PARIS EUROPLACE

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How can securitisation contribute to the financing of the EU agenda?

Concrete, targeted, proportionate, and prudent recommendations to accelerate the scale-up of the EU securitisation market, in line with recent policy statements

About Paris Europlace

Paris Europlace represents Paris international financial centre's market players, including banks, insurance companies, asset managers, financial intermediaries, international corporates, and other financial services providers. Paris Europlace ambitions include making the European Union more resilient and attractive to better fund the twin transition.

Paris Europlace has a dedicated Securitisation Working Group (WGS), under its European Financial Regulation Committee, which adopts an international approach when analysing the ongoing financial and prudential regulation in the EU and other jurisdictions (primarily the United States and the United Kingdom).

Members of Paris Europlace WGS are securitisation specialists, often with decades of practice in this market, and working both on the issuing and investing sides, but also on transaction structuring, labelling, rating, servicing, thereby Paris Europlace is uniquely qualified to provide fact-based feedback to European policy makers, considering the overall securitisation ecosystem.

Paris Europlace gives particular thanks to Véronique Ormezzano (VYGE Consulting) and Gilles Saint-Marc (Kramer Levin) as co-chairs of the WGS, Alexander Batchvarov (Bank of America Merrill Lynch), Ian Bell (PCS), Georges Duponcheele (Great Lakes Insurance SE), Nathalie Esnault (Crédit Agricole), Tamar Joulia (IACPM), Alexandre Linden (BNP Paribas), Catherine Royère (BNP Paribas), Julio Suarez (AFME), Baptiste Uguen (Fédération bancaire française), Frédéric Zana (Crédit Agricole), Yves Zerkovitz (BPCE) and all members of the working group for their contributions.

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Executive Summary

Numerous recent statements and reports (Donohue, Letta, Noyer, ECB Governing Council, ESMA) have identified securitisation as a priority policy area, as Paris Europlace did[1], in the context of the revival of the Capital Markets Union.

Indeed, figures, whether from public sources (EU Commission, EBA, ESMA, ESRB) or private ones (AFME, IACPM, Moody's, Bank of America) are unanimous. The size of the EU securitisation market is small in relative and absolute terms, compared not only to the US but also other jurisdictions such as Australia, Canada, China, and Japan. The introduction of the 'STS' label (Simple, Transparent and Standardised) in 2019 has not reversed the trend. Recent changes in prudential treatment for synthetic STS transactions have led to some acceleration in this market segment[2]. However, overall securitisation represents a major untapped source of financing and risk sharing for the European economy, hence its development is essential over the next few years to unlock more capital to finance the twin transition.

While the growing consensus among policy makers about the urgent need to re-launch the EU securitisation market is a crucial pre-requisite for reforms to succeed, there remains some hesitations about the specific nature of the amendments needed to remove the existing obstacles to scale-up the securitisation market on the offer and demand sides. Moreover, some continue to voice concerns, notably referring to:

- a lasting stigma from the Global Financial Crisis, which severely hit several EU banks and institutional investors, mostly through their investments in US subprime securitisation investment products;
- a sense that ultra-accommodative monetary policy, rather than regulation, may have been the main driver for underperformance of the EU securitisation market, and that, with the monetary policy tightening initiated in 2022, the market may grow organically;
- potential financial stability risks that may derive from a sharp, poorly managed development of the market;
- a willingness to have the changes needed in the bank prudential framework, to be first agreed at the BCBS level, to avoid new deviations in the EU framework.

The present report aims at addressing:

- the specific set of adjustments needed to unlock the EU market, from an offer and demand standpoint, and address the specific market gaps across the diverse segments of the securitisation market.
- the concerns, we strongly believe no longer valid, but often expressed by a few EU policy makers still reluctant to move, with the aim of contributing to an accelerated implementation of the stated policy goals; and
- the key success factors to ensure that this important and multifaceted relaunched project can be implemented in a consistent, robust, and efficient way to deliver, this time, the expected results.

On May 22nd, Commissioner McGuinness announced that the European Commission will consult on securitisation this autumn "to ensure that we can act as soon as possible to scale up the EU securitisation market." In this context, we urge the Commission to consult on those concrete, targeted and prudent adjustments, so that securitisation can play its role in the massive investments needed to achieve European ambitions over the next few years.

[1] See Paris Europlace report on 2024-2029 European priorities (Here)

[2] See Appendix 5 for a description of recent changes in the prudential treatment for banks.

What needs to be done?

The present report, written by a working group including some of the best European experts in securitisation, across the whole ecosystem (banks, insurance companies, investors, rating agencies, law firms, service providers, industry associations, etc.) leverages on the High-Level Forum (HLF) work, the recent reports from the authorities on the European securitisation markets, the data and market insights from industry associations (AFME, IACPM) and rating agencies, the work from its members, as well as academic and market research. Our report aims at equipping the new European Commission with the building blocks of a complete recalibration of the securitisation framework, addressing the main remaining concerns, providing concrete legislative, regulatory and supervisory proposals, and accelerating the implementation of the recent strong political mandates.

Calibration flaws and technical recommendations are well known, since the High-Level Forum on the CMU (2020) and the report of the Joint Committee of the ESAs (2022). Some recommendations have been implemented in the Capital Markets Recovery Package, such as the possibility for synthetic transactions to benefit from the STS label, which has played a key role to support the growth of synthetic transactions observed in the last years (although level 2 texts are creating areas of undue complexity and uncertainty, and level 1 text has -inadvertently- fragmented the investor base). On the other hand, the introduction of the output floor in CRR3 was threatening the viability of all types of securitisation transactions for banks as originators, as a (probably unintended) consequence which appeared as impact studies became more granular. Thankfully, a transitional recalibration of the "p-factor" has been introduced by the European Parliament in CRR3 to partially reduce the negative impact of the output floor.

But many aspects remain unaddressed, preventing the development of an efficient securitisation ecosystem, at odds with the considerable investments needed to address the twin transition and other demographic or geostrategic priorities.

In short, the securitisation market exists, and some transactions can be done, but in the current regulatory context, the EU securitisation market is not scalable, and therefore unable to fulfil its potential role in the financing of the EU strategic ambitions.

To truly revitalise the EU securitisation market, a package of targeted, prudent, proportionate and risk-sensitive measures should be implemented, as a "quick win." This package needs to address the following policy goals:

- **Policy Goal 1: Reduce existing disincentives to securitise, for banks as issuers, by:**
  - Recommendation 1: Reduce the excessive 'capital non-neutrality' generated by the 'p-factor'.

    Paris-Europlace proposes four options to address this issue, without generating undercapitalisation of the mezzanine tranches.
  - Recommendation 2: Reduce the excessive risk weight floor applying to senior tranches.
    Paris-Europlace proposes two options, one consisting in reducing the current fixed value of the risk weight (RW) floor, and the other one consisting in making the RW floor risk-sensitive, as a function of the risk of the underlying portfolio.

  These adjustments should apply across all methods applying to securitisation, i.e., SEC-IRBA, SEC-SA, SEC-ERBA and IAA. They would help make the securitisation of a broader

range of bank portfolios economically viable, as the risk transfer would translate into a more commensurate recognition of the capital relief. This would benefit to high quality portfolios such as retail mortgages, as well as to a broader range of banks, including small and medium size banks across the EU, applying SEC-SA for their loan portfolios and securitisation activities.

- Recommendation 3: Reducing barriers to entry for banks to securitise would also require, on the supervisory side, to streamline the Significant Risk Transfer (SRT) assessment process, while making it more risk-sensitive, notably by:

  - Ensuring a more fluid SRT assessment process by the competent authorities, as, despite recent progress, time-to-market for these activities remains too long for enabling banks to have visibility on execution and for investors to have enough visibility on pricing.

  - Adopting a more pragmatic and less costly approach to the "market test", by requiring banks to sell no more than 15% of each of the tranches, in line with EBA's recommendation #12 on the Principles Based Approach test.

  - Clarifying that SRT tests should be performed at inception only.

  Paris-Europlace would welcome further dialogue with the ECB and the EBA as regards the improvement of the efficiency of the SRT assessment process.

- **Policy Goal 2: Revitalise the participation of the insurance sector as investors or protection providers in securitisation transactions**

  - Recommendation 4: for insurers as funded investors, on the assets side, eliminate the unjustified gap in capital charges existing in Solvency II between the calibrations used for bonds and loans and calibrations designed for senior STS products, as well as the unjustified gap existing between covered bonds and senior STS products. In addition, differentiate the prudential requirements of non-STS tranches (still the bulk of the market in Europe) by introducing a distinction based on seniority.

    These adjustments should be included in the quick win package, given the investor base in cash securitisation is currently insufficient to support further market growth, especially following the end of the ECB ABS purchase programme.

  - Recommendation 5: for insurers providing credit insurance through unfunded protection, on the liability side, make well-capitalised (re)insurance companies eligible as protection providers in synthetic STS transactions.

- **Policy Goal 3: Remove the disincentive for banks to invest in third-party securitisation, notably by improving the LCR treatment of senior tranches, while improving market liquidity for all players.**

  - Recommendation 6: reduce the existing gaps with Covered Bonds in the LCR classification of securitised products, and corresponding haircuts, to unlock bank investments in third-party securitisation senior tranches, thus favouring prudent private sector risk sharing and financial stability.

    To note, LCR eligibility is an important investment criterion for the banks but also for non-bank investors, who take this liquidity aspect into account in their investment decision.

Rating-based triggers also exclude senior tranches of securitisations subject to sovereign rating ceiling. Work on eligibility criteria and alternative proposals is still in progress, and proposals will be made shortly.

Finally, securitisation is discriminated against other products with the 5-year maturity cap for LCR eligibility. This maturity cap clearly restricts issuance volumes for RMBS.

- **Policy Goal 4: Open the market to a broader range of issuers and investors, including UCITS funds, to increase volumes by reducing existing entry barriers and unnecessary regulatory burden for issuers and investors, introducing proportionality in due diligence and reporting requirements, including as regards senior high-grade transactions, private transactions, and involvement of EU players in third-country transactions.**

    - Recommendation 7: review the current disclosure and due diligence requirements to more accurately meet the supervisors' and investors' needs, while limiting the burden of completing the disclosure to what is actually necessary. Simplifying the reporting process would also benefit less frequent European bank issuers, and to that end, one could explore the consolidation of the multiple reporting formats and obligations currently affecting issuers and investors into an integrated reporting framework, which would allow for proportionality as a function of the type of transaction, based on different criteria. Indeed, it is essential to differentiate the due diligence obligations and disclosure templates according to different categories of issuers, investors, asset classes, types of transaction and types of placement, with a view to adapting the nature and extent of information disclosure and due diligence requirements to these different situations.

    - Recommendation 8: acknowledge the importance of the position of EU institutional investors in the global securitisation market and avoid penalizing EU investors to invest in international securitisation markets by replacing the current requirement to apply ESMA templates to non-EU transactions, by a principle of equivalence or a mutual recognition scheme.

Policy Goal 1 Supply	Policy Goal 2 Demand from insurers	Policy Goal 3 Demand from banks' treasuries	Policy Goal 4 Market efficiency
•Reco 1: Address capital non-neutrality •Reco 2: Increase risk-sensitivity in risk weight floor •Reco 3: Address supervisory dynamics	•Reco 4: Calibrate coherently insurers' capital charges •Reco 5: Authorise European insurers to participate in 'unfunded synthetic STS'	•Reco 6: Address bank liquidity regulation, needed for supply and demand sides	•Reco 7: Address administrative impediments •Reco 8: Make Europe a centre of international finance, not just a centre of regional finance

How to address the remaining concerns?

