SwissFinanceCouncil
Fostering International Dialogue

SFC response to the European Commission consultation document on "An EU framework for simple, transparent and standardised securitisation"

We welcome the opportunity to respond to the European Commission's consultation on securitisation. We agree that securitisation is a key aspect of the EU Capital Markets Union. The SFC wishes to highlight the following six priorities, which we see as critical for early progress on reviving the EU securitisation market.

I. International dimension:

It is critical to ensure that the EU securitisation market facilitates both investment from outside the EU into EU securities, and the ability of EU investors to grow their savings by investing beyond the EU. Access to finance from beyond the EU is critical to the CMU's success at providing funding for growth and jobs, while a diversification of portfolios beyond the EU will help manage risk and increase returns for EU savers. At a minimum, the EU should strive for global principles to be established for qualifying securitisations which would be implemented consistently by all jurisdictions, and there should be mutual recognition of risk retention requirements.

II. Qualifying criteria should be principles based and not overly prescriptive:

The criteria for achieving qualifying status needs to ensure different types of structure can be accommodated, provided they are transparent and capable of effective risk analysis. The European Commission (EC) should avoid introducing a highly prescriptive and rigid approach to determining qualifying status as this may result in securitisations that lend themselves easily to effective risk management being excluded from the qualifying category should they fail to meet a very specific, non-material criterion.

III. Criteria has to be consistent across all sectors:

The criteria for qualifying securitisations should be consistent across all relevant EU legislation. We do not see any policy rationale for the requirements for qualifying status to differ across banking, insurance and asset management. A consistent approach will ensure a level playing field across the EU and will increase the diversity of the potential investor base.

IV. More consideration for potential synthetic securitisations:

Whilst synthetic securitisations do not have a direct funding benefit, they enable the risk of a pool of assets (e.g. SME loans) to be transferred to investors (e.g. asset managers) other than banks, and can free up bank capital for lending to the real economy (which will continue to play a significant role even if the capital markets play a greater funding part in future).

IV. Calibration of capital regime:

There is no chance of reviving the EU securitisation market if securitisation continues to be unduly penalised relative to other asset classes in capital treatment. It is crucial that the EC considers both the investor and issuer/originator position. Securitisations are generally more expensive to issue than many other alternative sources of funding, but securitisation results in risk transfer which other funding instruments, including covered bonds, do not. Material recognition of risk transfer from an accounting and a regulatory capital perspective is essential to incentivise issuers to consider securitisation over other alternative sources of funding. Whilst the CRD IV securitisation regime explicitly provides for originators to achieve "significant risk transfer" and take capital relief where certain criteria are met, we believe the application of the rules is inconsistent across the EU.

VI. Provision and availability of information /transparency:

Efforts are needed to standardise information requirements for those wishing to access securitisation markets so that their assets can be better understood and securitised, and remain transparent throughout the process.

Question 1:

A. Do the identification criteria need further refinements to reflect developments taking place at EU and international levels? If so, what adjustments need to be made?

B. What criteria should apply for all qualifying securitisations ('foundation criteria')?

Need for consistency across EU legislation

The criteria for qualifying securitisations should be consistent across all relevant EU legislation. We do not see any policy rationale for the requirements for qualifying status to differ across banking, insurance and asset management. A consistent approach will ensure a level playing field across the EU and will increase the diversity of the potential investor base. There will be variations driven by jurisdictional differences (for example a Dutch RMBS investor report should look different to a UK RMBS investor report due to the underlying mortgage characteristics differing), however consistent requirements of issuers within countries, and consistent treatment of equivalent issued securities across the EU, will be helpful.

Need for global consistency

Similarly, it is important to have international co-ordination and consistency in the approach to determining qualifying status in order to ensure non-EU investors can invest in EU securitisation and vice-versa. As stated in the Swiss Finance Council's response to the Commission's CMU Green Paper, we consider it essential that the Commission gives sufficient attention to the international dimension as it will be very important to ensure that non-EU investors have the right incentives to invest in EU securitisations. The aim should not be to limit the investor base to EU investors only, as this is unlikely to result in a sufficiently large investor base and will limit the potential liquidity of the secondary market.

