structure up to $100 billion of loans will be made available, with terms of three years and fully secured by "eligible ABS" which includes auto loans and leases, student loans, credit card receivables (both consumer and corporate), equipment loans, floorplan loans, insurance premium finance loans and certain small business loans guaranteed by the US Small Business Administration.

This letter requests urgent action from both the ECB and the Commission, as appropriate, to provide targeted (and, if felt necessary, time-limited) relief to the European securitisation markets. Securitisation is key to long-term European growth and financial stability, and also has an important role to play in ensuring funding continues to flow to the real economy to help weather the coronavirus crisis and promote a recovery when conditions improve.

We struggle to understand why the support provided to securitisation, particularly by the ECB, has been so limited and cautious. The regulation of European securitisation today has been described by the EBA as "best in class", and the ten-year performance track record of European securitisation through and since the financial crisis is strong. The problematic asset classes and structures of the 2008-2009 global financial crisis, such as subprime mortgages, structured investment vehicles ("SIVs") CDOs and CDOs-squared etc. do not exist any longer in any material amounts – if at all.

In these particularly stressful market conditions, we therefore urge the ECB and the Commission to recognise the needs of the securitisation market for greater support and to respond to our requests below which we set out in two sections: one section listing actions we believe to be within the power and competence of the ECB, and a second section doing the same for the Commission.

Urgent action required to be taken by the ECB

We respectfully urge the ECB, as soon as possible, to:

- Broaden its eligibility criteria for European securitisations for the purposes of its repo operations (Eurosystem) and its purchase plans (ABSPP and PEPP). We also ask for increases in issuer and instrument limits to reinforce

[1] See: https://www.federalreserve.gov/newsevents/pressreleases/monetary20200323b.htm
[2] https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200323b3.pdf

confidence in the market, particularly given the short-term absence of primary issuance.

- Provide urgent clarification that asset-backed commercial paper (ABCP) can be eligible under the ECB 750 billion Pandemic Emergency Purchase Programme (PEPP). The European ABCP market represents USD 100 billion equivalent of short-term funding – a material amount. Yet liquidity in this market has dried up as a result of the coronavirus emergency. We ask that the ECB clarifies and confirms that ABCP can be eligible under the PEPP: the ECB announcement on the PEPP states that "To expand the range of eligible assets under the corporate sector purchase programme (CSPP) to non-financial commercial paper, making all commercial papers of sufficient credit quality eligible for purchase under CSPP". ABCP funding vehicles are not financial institutions; rather they are vehicles used to finance corporate receivables, so technically it seems that ABCP could be eligible, but urgent and official ECB confirmation and clarification of this is required. If ABCP conduits cannot fund on the markets or through facilities provided by central banks, they will draw on the liquidity lines provided by their sponsor banks; this in turn would reduce funding that would otherwise be available from those sponsor banks to support the real economy, and could also trigger contractual termination of funding for corporate borrowers who access liquidity through ABCP to fund their working capital and in turn restrict funding for the real economy needs of European businesses and consumers.
- Make purchases under the repo operations and ABSPP and PEPP operationally easier and wider in scope, and make the discount that the ECB applies to ABS for repo purchases more sensitive to ratings and the STS label. The discount has been a flat 16% discount regardless of rating or whether the transaction is labelled STS or not. We note the ECB's 7th April announcement; while the reduction in absolute terms of the haircut for ABS is helpful to some extent in reducing slightly the harsher treatment of securitisations, because it applies across the board to *all* eligible asset classes it does not address either different ratings (as is the case with other eligible asset classes) or whether a securitisation is STS.
- Corporate and covered bonds are bought simply on the basis of a credit rating, yet ABS requires overly detailed credit documentation and time-consuming approval for AAA-tranches of well-established issuers with strong track records. We have always felt such processes to be excessive for such senior tranches, and in the face of the coronavirus emergency believe this even more strongly.
- In addition, ABCP issued by fully supported conduits could be also bought or repo-ed on the basis of their short-term credit ratings.
- Our members active in the secondary market agree that while recent figures show that weekly gross purchases for ABS instruments have been much higher than usual, these investments seem to be focused on primary market deals that have closed in recent weeks rather than in the secondary market where support is most needed at present.
- On a purely practical level, our members encounter difficulty in being able to engage with the ECB on an operational level; anecdotally we hear that some of the local central banks simply pass on or refuse to bid on many of the bonds in the ABSPP, providing no feedback or transparency as to the reason. This is particularly the case in the secondary market.