Regarding the scepticism or the pushback that may still be expressed by some European voices, the report provides some background explaining why Paris Europlace believes those concerns are misplaced or exaggerated:

- **The remaining stigma from the Global Financial Crisis is largely undue as regards EU securitisation**
  - The track-record of EU securitisation, even during the GFC, has been much better than the US one, as reflected in much lower loss rates[3].
  - A complete overhaul of the securitisation regulation has been implemented in the EU, for both STS and Non-STS transactions, addressing the flaws that led to the crisis (interdiction of re-securitisation, retention requirement, extensive due diligence and transparency requirements, regulation and oversight on rating agencies, etc.);
- **The change in the ECB monetary policy stance since 2022 will not suffice to revive the market.**
  - The abundant liquidity provided by European central banks over the 2010s may have reduced the need for cash securitisation, but these liquidity conditions were also observed in other jurisdictions that have not experienced such a decline in securitisation issuance. In any case, the viability of the securitisation market should not depend on monetary conditions.
  - Abundant liquidity is a source of funding, but not a source of capital: therefore, we also need a very efficient and resilient market for risk transfer securitisations.
  - Covered bonds did not eliminate the need for securitisation either, as both tools are complementary: covered bonds are a funding tool highly connected to the rating of the issuing bank, but not a risk sharing tool, and therefore have no benefit in terms of capital efficiency.
  - In reality, the European Union has implemented a much more restrictive regulatory framework than other jurisdictions have, especially the United States. While it has wisely prohibited potentially harmful securitisation practices (such as re-securitisation, securitisation without retention, etc.), it has maintained excessive prudential penalties and regulatory burdens, many of them calibrated on practices that are no longer relevant.
- **A development of the EU securitisation market, from the current low base, would be far from generating excessive financial stability risks. Instead, it would rather contribute to financial stability by enabling a higher diversity of sources of capital and financing to be channelled to financial institutions, thus contributing to more harmonized funding conditions for European businesses and households.[4]**
  - Looking at current issuance volumes in the EU, it is clear that securitisation issued by EU banks out of their own balance-sheet does not have the scale that may generate a

[3] Source: Moody's.

[4] Appendix 6 provides more details about financial stability aspects of securitisation.

systemic risk, and would have considerable room for growth before reaching a potentially worrying level.

- The EU gradually built up a strict supervisory framework for Significant Risk Transfer transactions, without any systemic damage. By end 2023, based on IACPM survey results, roughly EUR300bn of loans were securitised by EU banks in a synthetic format, with EUR24bn of first loss protection, out of a total of EUR5tr of loans carried by European banks on their balance-sheets. This volume can significantly increase, and benefit real economy growth in all members states.

- According to research by BNP Paribas Exane[5], based on EU banks' Pillar 3 data, securitisation today reduces RWA of banks by 0 to 5%. This low level of risk transfer could be largely expanded before representing an excessive reliance on securitisation. In a scenario where this range were to increase to a 3% to 10% range, banks would save up to EUR50bn in capital requirement, representing up to 15% of their market capitalization, which would strengthen their resilience. Assuming that the saved capital would be reinvested in new lending, the amount of financing that could be unlocked could reach EUR2.9tr over time, or about 15% of EU GDP.

- Securitisation is a bridge between bank origination and market financing or risk taking. By developing securitisation, loan origination as performed by banks, under strictly regulated and supervised origination and monitoring frameworks, protects borrowers and investors/risk takers, and reduces the risk of weakening credit standards. In the context of a European economy largely financed by banks, developing securitisation is a way to avoid that the financing of the EU strategic ambitions be constrained by the capacity of banks to carry those additional exposures on their balance-sheets.

- Enabling (re)insurers to grow their role as sellers of credit protection further diversify the risk profile of the ultimate holders of risk, and therefore improves financial stability.

- Securitisation (unlike covered bonds) is a way for issuing banks to cap their losses in extreme circumstances, which improves their resilience. It is also a safe way to develop private risk sharing, and enhance the resilience of the Euro area and the EU financial system as a whole.

- **The EU should not wait for the BCBS to solve its problems.**

  - The 2013 BCBS framework on securitisation has not been implemented in some jurisdictions, including the US.

  - A revision of the securitisation standard is not on the agenda of the BCBS, according to the most recent work programs and speeches.

  - The EU led the way to develop a Simple, Transparent and Standard (STS) framework, which was closely followed in Basel by a (much less restrictive) Simple, Transparent and Comparable (STC) framework. The EU could take the lead once again to design a new, more risk sensitive framework, supporting a prudent and responsible development of the EU securitisation market.

[5] BNP Paribas Exane European Research – Securitise to energise – 13 May 2024 – Restricted access – Bank data as of 31 December 2023 – BNP Paribas Exane estimates.

Some key success factors

In order to ensure that the securitisation agenda achieves the overall goals set by the political leaders, in an efficient and timely way, Paris Europlace sees several key success factors to consider.

First, **the Joint Committee on Securitisation should be empowered to drive the process in close liaison with DG-FISMA.** Securitisation is a technical, and multifaceted topic, as there are multiple legal and regulatory texts addressing various aspects or types of regulated entities. Therefore, the capacity to ensure consistency, in both substance and timeline, across the various regulatory bodies involved is key to ensure a proper implementation and achieve the targeted outcome. An evolution of the role and governance of the Joint Committees could be envisaged as part of the upcoming ESAs review.

Second, dialogue with practitioners is essential. This dialogue must be permanent, transparent, and constructive. It needs to include the whole ecosystem, from investors to issuers, but also rating agencies, label providers, law firms, accountants etc… Such a variety of expert profiles do not exist in the existing ESAs Stakeholder Groups. **A dedicated Securitisation Experts Group should be created to institutionalize the existing dialogue across various types of players, the Joint Committee and involved regulators.**

Third, **the targeted recommendations proposed in this report should be implemented as a package**, given challenges and solutions are different between transactions originated by banks, subject to CRR/CRD and other types of issuers, insurers offering funded or unfunded protection, subject to Solvency 2 and other types of investors, senior tranches of public transactions issued for funding purposes, of private Significant Risk Transfer (SRT) tranches of securitisations, and junior tranches, STS and Non-STS segments, noting also the different scopes of application of prudential regulations (EU banks, EU insurers), and of the securitisation regulation SECR (covering all transactions, STS and Non-STS, and all issuers and investors acting in the EU, including when involved in third country transactions).

Given the diversity of the securitisation market (by asset class, by type of issuers, investors, structuring features…), a cherry-picking approach, consisting in targeting a specific market segment, would be counterproductive as it would not offer the critical mass that issuers and investors need to invest in resources. Indeed, for teams to originate, structure, analyse and monitor securitisation transactions a too small niche within the already subscale securitisation market is not sufficient. Examples of past attempts were to focus on SME securitisation, NPL securitisation, and now green securitisation. If the securitisation framework is appropriately repaired, there will be SME securitisations, NPL securitisations, green securitisations, and in much larger amounts than if sub-niches are addressed in isolation. Indeed, such niches in the niche cannot prosper without a dynamic overall securitisation ecosystem that can attract new investors.

Paris Europlace also supports the proposal contained in the Noyer report, of a European securitisation platform, to provide a national and European guarantee to standardise and scale-up the securitisation market. We believe that the European Union should consider leveraging the European Investment Bank (EIB) or the European Investment Fund (EIF) with a view to developing a strong EU guarantee scheme as an existing efficient framework to be scaled up and as an alternative to the US government-sponsored enterprises Fannie Mae and Freddie Mac. However, such project is likely to be a long-term ambition, and it should not prevent from working as a priority on immediate regulatory and prudential obstacles. Therefore, this subject is not addressed in the present report.

1 Introduction

In its April report[6] on the *2024-2029 European Prioritie*s, Paris Europlace identified the need **to give an ambitious boost to securitisation, to unlock significant funding for the green and digital transition**. Why an 'ambitious boost'? Because the securitisation market **remains largely sub-scale under Europe's now extremely tightly regulated framework**.

This diagnosis is not new. The exact same point was already made in 2020 in the report[7] of the "High Level Forum (HLF) on the Capital Markets Union (CMU)", a group of 28 experts gathered by the European Commission to inform the "CMU 2.0" action plan. At the time, the HLF stated that "*securitisation offers opportunities for investors to invest in consumer and corporate credit exposures that otherwise would not be available to them. It also ensures that credit risk does not solely stay with banks and allows banks to free up capital, thereby increasing their capacity to extend new funding to SMEs and support the transition to a more sustainable economy.*" The HLF recommended "*targeted, prudentially sound amendments*" to the securitisation rules. Some of those recommendations were implemented with partial success, such as the Synthetic STS framework, but the most important long-standing well-identified obstacles have not yet been tackled. The holistic review of the securitisation framework, initially planned for 2022, has been delayed and key aspects remain unaddressed, preventing a harmonious re-development of the EU securitisation ecosystem.

In the meanwhile, the financing needs of the EU are rising fast. And the current Capital Markets cannot cope. Its size is a paltry compared to the US. The alarm bell has been rung by Christine Lagarde, President of the ECB, when she said late last year: "*Despite two European Commission action plans, Europe's capital market remains fragmented. […] A genuine CMU would mean building a sufficiently large securitisation market, allowing banks to transfer some risk to investors, release capital and unlock additional lending.*"

In March 2024, the ECB Governing Council has spotted the source of the problem. It chose its words carefully to describe the worrying gap between intention and outcomes: "*It is clear that the EU needs to move beyond broad statements and a piecemeal approach on CMU […]".* A priority would be to ensure *"that the EU securitisation market can play a role in transferring risks away from banks to enable them to provide more financing to the real economy, while creating opportunities for capital markets investors.*"

Following extensive work by Eurogroup President Paschal Donohue, the Eurogroup in inclusive format agreed with this objective, mandating the European Commission to make an assessment that should cover "*the adequacy of our toolbox, including the prudential treatment of securitisation for banks and insurance companies and the reporting and due diligence requirements*" and to "*should consider coming forward with corresponding proposals*".

Former Prime Minister Enrico Letta in his April report on the Single Market considers that by 2025, the new European Commission's roadmap should "*revise the securitisation framework to simplify the utilisation of this instrument, crucial for diversifying asset investment and releasing banks' balance sheet capacity.*"

It is not a matter of financial wizardry. It is a matter of European growth and financial sovereignty. It is also a matter of European competitiveness.

[6] https://www.paris-europlace.com/en/news/paris-europlace-publishes-its-report-on-european-priorities-for-2024-2029-21300

[7] https://finance.ec.europa.eu/document/download/e3689370-b1ba-49fd-8829-646592d9464f_en?filename=200610-cmu-high-level-forum-final-report_en.pdf

The feeling of urgency is palpable.[8] Something needs to be done. The use of the word "relaunch" rather than "launch" is telling. It shows that this is not about a grand political project; it is about fixing something that has been broken. But broken by what? Honorary Governor Christian Noyer and the group of experts of his Commission describe in details what broke the market, as the High Level Forum had done already in 2020. They diagnosed that "*Europe has implemented a much more restrictive framework than other jurisdictions, especially the United States. While it has wisely prohibited potentially harmful securitisation practices (such as re-securitisation, securitisation without retention, etc.), it has maintained excessive prudential penalties and regulatory burdens, calibrated on practices that are no longer relevant.*" And Commission Noyer has a cure: "*In this context, it is imperative to quickly correct the regulatory and prudential framework for securitisation.*" They go deep in the details of the medical protocol: "*The first priority should be to restore the investor base by correcting the prudential framework applicable to insurers and by extending eligibility to liquidity buffers for banks (LCR). The second priority is to simplify transparency rules to facilitate both the issuance and acquisition of securitisation assets […]. Finally, the banking prudential framework must be adjusted […], even if this implies deviating from Basel rules […]. The only missing element is a rapid implementation schedule.*"

In short, the securitisation market exists, and some transactions can be done, but in the current regulatory context, the EU securitisation market is not scalable, and therefore unable to play its full role in the financing of EU strategic ambitions.

This consensus among central bankers and European finance ministries is extremely encouraging, and Paris Europlace fully supports those converging views aiming at reviving the European securitisation market to foster a more efficient financing of the European economy. An efficient, risk sensitive, transparent securitisation framework can contribute to strengthening the capacity of the financial sector to fund the EU strategic goals by sharing part of the risks carried by banks to investors, such as insurance companies, who precisely need diversified assets in terms of risk and return. Securitisation can enable market participants to better manage and share risks, which in turn could enable financial institutions to unlock additional lending and move towards more market-based financing of the economy, rather than depending mainly on bank lending.