We propose that a global standard, or at the least global principles, should be established for qualifying securitisations which would be implemented consistently by jurisdictions globally. This could be developed as a BCBS and/or ISOCO initiative. Our less favoured fall-back option would be for the EU and non-EU jurisdictions to establish a process to enable mutual recognition of each other's qualifying securitisation regimes. This should take the form of an objectives based assessment.

Under both approaches, the key issue is that a non-EU based investor should be able to invest in an EU originated securitisation and benefit from preferential regulatory treatment for that exposure in the same way as an EU investor would and vice-versa. This would immediately significantly widen the potential investor base for qualifying securitisations.

Treatment of synthetic securitisations

Consideration should be given to the potential for synthetic securitisations to achieve qualifying status. Whilst synthetic securitisations do not have a direct funding benefit, they enable the risk of a pool of assets (e.g. SME loans) to be transferred to investors (e.g. asset managers) other than banks, and can free up bank capital for lending to the real economy (which will still be important even if the capital markets play a greater funding role in future). Correctly structured synthetic securitisations can be a highly useful tool for bank capital management and risk transfer out of the banking sector. It is also important to ensure bank risk weighted asset relief and investor capital treatment are both appropriately aligned to the genuine level of risk transferred.

Criteria for qualifying securitisations

The criteria for achieving qualifying status should be principles based and not overly prescriptive to ensure different types of structure can be accommodated, provided they are transparent and capable of effective risk analysis. The Commission should avoid introducing a highly prescriptive and rigid approach to determining qualifying status as this may result in securitisations that lend themselves easily to effective risk management being excluded from the qualifying category should they fail to meet a very specific, non-material criterion. Also, a more principles based approach will better accommodate securitisations with different underlying assets as it is likely that a prescriptive one-size-fits-all approach will not adequately reflect the specificities of different types of underlying assets.

The approach should be to ensure the transparency and simplicity of transactions so that investors can effectively assess the risk of the transactions. The aim should not be to eliminate risk. Consistent with this, *all* tranches in a securitisation should be able to benefit from qualifying status, not just senior tranches, provided the qualifying principles are met. Different investors have different risk appetite and an investor willing to invest in more junior tranches should be incentivised to do so provided the securitisation is transparent and the structure is capable of effective risk analysis. Creating the correct incentives for investors to invest across the tranche structure is important in the context of the leverage ratio as banks will be disincentivised from retaining significant exposures to own originated securitisations (above the minimum that must be retained for risk retention purposes) given that the exposures will count towards the leverage ratio denominator. Moreover, banks will be more able to use securitisation for risk weighted asset relief if they can place junior tranches efficiently. This is especially true if synthetic securitisations cannot qualify. As mentioned before, it is also important to ensure bank risk weighted asset relief and investor capital treatment are both appropriately aligned to the genuine level of risk transferred.

Question 2:

A. To what extent should criteria identifying simple, transparent, and standardised short-term securitisation instruments be developed? What criteria would be relevant?

B. Are there any additional considerations that should be taken into account for short-term securitisations?

ABCP are a key part of securitisation markets and provide an important source of funding to the real economy (e.g. trade receivables being securitised). However, ABCP securitisations are structured differently from term securitisation markets. It is therefore potentially challenging or inappropriate to subject ABCP to some/all of the criteria applicable to be deemed simple, transparent and standardised. We note the distinction between pre-crisis SIVs and multi-seller ABCP conduits (the former having disappeared from the market versus ABCP conduits with full liquidity support that did not suffer losses due to liquidity crisis). Although ABCP does not fit neatly into the simple/transparency criteria, we believe it would be detrimental for it to fall into a category that disadvantaged its capital and other treatment.

Question 3:

A. Are there elements of the current rules on risk retention that should be adjusted for qualifying instruments?

B. For qualifying securitisation instruments, should responsibility for verifying risk retention requirements remain with investors (i.e. taking an "indirect approach")? Should the onus only be on originators? If so, how can it be ensured that investors continue to exercise proper due diligence?