We are also concerned that, if such support is not forthcoming, when the impact of the coronavirus emergency on fixed income markets is assessed in several months' time the reputation of European securitisation will yet again have been damaged – not because of poor credit performance or losses, but because of differential market performance which is driven not by fundamentals but the greater degree of public support provided to other fixed income sectors such as government, covered and corporate bonds. The reality is that public sector intervention is what is making the difference to market performance in current conditions, and securitisation is in our view being unjustly neglected.

Urgent action required to be taken by the European Commission and, where appropriate, the ESAs

In our letter of 16th March 2020, which we enclose, we referred to the wider need to review Regulation 2017/2402 (the "Securitisation Regulation") and the framework for Simple Transparent and Standardised ("STS") securitisation to significantly improve aspects of the framework.

However, in this letter we focus on the following near-term priority measures in response to the coronavirus emergency:

- Under the new LCR regime, with effect from 1st April 2020 qualifying tranches must be AAA (as opposed to AA- under the previous LCR regime). We believe this was an unintended consequence of changes in the meanings of CQS equivalents and have highlighted this before in previous discussions. It is one thing for this discrepancy to exist in normally-functioning markets, but in current market conditions if securities are downgraded by, say, only 1 or 2 notches due to increases in arrears or negative economic forecasts or a sovereign downgrade (even though AA- remains a very high rating) this could amplify difficulties for bank investors by diminishing their liquidity buffers which may already be under pressure, as well as leading to forced sales further destabilising the market.
- We have discussed with the Commission previously the failure to recognise STS securitisation in the LCR by promoting STS senior tranches from Level 2B to Level 2A. This remains an important discriminatory factor adversely affecting securitisations. There is little doubt that market conditions would be improved for securitisations if the Commission were able (even temporarily, for a limited period) to relax these requirements to allow (say) rating levels AAA and AA (or CQS equivalents) STS securitisation senior tranches to be eligible at Level 1A, and widen the eligibility criteria on ratings to AA- or even A- (or CQS equivalents) for lower buckets. We note that the ABSPP accepts securities ranging from rating levels AAA to BBB- (or CQS equivalents), and the ECB Collateral Framework still requires higher ratings / CQS than corporate equivalents.
- Postpone to a more appropriate time imminent major regulatory changes which have major operational implications such as the RTS on disclosure, accompanying ESMA templates and repository data completeness and completion thresholds. The existing ECB templates can continue to be used to meet disclosure requirements for STS eligibility and repo eligibility for public transactions. The current environment is not conducive to supporting an implementation of these complex, detailed new frameworks from an operational and market stability perspective. For example, in addition to implementing the new disclosure rules, originators are now also having to

decide how to create *additional* reporting to cover coronavirus-related actions such as "payment holidays" and splitting out the impact on arrears reporting. None of this is (understandably) covered in the ESMA templates. Providing investors with the information that they actually need to understand their investments should be the top priority in the current environment.

- Continue the existing differentiation between public and private securitisations, as per current practice. Such activity as remains in securitisation in today's market tends to be in the private placement sector, and now would not be the right time to impose a new set of requirements which could dampen issuance in this sector, which is critical at the moment as markets are closed for public securitisations.
- The soon-to-be published Guidelines on Weighted Average Maturity should be realigned with market practices (for example, taking into account prepayments) and more broadly as indicated in our response to EBA's consultation on this.
- The risk retention regime does not allow for bankruptcy of the originator, and the subsequent sale of the risk retention position(s) by the administrator or liquidator, of which there is a greater risk in a recession. The consequence is to penalise investors who find themselves holding ineligible securities which are unsaleable. This should be addressed in the upcoming new RTS for risk retention or via EBA guidelines.

While this letter is confined to urgent action required to support the European securitisation markets as a result of the coronavirus emergency, we stress that a wider review of the framework and the proposals included in our letter of 16th March 2020 remains essential to improve the regulatory framework and ensure that securitisation as both a financing and risk transfer tool plays its role in the future economic recovery. A separate review of the Securitisation Regulation and prudential framework should be pursued at the earliest opportunity.

We believe that all of the above requests are credible measures that could be taken, perhaps in some cases on a time-limited basis, to support the European securitisation markets. This is key to ensure that the market continues to function and remains available to play a role in the economic recovery that we all hope will come.

We have previously, in less-pressured circumstances, engaged with both the ECB and the Commission, as well as ESMA and EBA, in detail on all the issues listed above and my expert colleagues and members stand ready, with your permission, to have more detailed conversations with your staff at your earliest convenience.

Yours sincerely,

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