Finally, Commissioner McGuinness announced, in a speech on May 22nd 2024, that the European Commission will consult on securitisation this autumn. She stated: "So right now, the Commission is analysing how best to revive the EU securitisation market, to make it more attractive for issuers and investors alike. And I can confirm that we will launch a public consultation in the autumn to ensure that we can act as soon as possible to scale up the EU securitisation market."

And in parallel, the Joint Committee Securitisation Committee (JCSC) will publish a report in Q4 2024 on the implementation and the functioning of SECR under Article 44 of the SECR. "Furthermore, the JC will also work on (i) further developing a common understanding of the rules, best practices and the supervisory tools to ensure a common supervisory approach at EU level; and (ii) market monitoring notably with regards to the developments in the volumes of private and public transactions, STS and Non-STS transactions." (13 September 2023).

But despite this commonly recognised sense of urgency, the path for implementation is still uncertain. On one hand, there are still voices that are reluctant to support securitisation reforms. On the other hand, the 'usual' policy making, legislative and regulatory processes in Europe may delay implementation too late to deliver its full benefits early enough in the EU 2024-2029 legislative cycle.

The present report, written by a working group including some of the best European experts in securitisation, across the whole ecosystem (banks, insurance companies, investors, rating agencies, law

[8] See Appendix 1 of this report - Key extracts from recent speeches and statements on securitisation.

firms…) leverages on the HLF work, the work from its members, the recent reports[9] from the authorities on the European securitisation markets, as well as expert research, and aims at equipping the new European Commission with the building blocks of a holistic review of the securitisation framework, addressing the main remaining concerns, providing concrete legislative, regulatory and supervisory recommendations, with the view of accelerating the implementation of the recent policy mandates.

While the holistic review of the framework will require some time, we believe that targeted measures towards a prudentially sound, risk-sensitive, and proportional framework can be taken in a short timeframe to obtain concrete results early in the new legislative cycle. This timing is crucial to accelerate the financing of the massive investments needed to achieve Europe's ambitious policy goals around the green, digital, and strategic autonomy agendas. As time is of the essence, we asked ourselves the question: what could be done in 20% of the time to make 80% of the impact.

Some issues can be fixed by the European Supervisory Agencies (ESAs) via the Q&A process. Some issues can be fixed with minor, targeted amendments of the regulation that can be implemented within a one-year timescale, in a 'quick-win' approach, like the one adopted in 2021 for the Capital Market Recovery Package, in line with the urgency of addressing the competitiveness gap, and the important contribution that securitisation can play in accelerating the financing of necessary investments. Some issues require greater Level 1 text changes, or discussion with international standard setters, and will have to take more time. Implementing a tiered approach (Q&A, 'Quick win', 'usual' processes), rather than waiting for an all-encompassing legislative package is essential for the European Union to boost rapidly the CMU.

As the Commission designs its consultation, it is essential that practitioners put on the table all options, and generate innovative ideas that would be concrete, risk-sensitive, prudent, and targeted. With this in mind, Paris-Europlace provides in this report a wide range of adjustments. While some are well-known no-brainers, others are more innovative, especially on the bank prudential framework, to offer solutions that reconcile the industry need for reducing excessive capital non-neutrality and the regulators' concern on formula stability and risk-sensitivity. Some of those options may need further work and calibration, but deserve to be considered as a matter a principle.

Our report is structured in four key sections, addressing four policy goals with concrete, implementable recommendations.

Section 2 addresses ways to increase the supply side (Policy Goal 1) by reducing the main disincentives to securitise that applies to banks as issuers, namely the need to reduce the excessive capital non-neutrality on non-senior tranches, and the need to reduce the excessive risk weight floor applying to senior tranches, as well as streamlining the SRT assessment process and at the same time making it more risk-sensitive.

Section 3 addresses way to increase the demand side (Policy Goal 2) by revitalising the insurance and reinsurance sector. This means, for (re)insurers investing on the asset side of their balance sheet, recalibrating in way that is coherent and grounded in data the Solvency II capital charges. For (re)insurers acting as protection providers in the unfunded market, to correct their omission in the list of guarantors in the STS market, as the current wording written in a hurry during the Covid Quick Fix has resulted in further fragmentation of the investor landscape in Europe.

Section 4 addresses ways to increase the demand side as regards banks' treasuries as potential investors (Policy Goal 3) in the European securitisation market. The main impediment is the

[9] The December 2022 reports from the Joint Committee of the ESAs, the EU Commission EGBPI non-paper in 2023 (EGBPI 16 February 2023 – Commission Expert Group Banking Payment and Insurance (Bank regulation and supervision)), the October 2023 ESRB report on the European SRT market, the May 2024 ESMA report on securitisation, and various consultations papers (FSB, ESMA, etc).

unjustifiable liquidity classification and haircuts that is applied to senior tranches of European securitisations in the Liquidity Coverage Ratio (LCR) that applies to European banks, but also penalizes all investors given it reduces overall market liquidity.

Section 5 addresses ways to facilitate access to market participants (Policy Goal 4), via a review of disclosure and due diligence requirements adapted to supervisors' and investors' needs, and by ensuring that Europe can be a base for investors acting in the global securitisation markets, and doesn't limit itself to being a regional market.

The conclusion addresses the concerns that are sometimes expressed as regards financial stability, as well as some governance proposals to ensure that the Securitisation action plan delivers its expected outcome.

To give context to the above points, it is important to understand recent developments in the European securitisation market. We have put in Appendix A1 the key extracts from recent speeches and statements on securitisation. We explain in Appendix A2 how securitisation is an essential and diverse tool to finance the real economy. We present in Appendix A3 the securitisation market trends and in Appendix A4 the credit performance of securitisation. In Appendix A5, we summarise recent prudential developments for banks. In Appendix A6 we look at the impact of potential market development on financial stability risks. In Appendix A7, we present ideas to improve the STS framework, and in Appendix A8 how private securitisation operations could be handled.

2 Policy Goal 1: Supply side: reduce disincentives to securitise for banks as issuers

Whether the dry up of the securitisation market in Europe[10] is driven by lack of offer or lack of demand is often debated in policy circles, to focus potential regulatory adjustments on the most binding constraints. Paris-Europlace considers that the securitisation market must be looked at as an ecosystem, and that the instrument must make sense both for the issuers and the investors. A decade ago, the post-crisis regulatory agenda implemented a very conservative framework probably aiming at disincentivising the use of securitisation, both from the issuers and investors standpoints, the (expected) outcome has been to discourage both regulated issuers and regulated investors.

2.1 Supply side dynamics

On the supply side, while banks would be natural users of securitisation in their funding and capital strategies, their share in placed securitisation issuance has constantly reduced, while non-banks have increased, whether corporates, credit funds, digital lending platforms, etc. Indeed, securitisation is today an expensive option for retail banks, used mostly at the margin, to diversify funding sources or transfer some risks, with high costs and barriers to entry.

Actually, the prudential framework for banks was calibrated at a very conservative level, disconnected from the risks, creating a significant 'non-neutrality' in the framework (i.e., the capital requirement after securitisation is higher than before securitisation, sometimes a multiple of the capital requirement of the underlying pool).

Another factor often cited to explain the decline in public securitisation issuance by banks is the abundant liquidity provided by central banks. Although this may have played a role in cash securitisation, it has no impact on synthetic transactions aiming at risk transfer. And even in cash transactions, we have observed only limited improvement with the more restrictive monetary policy of today. It should also be observed that other jurisdictions also provided abundant liquidity to banks over the last decade, but their securitisation market continued to experience solid growth.

From an issuer perspective, **the decision to securitise a portfolio must be value creating**, which means that the cost of securitisation must be compensated by a commensurate capital saving, otherwise the transaction is value destroying, and just does not happen.

In the EU, banks are the main source of funding to the economy, and therefore should be recognised as the natural and main source of, or transmission channel for, assets to be securitised. However, the existing prudential framework entails undue disincentives for banks to issue securitisation, stemming from the excessive 'capital non-neutrality', i.e., the fact that capital attached to securitised portfolio significantly exceeds the capital attached to the portfolio before securitisation.

This capital non-neutrality is driven by two distinct prudential rules:

- the 'p-factor' which distributes the capital across securitisation tranches (see Section 2.2),
- the risk weight floor applied to the most senior tranche (see Section 2.3).

Recently, and in particular after the possibility was given for synthetic transactions to be eligible to the STS label, the synthetic market has grown[11]. However, given current calibration, only a limited portion

[10] See Appendix 3 - Securitisation market trends

[11] See Appendix 5 – Recent changes in the prudential framework for banks

of the banks' portfolios can be securitised in a value creating mode. Assuming that the quantitative issues are rectified, it will be important to also start thinking on how to further streamline the SRT assessment process, while making it more risk-sensitive (see Section 2.4).

Moreover, issuance of securitisation develops for non-banks financing the economy, as they need securitisation for funding purposes, given that they have no access to deposits, nor to central bank funding. As such, the development of securitisation market is also a pre-requisite for them, and while they are typically not subject to bank prudential rules, they are affected by the burdensome due diligence and reporting framework, which impacts both issuers and investors (see Policy Goal 4), as well as overall lack of liquidity and depth of this market.

2.2 Recommendation 1: Reduce the excessive capital non-neutrality generated by the p-factor

2.2.1 Key takeaway

This sub-section addresses ways to reduce the excessive capital non-neutrality generated by the existing design of the prudential formula and its parameter, the p-factor. Paris-Europlace proposes four options to address this issue, without generating undercapitalisation of the mezzanine tranches. The first two options are for SEC-IRBA (at the top of the European hierarchy of approaches) and the other two are for SEC-SA (in the second position in the hierarchy).

These options should be tested based on a quantitative impact study applying to a representative range of transactions and regulatory regimes.

For the longer term, for discussions within a Basel context, we also look at the effect of introducing a new model based on an 'inverted-S' that would better align risk and capital requirement. We use this approach to compare the 2013 Basel calibration of SEC-ERBA and IAA.

- **For SEC-IRBA**

Option IRB1: Recalibrate the p-factor boundaries in SEC-IRBA

Regarding a simple short-term adjustment related to SEC-IRBA, the banking industry has proposed, so far, a p-factor subject to a floor of 0.1 (down from 0.3 currently), and subject to a cap of 0.3 for STS transactions. This proposal was included in the possible set of measures envisaged by the Commission in its EBGPI Non-paper on the review of the securitisation prudential framework (16 February 2023). For non-STS transactions, the banking industry has been in favour so far of a p-factor subject to a floor of 0.25 (down from 0.3 currently), and subject to a cap of 0.75.

This set of amendments of the p-factor would reduce more drastically the capital non-neutrality; however, regulators have objected that, if the p-factor is too low, it could generate instability as regards the risk weight of some mezzanine tranches.

Option IRB2: Other potential options

Another option could be to maintain the p-factor at a floor of 0.3 for both STS and Non-STS, but to introduce a cap of 0.5 for STS and 0.75 for Non-STS.

Another option, to be investigated based on quantitative studies, would be to reduce the p-factor on "senior enough" tranches.

- **For SEC-SA**

Option SA1: Extend the scope of the 'Boyer amendment' to SEC-SA

As a simple short-term adjustment, extending the so-called Boyer amendment, introduced temporarily in CRR3 to reduce the negative impact of the output floor, to the SEC-SA, without restriction of use. This may unlock a significant part of the potential securitisation market, by partially removing a significant obstacle for banks using SEC-SA. While this would be a step in the right direction, it would still maintain significant non-neutrality.

Option SA2: Introduce a scaling factor in SEC-SA

Paris Europlace proposes another solution to reduce capital non-neutrality while avoiding cliff effects, consisting in scaling the capital input into the existing design of SEC-SA instead of recalibrating the p-factor. This would remove at once the biggest design flaw in the capital formula that misalign risk and capital, while ensuring financial stability by making sure that mezzanine tranches are not undercapitalised. Based on our calibration, the scaling factor SF should be 0.575 for STS and 0.65 for Non-STS (which would still generate a capital surcharge of 15% for STS and 30% for Non-STS).