The current EU risk retention regime places the obligation on the investor to ensure the risk retention requirements have been satisfied (indirect approach). While this can create legal and compliance risk for investors and can be seen to disincentivise investors who value certainty, we do not think that it should be replaced by the direct approach. Instead we would support that the direct approach be complimentary to the indirect approach (an approach also supported by the EBA in its report on securitisation risk retention published in December 2014). This will allow regulated and non-regulated issuers to utilise the approach that they see fit. For the avoidance of doubt, this would not absolve investors from their obligation to undertake thorough due diligence on securitisation investments, but in the case of risk retention, investors should be able to rely on a positive statement by the originator that the risk retention requirement has been met. This approach should apply to both qualifying and non-qualifying securitisations.

In addition ,the risk retention rules do arguably not adequately contemplate securitisation of whole loan portfolios acquired below par. In particular this is relevant for non-performing loan pools, where the acquisition price may be materially below par. Whilst secondary trading of whole loan portfolios does not directly support the macro-economic objectives of this consultation, a functioning market aids European banks in deleveraging and capital release efforts, which in turn permits banks to support growth and job creation. Therefore due to this indirect benefit we believe the risk retention rules should be adjusted to contemplate both qualifying and non-qualifying securitisations of whole loan portfolio sales.

It is important to have international co-ordination and consistency in rules to ensure non-EU investors can invest in EU securitisation and vice versa. At a minimum, there should be mutual recognition of risk retention requirements.

Question 4:

A. How can proper implementation and enforcement of EU criteria for qualifying instruments be ensured?

B. How could the procedures be defined in terms of scope and process?

C. To what extent should risk features be part of this compliance monitoring?

No response.

Question 5:

A. What impact would further standardisation in the structuring process have on the development of EU securitisation markets?

B. Would a harmonised and/or optional EU-wide initiative provide more legal clarity and comparability for investors? What would be the benefits of such an initiative for originators?

C. If pursued, what aspects should be covered by this initiative (e.g. the legal form of securitisation vehicles; the modalities to transfer assets; the rights and subordination rules for noteholders)?

D. If created, should this structure act as a necessary condition within the eligibility criteria for qualifying securitisations?

It is important to carefully calibrate any type of standardisation appropriately. Any asset backed securities issuance has an inherent amount of complexity depending upon the nature of the underlying assets.

Therefore, whilst an element of structural standardisation is useful (for example, regarding the legal requirements for SPVs, and the modalities to transfer assets), overly prescriptive rules could restrict the ability to incorporate certain asset classes, structure bonds that appeal to certain investor groups, or to align issuer and investor goals.

Finally, it is sometimes argued that repeat issuance platforms are overly complex, however the ability for investors to analyse a single structure, a single collateral pool and reuse that analysis at the point of each issuance is ultimately valuable, and facilitates greater secondary market liquidity.

Question 6:

A. For qualifying securitisations, what is the right balance between investors receiving the optimal amount and quality of information (in terms of comparability, reliability, and timeliness), and streamlining disclosure obligations for issuers/originators?

B. What areas would benefit from further standardisation and transparency, and how can the existing disclosure obligations be improved?

C. To what extent should disclosure requirements be adjusted – especially for loan-level data – to reflect differences and specificities across asset classes, while still preserving adequate transparency for investors to be able to make their own credit assessments?

The level of disclosure for securitisation transactions compares favourably with other asset classes. Therefore, requiring the publication of more data should not be the goal, rather, we believe that measures should be taken to increase the accessibility, standardisation and comparability of information. However it is important to recognise jurisdictional differences and ensure these are brought to investors' attention, and not obscured.

In particular, we note that under the proposed new Basel capital regime for securitisations, the "Securitisation Internal Ratings-Based Approach" (SEC-IRBA) is at the top of the hierarchy and in order to use SEC-IRBA, it is necessary to have sufficient information to calculate KIRB (including PDs and LGDs). A bank that cannot calculate KIRB for a given securitisation exposure would have to use the Securitisation External Ratings-Based Approach (SEC-ERBA) provided that this method is implemented by the national regulator. A bank that cannot use the SEC-IRBA or the SEC-ERBA (either because the tranche is unrated or because its jurisdiction does not permit the use of ratings for regulatory purposes) would use the Securitisation Standardised Approach (SEC-SA), with a generally more conservative calibration.

Having sufficient information in order to calculate KIRB therefore becomes crucial under the new Basel regime as otherwise more conservative and less risk sensitive capital requirements will apply. To facilitate this, we believe it would be helpful to have a central platform where the information could be accessed. The aim should be to create a single cross-border EU solution to making key data (including data held by NCAs) more easily available to investors, while respecting the commercial and confidentiality considerations of the originators. We do not have a firm view on what form such a platform could take but we suggest it would be most credible if the EC and/or EBA/ESMA were involved. A joint public/private sector solution could also potentially be found.

Question 7:

A. What alternatives to credit ratings could be used, in order to mitigate the impact of the country ceilings employed in rating methodologies and to allow investors to make their own assessments of creditworthiness?

B. Would the publication by credit rating agencies of uncapped ratings (for securitisation instruments subject to sovereign ceilings) improve clarity for investors?

This could potentially be helpful, however, clarity would be required upon the linkage between the uncapped rating and the sovereign ceiling - to what extent would macro-economic changes result in a reassessment of both the uncapped rating and the sovereign ceiling.

Question 8:

A. For qualifying securitisations, is there a need to further develop market infrastructure?

B. What should be done to support ancillary services? Should the swaps collateralisation requirements be adjusted for securitisation vehicles issuing qualifying securitisation instruments?

C. What else could be done to support the functioning of the secondary market?

We support the response to this question submitted by AFME:

One of the biggest challenges to the secondary market for securitisations will be the fundamental changes to the market infrastructure that will arise as a result of MiFID II. Since securitisation is typically a buy-to-hold market, the pre trade and post trade transparency requirements could have significant implications if the calibrations in the final RTS are not appropriate. Therefore, we urge the European Commission to ensure that the outcome of MiFID II is consistent with the objectives of CMU.

Specifically, if caught within the pre trade transparency regime, market makers will be forced to offer prices to their clients on a multiple execution basis. Given that many securitisations trade infrequently, such a requirement will constrain the ability of market makers to fulfil their role by committing their capital to facilitate trades. The result will be less liquidity and wider spreads.

Further, the post trade transparency requirements requiring immediate publication of trade information could have a notable impact on the securitisation secondary market. Specifically, the maximum deferral of 48 hours for price publication is insufficient for less frequently traded bonds since it will not provide market makers with sufficient time to hedge and unwind their risks. The thinness of such markets causes concerns that the transparency regime could have an implied unmasking effect of the identity of the firm taking on risk. We believe that data on this segment of the market would support a view that is it not uncommon that specific instruments trade as little as once or twice per year and that without appropriate deferrals, at least one of the participants would be inferred by the information published (i.e. seller) alongside potentially sensitive information to that counterparty (i.e. price). We understand a key feature of the proposed transparency regime was the anonymity of parties to a specific transaction and the market transparency regime must be calibrated to ensure this.

Question 9:

With regard to the capital requirements for banks and investment firms, do you think that the existing provisions in the Capital Requirements Regulation adequately reflect the risks attached to securitised instruments?

Need for a level playing field

The capital and liquidity requirements for securitisation exposures for banks and insurers must be made more risk sensitive, both from an absolute perspective, and also relative to the requirements for alternative funding sources to ensure a level playing where risk rather than structure type is the key driver of prudential treatment.

Need for capital recognition for risk transfer

It is crucial that the Commission considers both the investor and issuer/originator position. Securitisations are generally more expensive to issue than many other alternative sources of funding but securitisation results in risk transfer which other funding instruments, including covered bonds, do not. Material recognition of risk transfer from an accounting and a regulatory capital perspective is essential to incentivise issuers to consider securitisation over other alternative sources of funding. Whilst the CRD IV securitisation regime explicitly provides for originators to achieve "significant risk transfer" and take capital relief where certain criteria are met, we believe the application of the rules is inconsistent across the EU. The EBA guidelines on significant risk transfer should in theory increase harmonisation but we believe at an EU and global level there needs to be increased willingness on behalf of supervisors to allow capital benefit for transactions that genuinely transfer risks from a bank's balance sheet to third party investors. Without this capital benefit, the incentives for securitisation over other forms of financing will be weak.

Question 10

If changes to EU bank capital requirements were made, do you think that the recent BCBS recommendations on the review of the securitisation framework constitute a good baseline? What would be the potential impacts on EU securitisation markets?