Paris Europlace proposes considering these various options, and include them in a quantitative impact study to ensure robustness of the calibration across various transaction types and regulatory options, in the new CRR3 context.

While the above options should be considered as part of a quick win at EU level, a longer-term solution would be to redesign the whole quantitative framework, as envisaged in the Joint Committee report, to evolve from the current "halfpipe" framework to an "Inverted S-Curve". Such a fundamental redesign would, in our view, be better addressed at the BCBS level, to ensure international consistency.

2.2.2 The diagnosis: three goals with only one parameter cannot be reached simultaneously

After securitisation, total Risk Weighted Assets (RWA) of all the tranches of securitisation associated with a securitised loan portfolio often reach twice the RWAs of the underlying loan portfolio. Under the two formulaic approaches, SEC-IRBA and SEC-SA, the capital required to cover the risk of the underlying portfolio is multiplied by a factor of (1+p), before the additional effect of the risk-weight floor. So, with the factor p set a 1, in SEC-SA, the capital requirement is multiplied by a factor of 2. While an increase due to additional risks created by securitisation (such as agency and model risks) was originally intended, after all the reforms implemented since the GFC to address those, the extent of non-neutrality is now recognised as unjustified.

Both SEC-IRBA and SEC-SA share the same Basel formula, the difference between the two approaches being the inputs to the formula. Borrowing from the world of gravity extreme sports, regulators have used the terminology "halfpipe design"[12] to describe the Basel formula (before the effect of a risk weight floor). The terminology means that the formula is in fact the engineered assembly of two disparate models: 'the flat table' corresponds to the junior part of the capital structure, where a fixed value set at the maximum risk weight of 1250% applies (whose origins are to be found in the 1990s[13]),

[12] https://en.wikipedia.org/wiki/Half-pipe

[13] See extract in Duponcheele et al (2024) explaining the reason. The effect of requiring in the late 1990s a capital deduction up to pool capital "*was to eliminate immediately the Basel I arbitrage structures of the early to mid-1990s. The "original sin" was the split between senior placed and junior retained which, in practice, might take the form 80%/20%. In this structure, everything was risk-weighted at 100% even though the split of economic risk is closer to almost all the risk for the junior and almost none for the senior. The regulatory response was devised within the Basel I constraints that existed at the time but has persisted ever since in the form of Basel rules for which all tranches up to pool capital K_{Pool} are deducted (or have a de facto 1250% RW) and tranches attaching above K_{Pool} are risk-weighted according to various regulatory approaches.*"

and a second model that plays the role of the 'transition'. This second model (the SSFA[14]) is a decreasing exponential function with the pool capital as a variable and a parameter 'p' (the 'p-factor').

Because the first model, 'the flat table' in the 'halfpipe design' (see fig. 2.2.1), requires a risk weight of 1250% for any tranche portion contained between zero and a threshold set too high, at one times pool capital, a junior tranche detaching at this too-high-a-threshold already produces the same amount of capital requirement as the entire pool. The second model just adds more capital by the proportion 'p', when all the tranche portions above the threshold are added up. This leads to capital non-neutrality, and depending on the value of 'p', to severe non-neutrality. This is why 'p' is also associated with the 'capital surcharge', i.e., the additional capital in excess of the pool capital. When 'p' is set at 1, then the increase in the capital requirements (the 'surcharge') is 100%. When it is set at 0.5, the surcharge is 50%. In SEC-IRBA, there is a minimum value 'p' set at 0.3, meaning that a securitisation in SEC-IRBA has a minimum of 30% of capital above the neutral level.

SEC-IRBA's main issue is that the p-factor can be 'out-of-control', especially for the retail framework, as a result of the sensitivity to tranche maturity, a variable that is not even a credit risk factor. The sensitivity to tranche maturity for retail assets (i.e., auto loans, SME retail, residential mortgages, credit cards) is, for senior tranches, a whopping 24% capital surcharge per year. After 5 years, the capital surcharge is thus +120%. For non-senior tranches, it is even higher at +135%. For the record, tranche maturity is not a risk factor in credit risk, never was and never will be; pool maturity is a risk factor and is not even taken into account in the formula sensitivities. Tranche maturity is not a proxy for pool maturity. This sensitivity has never been justified academically, and BCBS has never made public the technical paper explaining how it arrived at its conclusion. Therefore, the only way to stop the effect of a non-risk factor, whose calibration is opaque, is to cap its outgrowth. The solution to an 'out-of-control' sensitivity is to introduce in SEC-IRBA a cap in the p-factor formula. While the p-factor minimum value of 0.3 for both STS and Non-STS would be maintained, Paris Europlace proposes introducing a cap of 0.5 for STS and 0.75 for Non-STS. Those values are purely judgemental, but informed by the range that a proper, transparently calibrated, risk-based capital model could produce.[15]

To paraphrase the French mathematician and chemist Antoine de Lavoisier that did not believe in alchemy, securitisation transforms the credit risk of the underlying pool, it does not make it disappear, it does not create it. There is no alchemy in the securitisation technique; there should not be capital requirement created out of nowhere.

The problem created by spontaneous capital requirement creation for European assets was highlighted in 2014 by Yves Mersch, then ECB's Executive Board Member, when he criticised the 2013 calibration work done by the Basel Committee on Banking Supervision (BCBS) by saying: "*It makes little sense to calibrate the international rules solely based on US experiences. It would be like calibrating the price of flood insurance for Madrid* [located on a high plateau] *on the experience of New Orleans. The current rules lump all ABS together and are much too conservative. They effectively question their existence.*" (ECB (2014)).

With a view to recalibrate the framework considering the low default history of European assets, the European Commission, the EBA, the ECB and the Bank of England, contributed to develop the STS framework in Europe, and with the help of IOSCO, pushed BCBS to adopt its ideas, and this became the STC framework. Neither of the European authorities were able to recalibrate what BCBS produced, across all the sensitivities to the risk factors, being regulatory asset class, seniority, granularity, pool capital, pool loss given default, and to the presence of a non-risk factor that is tranche maturity. There is no public document explaining the BCBS methodology in a way that can be replicated and academically scrutinised, and neither the EC, the EBA, the ECB nor the Bank of England can justify the

[14] SSFA stands for Simplified Supervisory Formula Approach for historical reasons, but it is not an 'approach'.

[15] For additional information, there is a series of publications on this subject on Risk Control's website (www.riskcontrollimited.com).

original sensitivities of SEC-IRBA. The original calibration for SEC-IRBA is opaque. Therefore, a pragmatic and political decision was made by the European authorities, for STS securitisations, to **halve the p-factor output** of this original opaque calibration, which was then left to be applied to non-STS. While this report is not the place for a mathematical debate, we note the obvious: it is implausible that a calibration based on data would result in halving each individual sensitivity of each individual risk factor, notwithstanding the non-risk factor that is tranche maturity. The decision of the European authorities was an elegant way of cutting a regulatory Gordian knot.

A minimum value of 0.3 was maintained to avoid falling into another technical problem: cliff-effects[16] and financial instability for the capital requirement of mezzanine tranches. By this we mean the sudden and exceptionally large increase in capital requirement that is created in some securitisation tranches if the portfolio's credit quality deteriorates (which occurs in an economic downturn).

Nevertheless, the halving of p-factor for STS, does not solve the problems for non-STS, a still very important component financing the European economy. Stakeholders that replied to the European Commission consultation on the functioning of the securitisation market (July 2021) share this view, as according to the JC of ESAs report (December 2022), they "*emphasised that current capital charges for securitisations might be too prohibitive, relative to comparable asset classes, and insufficiently risk sensitive.* ***Capital non-neutrality embedded in the framework*** (emphasis added) *(due to the current level of the p-factor and the risk weight floors) has been considered too high in relation to the lower agency and model risk featured by securitisations post the global financial crisis thanks to several supervisory (TRIM, SREP) and regulatory initiatives (EBA IRB repair, STS framework, SECR and output floors, though the latter are not yet in force).*"

This non-neutrality of the capital measure for securitisation leads to a regulatory impasse, acknowledged by the JC of the ESAs, which highlights the need for an open discussion on the shape of the RW function: *"It is understood that legislators targeted different goals and effects with the formula-based approaches. First, to reduce cliff effects. Second, to ensure a deduction of capital as high as the capital before securitisation. Third, to avoid an unreasonable level of capital non-neutrality. This represents a conflict of objectives, as one can only achieve two out of these three goals within the current halfpipe design.* ***All three goals cannot be reached simultaneously*** (emphasis added) *[…] This finding of the conflicting three goals suggests for an open discussion on the shape of the RW function."*

The European authorities have historically intervened twice in attempting to repair the original work done by the BCBS. The first time, with STS, when they halved the p-factor when calibrating a carveout that became the STS framework. The second time, in 2023, the co-legislators, the European Parliament and the Council of the European Union adopted the "Boyer amendment", to halve again the p-factor in SEC-SA, but only temporarily, only for IRB banks and only for the purpose of the Output floor (the value drops to 0.25 in SEC-SA for STS and to 0.5 for non-STS). The cure: aligning risk and capital requirement

2.2.2.1 Reducing the p-factor

In order to reduce inefficiencies from current capital non-neutrality, the banking industry has asked for many years for a reduction of the p-factor and for a complete revision of determining capital requirements in securitisation, among other proposed improvements. This p-factor is responsible for the increase of capital, under the current 'halfpipe design' with a 'flat table' with length at one times pool capital (the '1250% RW threshold'). A value that is too low leads to the side-effect of undercapitalising the portion of mezzanine tranches located just above the threshold. Indeed, when

[16] However, we note that this cliff-effect is linked to the presence of the "table" in the "half-pipe design" that is calibrated to cater for a now-extinct Basel I arbitrage that existed in the mid 1990s. The world has moved on. Such Basel I regulatory arbitrage are no longer possible in a risk-sensitive framework, and the "table" of 1250% risk weight no longer needs to be up to one times pool capital.

the value is at 0, a vertical cliff-effect appears, where the marginal capital requirement drops suddenly from 1250% RW to 0% RW at the level of the threshold. A value that is too high, as it is currently the case with a p set at 1, leads to an unjustified departure of capital neutrality; it allocates too much capital to cover the correlation risk that is embedded in mezzanine tranches.

Under the current design and with the current threshold, it is not possible to have both a safe allocation of capital requirement to all the mezzanine tranches **and** staying close to capital neutrality. Another approach to tackle this dichotomy is needed. We present below one with a quick win, using the existing design but scaling the capital input, and one for the long-term with an inverted S-curve.

2.2.2.2 Possible solution for a quick win: scaling the input to the capital formula

This idea was first presented by William Perraudin of Risk Control at the AFME & Paris Europlace conference in May 2022.[17] At the core of this idea is that "*one should design regulatory rules to be consistent with the relative riskiness and liquidity of different financial instruments. Not doing so leads either to partial or complete elimination of financial activities or to regulatory arbitrage by the industry unacceptable to regulators.*" He proposed that European regulators, who had been surprised by the moribund nature of the European securitisation market which is in striking contrast to thriving ones in other jurisdictions and were reviewing at the time the securitisation capital and liquidity rules, should proceed in two steps. Step 1 was to understand the true implications of rules and how they relate to actual risk and liquidity, and that the discipline of detailed ex-ante analysis and subsequent Quantitative Impact Study (QIS) that used to guide rule making should be restored and reinvigorated. Step 2 was to make sensible interventions to reduce distortions and inconsistency with actual risk and liquidity. His first three recommendations were: "*1) Reconsider the basic calibration rectifying the major incoherence that exists between actual risk and capital charges in the mezzanine range. 2)* ***Scale capital (K_{IRB}/K_A) before inserting them into the Simplified Supervisory Formula Approach (SSFA) which is the basic equation of the SEC-IRBA and SEC-SA.*** *3) Make the senior tranche floor in the SEC-IRBA and SEC-SA proportional to pool RWs not a constant*".