No, we consider that the BCBS proposals are overly conservative. They also lack risk sensitivity and predictability given that the capital requirements under the different approaches in the hierarchy differ significantly.

We support the response to the second part of this question provided by AFME.

Question 11:

How should rules on capital requirements for securitisation exposures differentiate between qualifying securitisations and other securitisation instruments?

It is important to give consideration to the capital regime for securitisation structures that are likely to fall outside of qualifying status, not because they are necessarily overly-complex or non-transparent, but just because they have certain features that do not meet the qualifying criteria. Steps should be taken to avoid a scenario where this part of the market is perceived as toxic and there should be no "cliff edge" of regulatory requirements between qualifying and non-qualifying instruments. Such a “cliff edge” will impact pricing of the underlying ineligible assets, which could be detrimental to the macro-economic goals of the consultation. We believe capital requirements should be lowered for qualifying securitisations but this should not prevent a review of the capital requirements for non-qualifying securitisations and potential lowering of capital requirements for non-qualifying securitisations as well where justified on a risk basis. The intention certainly should not be to incentivise investment in qualifying securitisation by reducing the incentives for investing in non-qualifying securitisation via increasing their capital requirements.

Question 12:

Given the particular circumstances of the EU markets, could there be merit in advancing work at the EU level alongside international work?

No response.

Question 13:

Are there wider structural barriers preventing long-term institutional investors from participating in this market? If so, how should these be tackled?

Given current market conditions and the availability of cheap central bank funding, it is important to recognise that any measures to restart the securitisation market, including a qualifying securitisation regime, are unlikely to have a significant impact until market conditions change and the availability of central bank funding decreases. From a supply perspective, there is currently little incentive for banks to issue securitisations given that cheaper funding is available elsewhere. So the aim should be to put in place a regime that will encourage investment in securitisation once monetary conditions and supply and demand conditions change in the future.

Such a regime should recognise that securitisation historically provided banks with the ability to access both capital and funding. A new regime must allow banks to efficiently access capital via the risk transfer benefit of securitisation, not just funding if it is to rival inherently cheaper (for the investor) funding tools such as covered bonds or term repo.

A lack of information about SMEs is a significant barrier to securitisation being a means to help them gain more access to financing. A standard template for providing information will make it easier to aggregate data on them, and thus easier to securitise funding. The Commission should propose a pan-EEA template, to provide information on the underlying borrower to begin the process with total transparency, as part of short-term objectives to kick-start the securitisation market.

US capital markets have benefited from public sector support, which has led to a further development of the US securitisation market. We do not support and would not advise the Commission to pursue such public sector entities. We would therefore advise that the level of ambition for securitisation be adjusted accordingly as it may take a longer time to maintain/revive a credible and sustainable securitisation framework.

Question 14:

A. For insurers investing in qualifying securitised products, how could the regulatory treatment of securitisation be refined to improve risk sensitivity? For example, should capital requirements increase less sharply with duration?

B. Should there be specific treatment for investments in non-senior tranches of qualifying securitisation transactions versus non-qualifying transactions?

Yes – this is particularly true for insurers / other investor types with naturally long dated liabilities.

Question 15:

A. How could the institutional investor base for EU securitisation be expanded?

B. To support qualifying securitisations, are adjustments needed to other EU regulatory frameworks (e.g. UCITS, AIFMD)? If yes, please specify.

No response.

Question 16:

A. What additional steps could be taken to specifically develop SME securitisation?

B. Have there been unaddressed market failures surrounding SME securitisation, and how best could these be tackled?

C. How can further standardisation of underlying assets/loans and securitisation structures be achieved, in order to reduce the costs of issuance and investment?

D. Would more standardisation of loan level information, collection and dissemination of comparable credit information on SMEs promote further investment in these instruments?

No response.

Question 17:

To what extent would a single EU securitisation instrument applicable to all financial sectors (insurance, asset management, banks) contribute to the development of the EU's securitisation markets? Which issues should be covered in such an instrument?

No response.

Question 18:

A. For qualifying securitisation, what else could be done to encourage the further development of sustainable EU securitisation markets?

B. In relation to the table in Annex 2 are there any other changes to securitisation requirements across the various aspects of EU legislation that would increase their effectiveness or consistency?

No response.