In July 2022, Risk Control published a note[18] on how the second item could be achieved for SEC-SA, the more important formula for the long term, as it is the driver the Output floor. Indeed Article 261.2 of the CRR defines KA, and states:

> *"For the purposes of paragraph 1, KA shall be calculated as follows:*
> *KA = (1 – W)*KSA + W*0.5 where*
> *KSA is the capital charge of the underlying pool as defined in Article 255;*
> *W = ratio of […]"*

This paragraph can simply be amended as follow (in bold), by inserting a scaling factor in the input:[19]

> *"For the purposes of paragraph 1, KA shall be calculated as follows:*
> *KA =* ***SF * (****(1 – W)*KSA + W*0.5****)*** *where*
> ***SF is a scaling factor set at 0.65;***
> *KSA is the capital charge of the underlying pool as defined in Article 255;*
> *W = ratio of […]"*

Why has the scaling factor SF been set at 0.65, while capital neutrality is achieved when the SF parameter is set at 0.5? The reason is simple and is stated in the Risk Control note: "*the regulatory*

[17] https://www.riskcontrollimited.com/public/Securitisation_Regulation_in_Europe.pdf

[18] https://www.riskcontrollimited.com/wp-content/uploads/2022/07/Reviving-Securitisation-in-Europe-by-Scaling-Inputs-to-Capital-Formulae-22-113a-04-07-22-v3.pdf

[19] Another version of the amendment can be written to isolate the parameter w, such as KA = **SF *** (1 – W) KSA + W 0.5

parameter 'p' carries a heavy burden in the SSFA in that it determines 1) the allocation of capital between tranches, 2) the capital surcharge post-securitisation and 3) the steepness of the cliff-effect. They are relevant to investment risk, economic risk and financial stability risk respectively. […] Hitting three targets with one parameter is an over-ambitious objective and, not surprisingly, the SSFA capital departs significantly from what one could obtain from a more rigorously formulated model."

When the 'p' is low (such as between 0 and 0.3), the cliff is vertical (0) or quasi-vertical (0.1) or very steep (0.2) and may affect financial stability, as banks retaining the risk of tranches located just above the 1250% RW threshold are at risk of having insufficient capital in a financial crisis. When the 'p' is too high (such as between 1 and 1.5), the capital surcharge is too high, the additional economic cost generated acts as a disincentive to securitise.

The investment risk that 'p' is also supposed to cover concerns correlation risk, which drives in a risk model the allocation of capital between mezzanine and senior tranches. Thus, reducing 'p' alone, may reduce one or two risks out of the three, but will increase the other one or two out of the three. For example, the extreme 'p' at zero produces capital-neutrality, but generates maximum correlation risk and maximum financial instability. A 'p' at 0.5 covers the correlation risk in a about-right manner for the upper mezzanines, a cliff-effect reduction in a manner that is not too steep, but with a high economic cost as it generates a 50% capital surcharge. A 'p' at 1.0 reduces the financial instability, but at a very high economic cost and overprotects the correlation risk, to unreasonable level.

By introducing a scaling factor set at 0.65 and keeping the 'p' value at 1, the 1250% RW threshold is reduced by 35% (i.e., the length of the 'flat table' in the 'halfpipe design' is reduced), and the effective smoothing parameter becomes a p-equivalent of 0.65.[20]

This technical fix keeps the Basel 'halfpipe design', but matches better the economic risk and the capital allocation, and produces a capital surcharge of only 30% (corresponding to the same surcharge as what is produced with the exiting p-floor of 0.3 in SEC-IRBA, but without undercapitalising mezzanine tranches).

We reproduce below in Figure 2.2.1 the graph contained in the Risk Control note, comparing the existing SEC-SA (for Non-STS) and the proposal described in this subsection.

This solution is aimed at having the maximum economic impact in Europe with the minimum amount of legislative changes. The change in the legal wording of Article 255 has been kept minimal on purpose so that it can be part of a 'quick win' European legislative process.[21]

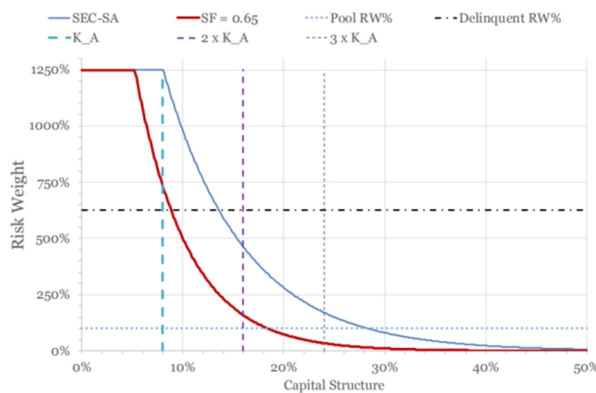
To understand the benefits of this solution, one needs to compare the curves with a risk-based capital model. This is illustrated in Figure 2.2.2 Panel a). We use the Pykhtin-Dev (2002) two-factor model[22], with a conditional correlation calibrated for corporates. A K_{IRB} is matched with K_A. The area in yellow is thus the capital of the pool before securitisation, expressed as its marginal value-at-risk for a bank's balance sheet. The area in red, between the yellow area and the blue curve of SEC-SA is the additional layer of conservatism in SEC-SA compared to a risk-based capital model. Its area is exactly equal to the area of the rectangle below the table of the 'halfpipe design' (from 0 to 1 times K_A on the x-axis, from 0% RW to 1250% RW on the y-axis), i.e., 1 K_A.

[20] Using the current definition of K_A, we have: $p * (SF * K_A) = (p * SF) * K_A = p' * K_A$ with p' being the effective smoothing factor; p' = (1 * 0.65) = 0.65.

[21] A similar adjustment was made by European authorities in the past for SMEs. The 0.7619 Supporting Factor (SF) for European SMEs is equal to the ratio of 8% (Basel II capital ratio) to 10.5% (Basel III capital ratio). When SF is applied to the capital requirement, it neutralises the increase for SMEs.

[22] Pykhtin, Michael and Ashish Dev (2002) "Credit Risk in Asset Securitisations: Analytical Model," Risk, 15(5), S16-S20, May.

Figure 2.2.1: Allocation of a 30% capital surcharge with SF set at 0.65 (Risk Control (2022)) while keeping the Basel halfpipe design.

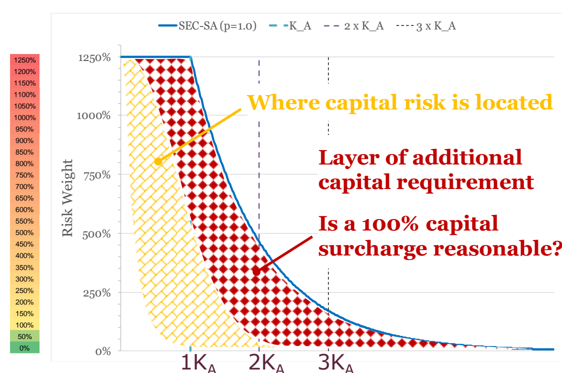


Note: If the scaling factor SF were set at 0.65 for non-STS, generating a capital surcharge of 30%, then a scaling factor SF set at 0.575 could be used for STS, in which case, the capital surcharge would only be 15% (half of 30%), very close to the capital neutrality. This is because the capital surcharge is determined by: "Capital surcharge = SF * (1+p) – 1". Whereas in the existing formula, we have an implicit SF set at 1.0, which gives "capital surcharge = 1.0 * (1+p) – 1 = p", which explains why 'p' is associated in most peoples' mind as being the capital surcharge itself, when, in reality, the primary mathematical role of 'p' is to allocate capital to the lower and upper mezzanine tranches (i.e., to cover for correlation risk).

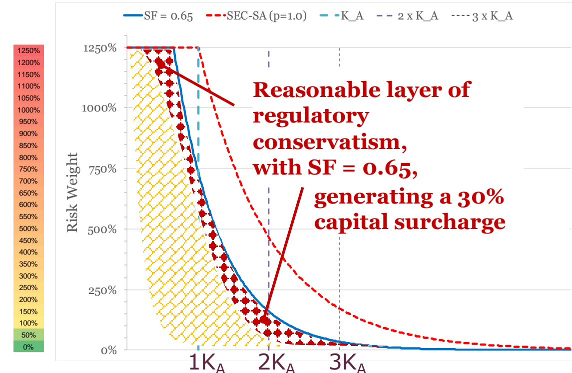
Figure 2.2.2 Panel b) shows the effect of introducing a scaling factor SF of 0.65 as an input to the capital formula. It has two effects. The table of the half-pipe design is shortened from 0 to 0.65 K_A. The effective p-factor is reduced from 1 to 0.65. The areas below the table are 0.65 K_A and below the exponential, it is also 0.65. The sum is thus 1.3 K_A, i.e., a 30% capital surcharge. This area is also equal to the red area. The red area is thus a 30% additional layer of regulatory conservatism that more than covers model risk and agency risk (estimated by some academics at 20%).

Figure 2.2.2: Non-STS SEC-SA vs. a risk-based capital model

Panel a) Existing parameters (p=1.0, $K=K_A$)



Panel b) Proposed parameters (p=1.0, $K=0.65*K_A$)



Paris Europlace proposes to test this option in a quantitative impact study.

2.2.2.3 Possible solution for the long term: replacing the current 'halfpipe design' with an 'inverted-S' curve

The current 'halfpipe design' of SEC-IRBA or SEC-SA is not based on a risk model. Risk models produce an 'inverted S' curve (as can be clearly seen in Figure 2.2.2 where the 'inverted S' is the boundary between the yellow area and the red area), where the capital requirement decreases first slowly starting from 1250% RW, then the decrease accelerates around a pivot that is close to K_{IRB} or K_A, and then decelerates in the mezzanine area. To achieve capital-neutrality, K_{IRB} or K_A should be the pivot of the capital allocation, weighted at the medium risk weight of 625% rather than 1250% under current rules.

Having a model with such a feature would be significant: mezzanine tranches would become less expensive, which would increase volumes of transactions with risk transfer (both traditional and synthetic). The currently inefficient capital allocation results in higher margins required from risk takers

and lower capital savings for the issuing banks. This scissor effect significantly reduces the capacity of banks to transfer risk, which is damaging both to the profitability of the banking sector, and its capacity to finance the economy.

Members of the Paris Europlace Experts Group on Prudential Regulation are currently working on various ideas on how to replace the current ‘halfpipe design’, while maintaining the correct capital allocation between mezzanine and senior tranches, and an overall coherent approach by stating that any tranche with an attachment point that is greater than another tranche should have less capital requirement (when expressed in risk weight terms).

One such idea, as mentioned in the EBA report dated December 2022, is to have an inverted SSFA for the junior portion up to K_{IRB} or K_A, and a SSFA for the portion above it, with a RW of 625% (half of 1250%) for the pivot. This idea corresponds in fact to the economic allocation of capital, if the regulatory model used to define the capital on the pool is also used to allocate the capital on the securitisation. There is no mathematical reason to have a non-neutral formula, since securitisation is just another allocation of the same losses estimated by the model. A proof of such allocation has been submitted to a scientific journal by Zana, and will be the object of a specific publication, and it can be generalised to define the IAA or SEC-ERBA tables with a differentiation between retail and corporate pools. The model assumes that underlying loans are not in defaults and are standard loans, and thus it should not be used for NPL transactions or for re-securitisation[23].

Table 2.2.1: Non-senior RWs per rating (Current SEC-ERBA vs. Zana Inverted-S model)

Rating	SEC-ERBA		Modelled Corporates (before floor)		Modelled Retail (before floor)	
	1 Year	*5 Year*	*1 Year*	*5 Year*	*1 Year*	*5 Year*
AAA	15%	70%	0%	0%	0%	0%
AA+	15%	90%	1%	2%	0%	1%
AA	30%	120%	2%	7%	1%	3%
AA-	40%	140%	5%	15%	2%	7%
A+	60%	160%	9%	30%	4%	14%
A	80%	180%	17%	53%	8%	25%
A-	120%	210%	49%	157%	25%	80%
BBB+	170%	260%	92%	241%	50%	130%
BBB	220%	310%	141%	325%	80%	184%
BBB-	330%	420%	243%	473%	161%	314%
BB+	470%	580%	364%	628%	275%	475%
BB	620%	760%	524%	830%	401%	635%
BB-	750%	860%	693%	1014%	557%	815%
B+	900%	950%	837%	1149%	709%	973%
B	1050%	1050%	945%	1236%	823%	1076%
B-	1130%	1130%	1046%	1250%	934%	1161%
CCC	1250%	1250%	1250%	1250%	1250%	1250%
Below	1250%	1250%	1250%	1250%	1250%	1250%

Using an average pool and conservative estimates, it is possible to compare the results of this model (before floor) for corporates and for retail with the current framework (SEC-ERBA). Those are shown in Table 2.2.1 for non-senior tranches, and in Table 2.2.2 for senior tranches.

Assuming that the current framework was built using IRB formulas with the p-factor, this comparison illustrates its impact: it increases the tails of the risk weights for the top ratings, which brakes the

[23] Investments in re-securitisation are not allowed in Europe (SECR).

capital-neutrality principle. It also provides an interesting insight on the lower risk weights before applying the floor.

It should be noted that the capital-neutral approach cannot allocate more capital than the underlying pool, which leads to many more configurations than a single table. The table is thus the result of a conservative estimate based on a wide range of pools: we have used pools ranging from 0.2% to 2% for the 1-Year PD, but since tranche size is adjusted to its rating, variations of RW between configurations are moderate.

The table for senior tranches is defined in coherence with the table for non-senior tranches, averaging the risk weights up to the top (before applying any floor).

The resulting risk weights can be significantly lower for the top ratings, since no floor is applied, but they also depend on the quality of the underlying portfolio and of the correlation of the pool (a wide range of 1-Year PD was used, as well as two correlation levels). A fixed Loss Given Default (like in the regulation) was assumed. The two tables try to encompass in a few numbers a more complex phenomenon, and they provide an interesting insight of the economic allocation of capital for an average-type transaction.

Those solutions will take time to develop and can wait for the incoming review of the future Basel rules, but Paris Europlace intends to contribute to ideas that are needed for the long-term functioning of the CMU. Our point is that the SEC-ERBA and IAA risk weights are currently excessive, for almost all rating ratings, and those two approaches need to the recalibrated at some point. It is difficult to justify that today's European economy needs to be dependent on a calibration that is more than a decade old.

Table 2.2.2: Senior RWs per rating (Current SEC-ERBA vs. Zana Inverted-S model)

Rating	SEC-ERBA		Modelled Corporates (before floor)		Modelled Retail (before floor)	
	1 Year	*5 Year*	*1 Year*	*5 Year*	*1 Year*	*5 Year*
AAA	15%	20%	0.1%	0.4%	0.1%	0.4%
AA+	15%	30%	0.2%	0.6%	0.2%	0.6%
AA	25%	40%	0.3%	0.8%	0.2%	0.7%
AA-	30%	45%	0.4%	1.2%	0.3%	1.0%
A+	40%	50%	0.6%	2.0%	0.5%	1.5%
A	50%	65%	1.2%	3.8%	0.8%	2.6%
A-	60%	70%	5.9%	18.8%	4.2%	13.5%
BBB+	75%	90%	12.2%	31.9%	8.8%	23.0%
BBB	90%	105%	19.5%	44.8%	14.2%	32.6%
BBB-	120%	140%	36.6%	71.2%	26.8%	52.1%
BB+	140%	160%	54.2%	93.6%	39.9%	68.9%
BB	160%	180%	70.0%	110.9%	51.8%	82.0%
BB-	200%	225%	87.1%	127.4%	64.7%	94.6%
B+	250%	280%	102.3%	140.5%	76.3%	104.8%
B	310%	340%	115.1%	150.5%	86.1%	112.6%
B-	380%	420%	129.6%	161.2%	97.3%	121.0%
CCC	460%	505%	417.0%	500.4%	417.0%	500.4%
Below	1250%	1250%	1250.0%	1250.0%	1250.0%	1250.0%

Overall, having a more capital-neutral measure for the entire securitisation framework (i.e., SEC-IRBA, SEC-SA, SEC-ERBA & IAA) is thus of the highest importance to allow the financing of asset portfolios by the most adequate financial actor. This can only be achieved over the long term through a more efficient capital market, which will become a reality if there is a deep revision of capital.

2.3 Recommendation 2: Reduce the excessive risk weight floor applying to senior tranches

2.3.1 Key takeaway

The second source of capital non neutrality is the risk weight floor (the 'RW Floor') applied to senior tranches. The current design of the RW Floor is a major impediment to enabling the securitisation technique to flourish in Europe. The current RW Floor has been designed as a **one-size-fits-all** fixed value (15% RW for Non-STS and 10% RW for STS), unrelated to the underlying risk of the asset pools (expressed by the asset pool risk weights). Consequently, securitising low risk assets for risk transfer purposes has become unviable, as the capital on retained senior tranches is not commensurate to the risk of the underlying assets. This limits considerably the development of high-quality assets securitisations, such as residential mortgages. In practice, the higher the RW before securitisation (i.e., the higher the riskiness of the portfolio to be securitised), the less the fixed value floor is penalising).

As regards the recalibration of RW floors, Paris Europlace proposes considering two options:

Option 1: Reduce the RW floor as a fixed value

The JC of the ESAs have advised the European Commission (December 2022) to reduce the RW Floor to a lower fixed value for securitisations. Expanding the ESAs recommendations to all types of securitisations, the industry has recommended so far for the floors:

Senior tranche Fixed value RW floors		**Current**	**Proposed**
SEC-SA[24] (Art 261-262)	**STS**	10%	7% (vs 10% EBA[25])
	Non-STS	15%	12% (like EBA)
SEC-IRBA (Art 259-260)	**STS**	10%	7% (like EBA)
	Non-STS	15%	12% (like EBA)
SEC-ERBA / IAA (Art 263-264)	**STS**	10%	7% (like EBA)
	Non-STS	15%	12% (like EBA)

This option consists on reverting to a fixed value of 7% for banks, in all their roles (issuing, investing, sponsoring) except as investors, for STS securitisations, and to a fixed value of 12% for Non-STS securitisations. There would be severe eligibility criteria, such as requiring a 2% granularity criterion, but there would be no thickness criterion for sold non-senior tranches.

Such a reduction in the RW floor would be an important step to allow securitisation of low RW assets.

Option 2: Adopt the implementation of a risk-sensitive RW floor

Paris Europlace proposes to consider a novel approach, to make the RW Floor proportional to the pool capital (K_{IRB} or K_{SA}), i.e., to move away from the idea of a fixed value floor to a risk-sensitive one, with a proportional factor of 10%. The advantage of this option would be that for higher risk portfolio, the risk weight floor would remain in the 10-15% range (based on underlying RW of 100% - 150% respectively),

[24] SEC-SA is the Standardized Approach, SEC-IRBA the Internal Ratings Based Approach, SEC-ERBA the External Ratings Based Approach, and IAA the Internal Assessment Approach to calculate the risk-weighted exposure amount for a position in a securitisation.

[25] ESMA, EBA, EIOPA, Joint Committee advice on the review of the securitisation prudential framework, Dec 2022 – Banking report – Table 3 for originators only and under conditions of eligibility criteria specified in Table 4.

while for low-risk portfolios the risk weight floor could be lowered to better reflect the quality of the underlying portfolio. Consequently, the capital saving for such transactions would be more commensurate, unlocking significant potential volumes.

Whichever option is considered for the RW floor that applies to the formula, the appropriate calibration should be applied to SEC-ERBA and to the associated IAA.

These adjustments would help make the securitisation of a broader range of bank portfolios economically viable, as the risk transfer would translate into a more commensurate recognition of the capital relief. This would, in particular, benefit to high quality portfolios such as retail mortgages, as well as to a broader range of banks, including small and medium size banks across the EU, applying SEC-SA for their loan portfolios and securitisation issuance activities.

2.3.2 The diagnosis: a one size-fits all value is not risk-sensitive

The RW Floor is currently a regulatory override that stipulates the minimum risk weight value that a securitisation tranche needs to have when the underlying formula in SEC-IRBA and SEC-SA produces a value below this minimum. It is also the lowest value in the underlying table function in SEC-ERBA and IAA. It is currently a fixed value of 15% RW for all securitisation tranches, bar for the senior tranche of STS securitisations where it is set at a fixed value of 10% RW. Designed by the Basel Committee as a fixed value, the RW Floor is insensitive to the risk weight of the underlying pools.

Among the many reasons why the securitisation market in Europe has shrunk, especially in the space of securitisations backed by European residential mortgages originated by banks, one is obvious: a value of 15% RW, and even of 10% RW, is disproportionate compared to the risk weight of most underlying pools that are remaining on banks' balance sheets. An analysis of the Pillar 3 disclosures of the major European bank lenders active in residential mortgages shows that the RW Floor can often be higher that the RW of the underlying pool itself. As a result, European banks are clearly incentivised to use the residential mortgage collateral for retained securitisations, solely for the purpose of managing liquidity requirements. The economic consequence for Europe is highly negative: by stopping de facto the market for placed securitisations in residential mortgages, European banks from countries that have a need for financing cannot use their best collateral to generate senior securitisation tranches placed with European banks from countries that have an excess of financing resources. In simple words, the Capital Markets Union does not work as an enabler of cross-border activities within the EU.

The current fixed value RW Floor is disproportionate for certain asset classes (e.g., residential mortgages, SMEs, retail consumer), while for other asset classes (e.g., corporate leveraged loans) it is considered as adequate. Under the SA, the underlying risk weight of leveraged loan pools, whose ratings are in the single 'B' range, is typically around 150% RW; under IRB, those risk weights can easily exceed, and sometimes materially so, twice the SA risk weight. Therefore, a RW Floor of 15% RW represents a proportion of 10% of 150% RW, the underlying risk weight of the pool under SA. And a RW Floor of 15% RW is sometimes below the 10% proportion of underlying IRB risk weights. Thus, the European CLO market is thriving, despite being non-STS. By leaving this state of affairs, policymakers in charge of the CMU are effectively accepting that the securitisation technique can be used to favour certain sectors of the economy while impeding others, without ever having made an assessment as to whether such choice is desired, both from a policy point of view and from an economic point of view. In simple terms, a fixed value RW Floor, as currently designed and calibrated, and implemented in European legislation, creates a distorted securitisation market that has little relation to the European economic activity.[26] It is a clear impediment to any revival attempts by policymakers.

[26] See https://www.eesc.europa.eu/en/agenda/our-events/events/securitisation-eu-way-forward/presentations

The Paris Europlace Securitisation Experts Group on Prudential Regulation underlines the proposal exposited in the paper entitled “Rethinking the Securitisation Risk Weight Floor” (Duponcheele et al., 2024),[27] a new proposal that needs to be evaluated operationally.

The paper presents a new design and calibration for the RW Floor of securitisation instruments and shows how it may be used as the basis for regulatory capital. Unlike the current RW Floor, which is specified as a constant percentage of par, it proposes a risk-sensitive RW Floor that equals a percentage of pool risk weights. This risk-sensitive proposal may be stated as:

$$\text{RW Floor} = 10\% \times K_{Pool} \times 12.5$$

where K_{Pool} is the capital K expressed as a percentage for the underlying securitised assets under the appropriate regulatory approach (Standardised Approach (SA) or Internal Rating Based approach (IRB)).

By setting K_{Pool} at K_{SA} for all investing banks, the level playing field that this simple proposal creates would strengthen the European Single Market. If they choose, policymakers could introduce greater differentiation by replacing the 10% factor of proportionality with a lower value for STS and a higher value for Non-STS securitisation.

Nevertheless, if the RW Floor were to be made proportional to the underlying risk weight of the pool, one should question the need for a differentiation for the senior tranche for STS and Non-STS (from a level playing field point of view (an economic discussion), and also from the perspective of analysing the risk content of such tranches (a mathematical discussion on asset correlation within a pool, and on operational risk)). In the historical context of the debate that occurred a decade ago in the regulatory community, the current STS and Non-STS differentiation under the current fixed value design of the RW Floor can be viewed as an attempt at making the RW Floor more risk-sensitive to better quality pools used in STS transactions, as they tend to have lower pool risk weights. Indeed, the Basel STC rules find their origins in discussions related to ‘High Quality Securitisations’ with high quality assets having lower risk weights in general than lower quality assets for which the fixed value RW Floor of 15% RW was considered adequate. Prudential rules should be more concerned with the riskier non-senior tranches that contain the systemic risk. Differentiation (STS vs. Non-STS, IRB vs. SA) should be applied for these non-senior tranches (via a review of the p-factor and of the cliff-effect generating deduction threshold, or via a scaling factor SF into the inputs of the formula for Non-STS and STS).

In the current state of affairs, any reduction in the RW Floor is welcomed by the industry, as it would bring a future fixed value closer to a relevant factor of proportionality; but this would not solve the problems of the CMU, as securitisation would still be a technique that favours certain asset classes over others. And should this be the route adopted by the regulatory community, there should be an open debate among lawmakers as to why residential mortgages or SMEs should be ‘punished’ in Europe.

2.3.3 The cure: a risk-sensitive risk-weight floor solution

Paris Europlace is thankful to the JC of the ESAs for having raised in December 2022 the issue that something needs to be done on the RW Floor. Nevertheless, since the work done in 2024, in collaboration with its Securitisation Committee Experts Group on Prudential Regulation on finding a more generic solution to the problems of the CMU, Paris Europlace proposes the introduction of a ‘risk-sensitive RW Floor’.

If a ‘risk-sensitive RW Floor’ was to be retained in fine by regulators, after the public consultation, it could be easily implemented through the following change (in bold) to Article 261.1 of the CRR:

[27] See https://www.riskcontrollimited.com/insights/rethinking-the-securitisation-risk-weight-floor/

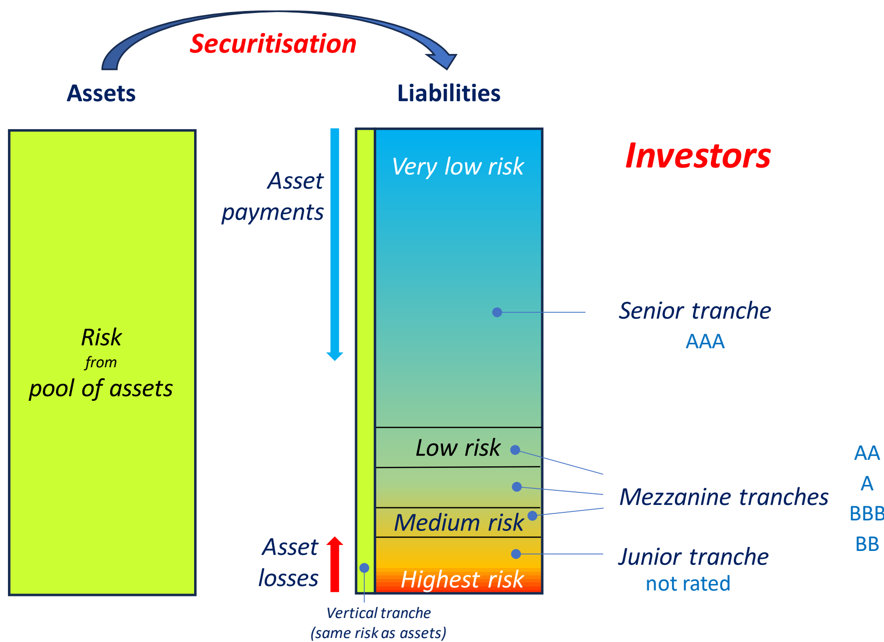
*Under the SEC-SA, the risk-weighted exposure amount for a position in a securitisation shall be calculated by multiplying the exposure value of the position as calculated in accordance with Article 248 by the applicable risk weight determined as follows, in all cases subject to a floor, **the lesser** of 15 %, **and a value equal to 10% times KSA times 12.5**:*

A similar amendment (in bold) would be added for SEC-IRBA in Article 259.1:

*Under the SEC-IRBA, the risk-weighted exposure amount for a securitisation position shall be calculated by multiplying the exposure value of the position calculated in accordance with Article 248 by the applicable risk weight determined as follows, in all cases subject to a floor, **the lesser** of 15%, **and a value equal to 10% times KIRB times 12.5**:*

Other the long term, in the context of future reforms of the Basel Committee securitisation standards (the current rules were proposed in their current form more than a decade ago, in December 2013, under a political leadership that was expressly anti-securitisation), Paris Europlace supports the implementation of a risk-sensitive RW Floor as an 'add-on' rather than a minimum of two values.

Figure 2.3.1: Principles of a securitisation



Note: the 'risk is colour-coded' in this figure.

The senior tranche has far less risk than a 'vertical' tranche that is retained to ensure alignment of interest with the issuer.

The regulation should reflect this basic financial fact.

The risk of a senior tranche is not an arbitrary fixed value.

The very low risk of a senior tranche is a fraction of the risk of the underlying pool of assets.

2.4 Recommendation 3: Streamline the SRT assessment process, while making it more risk-sensitive

Reducing barriers to entry for banks to securitise also requires, on the supervisory side, to streamline the Significant Risk Transfer (SRT) assessment process, while making it more risk-sensitive.

2.4.1 Key takeaway

There are three prominent issues for banks applying for a supervisory assessment of the "Significant Risk Transfer":

1. Ensuring a more fluid SRT assessment process by the competent authorities, as, despite recent progress, time-to-market for these activities remains too long for enabling banks to have visibility on execution and for investors to have enough visibility on pricing.
2. Adopting a more pragmatic and less costly approach to the "market test", by requiring banks to sell no more than 15% of each of the tranches, in line with EBA's recommendation #12 on the Principles Based Approach test.
3. Clarifying that SRT tests should be performed at inception only.

Paris-Europlace would welcome further dialogue with the ECB and the EBA as regards the improvement of the efficiency of supervisory practice issue.

2.4.2 The issues

Banks are constrained in their capacity to use securitisation as a capital optimisation tool and risk transfer tool, by the uncertain, complex, and burdensome SRT process, as applied by Competent Authorities. While there has been progress in efficiency, the process remains suboptimal and negatively impacts time-to-market and pricing certainty.

To improve supervisory certainty and time-to-market, and although they do not rank first among the priorities we see, three aspects should be looked at:

- **The assessment process should be further improved**

  SRT assessment has become more efficient over time and dialogue between banks and their JSTs have overall improved. In this context, implementing EBA recommendations laid down in the 2020 SRT report on the SRT assessment process (e.g. "structural features", "stop-the-clock", "self-assessment") would be a huge step backwards.

  The "structural features review" processes proposed by the EBA in many recommendations (# 1, 6, 19) are too long, whether for "simple" or more complex transactions: all in all, the effective assessment time period of some transactions would likely largely exceed 6 months, which is excessive and significantly longer than the recently improved process implemented by the ECB. And the fact that at any time, the Competent Authority could "stop the clock" removes any benefit from the intended improvement of the process.

  Finally, we reiterate the need for Competent Authorities' permission or non-objection prior to execution: banks cannot take the risk of executing a transaction if the SRT is rejected and the existence of SRT calls is not a sufficient safeguard because of the upfront costs of the structuration and of the negative impact on investor appetite. In this regard, the EBA proposal is also a significant step backwards compared to the current setup.

- **The "Market test" threshold should be lowered**

  In line with the EBA's recommendation #12 on the Principles Based Approach test, we believe that selling no more than 15% of each of the tranches that are not 1,250% risk-weighted is sufficient to demonstrate that the pricing of those tranches is consistent with market conditions, a criterion deemed important to avoid that risk transfer might be reduced by subsidizing investors through interest payments higher than market prices. Higher proportion of tranches to be sold, as currently required by supervisors, considerably increases the cost of the securitisation, without proportionally increasing the risk transfer, which significantly reduces the economic viability of the transactions.

- **Fixing a regulatory loophole: SRT tests calculation at inception**

  In its recommendation #14, EBA recommends running the Commensurate Risk Transfer (CRT) and SRT tests at the initial assessment of the transaction but not on an ongoing basis for the monitoring of the SRT. They indicate that those tests should be re-run only in case of missing or inaccurate information at the time of the original assessment or in case the bank execute any transaction as defined in CRR article 250 and some specific cases as contemplated by the EBA in its guidelines on implicit support.

  If at this stage the practice is indeed to perform the CRT test only at the initial assessment, as recommended by EBA, clarification that the quantitative SRT test required by the CRR (Articles 244(2)(a), (b) and 245(2)) should also be performed at inception would be very helpful.

  There may be, however, situations where the mezzanine tranche ceases to meet the definition of a "mezzanine". In case of deterioration of the K_{IRB} (e.g. following the implementation of new rating models), or occurrence of important losses, the RW of the mezzanine could reach 1250% RW and therefore cease to be qualified as a mezzanine as per CRR definition - art.248(18) – without being qualified as first loss tranche, creating a case not contemplated by the regulation.

2.4.3 The cure

Overall, our proposals intend to make the Significant Risk Transfer assessment process more efficient to improve time-to-market and pricing visibility, a pre-requisite for opening the scope of portfolios that could be securitised by banks in an economically viable way, and a prerequisite for many investors to enter this market with confidence.

Paris-Europlace would welcome further dialogue with the ECB and the EBA as regards the improvement of the efficiency of the SRT assessment process.

3 Policy Goal 2: Demand side: Revitalise the insurance sector as investors or protection sellers

3.1 Demand side dynamics

Investors on publicly placed senior tranches are clearly not enough in number and volume, even in the current low level of issuance, especially since the ECB has discontinued its purchase program.

It is basically limited to 20-30 bank investors, asset managers and public institutions. Not only the number of investors in these tranches has significantly reduced over the years, but also order sizes (especially with asset managers) can be quite small (while much larger for covered bonds), placing reliance on a handful of anchor investors.

According to its 2022 report on Monitoring systemic risks in the EU securitisation market, the European Systemic Risk Board (ESRB) stated "EU banks remain the main holders of EU securitisations. Nonetheless, EU banks retain securitisations mostly for use as collateral in central bank operations. In the second quarter of 2021 euro area banks held 84% of the total market value of euro area securitisations. Of these, 40% of true sale securitisations held by euro area banks had an AAA external credit rating. This apparent large share of banks does not show a dynamic market, as in the case of retained transactions, the bank only transforms illiquid portfolios into collateral eligible to the ECB, which does not create any room for new lending. Actually, bank investors were partially crowded out of the market, as potential buyers of senior securitisation tranches, given banks, even when buying STS tranches, are penalised with a significant haircut, higher than covered bonds, which makes them too onerous to play a role in the management of the liquidity buffer (LCR). (see Policy Goal 3)

The next largest holders of euro area securitisations were investment funds (including money market funds or MMFs) and insurance corporations, with 7% and 5% of the total market value respectively." The report does not breakdown the insurance companies in EU and non-EU categories.

As regards the role played by the ECB[28], the Eurosystem started to purchase securities under the asset purchase programmes (APP) in October 2014. The stated objectives of the purchase programme were to:

- further enhance the transmission of monetary policy
- facilitate the provision of credit to the euro area economy
- ease borrowing conditions for households and firms
- contribute to a sustained adjustment in inflation rates.

The ABSPP also aimed at helping banks to diversify funding sources and at stimulating the issuance of new securities which ultimately facilitated the provision of credit to the real economy.

As of July 2023, the Eurosystem no longer conducted direct purchases of asset backed securities. At this date, the total outstanding of the ABSPP was only EUR16bn, out of a total of EUR3.1tr APP, or a minimal share of 0.5%. This compares with close to EUR300bn of Covered Bonds (CBPP3), close to EUR335bn of Corporate Sector bonds (CSPP), and EUR2.5tr of Public Sector bonds (PSPP).

As seen above, the Eurosystem also plays an important role in accepting strictly defined ABS tranches as collateral, mainly retained tranches. While the ABS portfolio represented only 3.3% of the total euro

[28] See Appendix A2.3.1 – The ECB for details about the ABS Purchase Program and the use of ABS as collateral by the Eurosystem

area eligible marketable assets (Q3 2023), or EUR598bn, it represented 30% of the total collateral mobilised by banks, or EUR365bn.

This means that 60% of outstanding eligible ABSs is used as a collateral at the ECB. This is the reflect of a common banks' strategy, consisting in issuing securitisation not for the purpose of placing the tranches in the market, but retaining the tranches and using them as collateral at the European Central Bank.

Should the issuance volume take off, the lack of investment capacity in senior tranches could worsen, putting pressure on costs, market execution and consequently reducing viability for the issuer – ultimately reducing issuer trust and willingness to invest in the product.

Investors in mezzanine and junior tranches are specialised funds, mostly non-EU, which are not subject to prudential regulation. EU insurance companies are also showing greater interest for those tranches (if STS).

3.1.1 Demand in senior tranches provides funding to the economy

Prudential regulation has discouraged (re)insurance companies to invest cash in securitisation tranches in their investment portfolios by setting capital charges in Solvency 2 at a higher level for a senior securitisation tranche than for the corresponding loan portfolio, although the latter does not provide any first loss protection. In addition, due diligence requirements on these senior tranches are also very prescriptive, impacting directly the capacity of (re)insurance companies to act in the primary market, and also indirectly as in case (re)insurance companies want to sell those assets (for example to pay new insurance claims (e.g. earthquakes, floods, etc.)), the potential buyer or market maker (if it is itself subject to EU rules) also needs to go through this burdensome due diligence process. The consequence has been that (re)insurance companies have considerably reduced the staff allocated to analyse and manage securitisation portfolios, and in some cases, even totally dismantled their securitisation teams. This explains that today why (re)insurance companies are not active in the discussions around the revision of Solvency II as regards securitisation. It will take time to rebuild capacity in the (re)insurance investment sector, but as explained later the recalibration of Solvency 2 is a pre-requisite to generate appetite.

In theory though, and as shown by non-EU (re)insurance companies that have remained active, securitisation should be a relevant asset in their portfolio allocation: they offer long-term maturities (especially RMBS), direct exposure on the underlying assets, without counterparty risk on the issuer, which means that they are not "competing" for credit lines with covered bonds and other bank debts.

3.1.2 Demand in non-senior tranches provides financing to the economy

Moving away from funding issues to financing issues, one needs to look at investors that provide capital velocity to banks.[29] Investors in mezzanine and junior tranches are specialised funds, mostly non-EU, which are not subject to prudential regulation. Nowadays, most transactions providing capital velocity come from the synthetic securitisation market, where banks retain the low-risk senior tranche, and protect the first loss and/or mezzanine tranches to achieve "Significant Risk Transfer", the pre-requisite to benefit from some capital relief.

Another report from the ESRB detailed the share of the key investor categories active in the specific SRT market, based on the SSM database of SRT transactions, covering both synthetic and cash transactions.[30] The estimated share of total SRT market credit protection sold are: credit funds specialised in SRT transactions (45%), insurance companies (5%), pension funds (5%), supranationals,

[29] Duponcheele et al. (2024) "European Competitiveness and Securitisation Regulations", [July], on Risk Control's website.

[30] ESRB (2023) "The European significant risk transfer securitisation market", Occasional Paper Series N°23, October (Here)

public development funds (15%), asset managers (30%). The figures are not split between EU / non-EU investors, nor between funded or unfunded guarantees (although one can guess that supranational institutions, public development funds and insurers are almost exclusively acting on an unfunded basis).

These specialised SRT investors are characterised by a high level of expertise, and extensive due diligence policies and tailored disclosure requirements, as pre-requisites to enter into a risk sharing transaction with an originating bank, often as part of building a long-term relationship with the bank, based on an in-depth understanding of the banks' origination standards and risk culture.

As **unfunded sellers of credit protection**, (re)insurers have been providing to European banks unfunded protection on tranches of synthetic securitisations. However, with the implementation of the Covid Quick Fix introducing the synthetic STS framework, their investment landscape was suddenly fragmented, and they are now limited to non-STS transactions. SRT and loan-by-loan credit insurance production remain however a marginal part of the underwriting book of multiline (re)insurers, enabling to benefit from the risk diversification advantage recognised in Solvency 2. Furthermore, (re)insurers providing unfunded protection to banks, are helping the sector rebuilding teams with expertise, which can later be redeployed to the asset side (providing the regulation no longer penalises the instruments). It is thus unfortunate that a regulation aimed at helping banks led indirectly to additional impediments for the (re)insurance sector.

Banks are also interested to grow unfunded risk sharing with well capitalised, highly rated, and prudentially regulated private credit insurers due to:

- their appetite for the senior mezzanine risk, when thicker tranches must be protected after Basel 3 implementation, which is increasing risk-weighted assets on corporate credits with the implementation of the output floor, and
- the diversification of counterparty risk offered by (re)insurers, increasing the robustness of the package of protection sellers (funded investors and unfunded (re)insurers) on the tranches aiming at significant risk transfer (SRT).

Therefore, regulated (re)insurers offer robust counterparty diversification and provide greater opportunities for banks to manage credit risk, counterparty limits and capital, and ultimately undertake further lending. (Re)insurers are thus a very important source of capital velocity for banks.[31]

However, the STS framework for on balance-sheet synthetic securitisations requires either funded credit protection (by way of cash collateral or 0% risk-weighted debt securities) or unfunded credit protection provided by a limited number of 0% risk-weighted multilateral development banks (EIF, EBRD, IFC).

To appeal to the widest range of appropriate investors, notably private credit insurers and re-insurers, the STS On-Balance-Sheet requirements should be amended so as not to limit the availability of a key distribution channel that is currently available to banks in respect to on balance-sheet securitisations.

We conclude that the (re)insurance industry has the capacity to contribute significantly to securitisation market growth and robustness in the EU, but the current regulatory landscape in Solvency II and in the securitisation regulations are refraining this growth.

[31] See https://www.eesc.europa.eu/en/agenda/our-events/events/securitisation-eu-way-forward/presentations

3.1.3 How to increase demand from the insurance sector?

Insurers and re-insurers (together "(re)insurers") can play two complementary roles in securitisation and are the only 'non-banks' which are in the scope of prudential regulations (Solvency 2) and supervisory oversight dedicated to their investments/risk taking in securitisation transactions.

As funded investors on the asset side of their balance-sheet, they can hold bonds issued by the SPVs in true sale securitisations, and credit linked notes issued by the SPVs or directly by the banks in synthetic on balance-sheet securitisations. Most European (re)insurers have reduced their investments in securitisations on the asset side, due to the effect of regulation. Section 3.2 makes a recommendation for the asset side of their balance sheets, to rectify this situation.

As the credit insurance arm of multiline (well diversified) non-life (re)insurers can also sell **unfunded credit protection from the liability side** of their balance sheets, and cover credit losses in specific tranches of securitisations. Contracts can take the form of credit insurance policies, non-payment insurance, risk participation agreements or guarantees.

According to the IACPM Survey on SRT Transactions Executed by Credit Insurers 2019-2023,[32] "*insurers participating in a separate annual IACPM survey are specialized credit arms of nonlife (re)insurers, not monoline credit insurers. In the period 2019-2023, the participating insurers executed 153 insurance protections on 127 SRT securitizations, for a total insured amount of close to EUR4 billion. Contrary to synthetic securitizations, unfunded protection is currently executed mostly on European loans pools (55% EU, 30% UK) with a growing share of loans to SMEs and large corporate, the third but decreasing asset class being residential mortgages. […] Insurers' appetite to protect SRT transactions continues to increase but is capped by their inability to access the growing EU STS market.*"

Section 3.3 makes a recommendation for the liability side of their balance sheets, to rectify this situation.

3.2 Recommendation 4: Recalibrate the Solvency II capital charges for (re)insurers as funded investors

For insurers as funded investors, on the assets side, policy makers should eliminate the unjustified gap in capital charges existing in Solvency II between the calibrations used for bonds and loans and calibrations designed for senior STS products, as well as the unjustified gap existing between covered bonds and senior STS products, and the very significant unjustified gap between STS and Non-STS products.

In addition, differentiate the prudential requirements of non-STS tranches (still the bulk of the market in Europe) by introducing a distinction based on seniority.

These adjustments should be made urgently, given the investor base in cash securitisation is currently insufficient to support market growth, especially following the end of the ECB ABS purchase programme.

3.2.1 Key takeaway

We note that European (re)insurers participation in the traditional securitisation markets has been in decline since 2010 and currently stands at about 3% of AUM for the large (internal model driven)

[32] IACPM (2024) "Private Risk Sharing exceeded EUR 1 trillion of cumulated volumes between 2016 and 2023, despite ongoing uncertainties in final regulatory treatment", Press release, May, (Here)

(re)insurers and about 0.5% for the solo (re)insurers; in contrast US (re)insurers have maintained and even increased their participation in the US and global securitisation markets for fixed rate and floating rate securitisation notes, mostly IG senior and mezzanine tranches. This trend is at least partially explained by the calibration of the regulatory requirements, which is too high and insufficiently segmented and risk-adjusted.

It also appears that smaller European (re)insurers have wound down (relocated internally to other investment areas) their specialised teams because of the shrinking of the European securitisation market, and, caught in a vicious circle, are now no longer able to assess the securitisation market investment opportunities and create demand for securitisations.

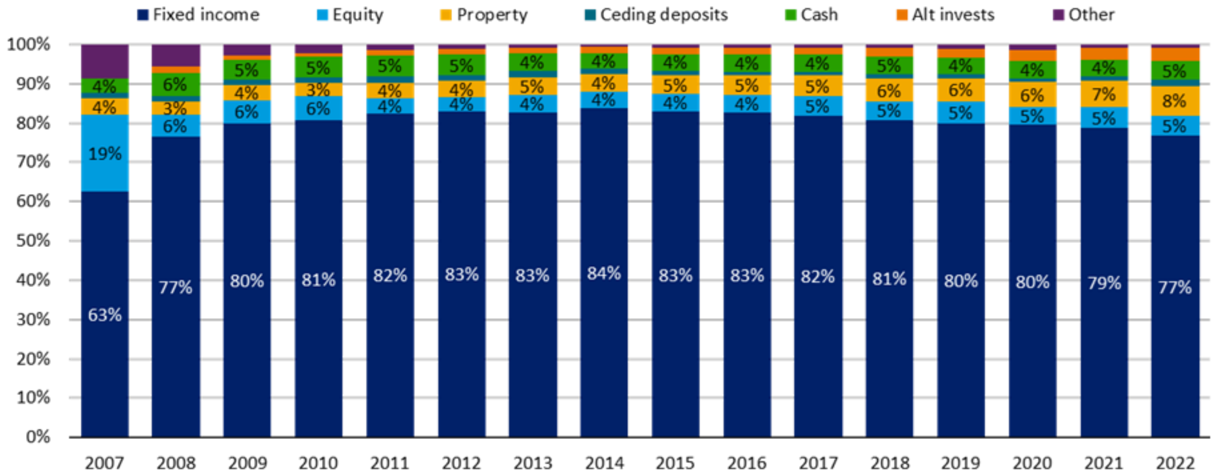
Thus, the first requirement to rebuild interest in the product, would be for authorities to see through the recovery of the securitisation issuance volume as part of the push to advance the EU CMU in general, and to bring a major overhaul to the capital charges for securitisation products under Solvency II, in particular. The extreme cliff-effects between STS and Non-STS capital charges for IG securitisation tranches and between capital charges for securitisation and for its underlying exposures cannot be justified. The charges are just too high, and the historical calibration are not based on relevant data.

3.2.2 The diagnosis: the disappearance of (re)insurers as investors in European traditional securitisation due to excessive and incoherent capital charges

To highlight the (now limited) presence of European (re)insurers' presence on the European traditional securitisation market, Paris Europlace leverages on a study done by Bank of America of the balance sheets of the largest European (re)insurers, whose combined amount of invested assets at the end of 2022 was EUR3.14tr.

Figure 3.2.1 shows that (re)insurance balance sheets remain primarily exposed to fixed income (77%) and the asset mix has remained stable over time. It is interesting to note that the largest share of Alternative Investments (3%) are mortgages and loans, offering attractive risk-adjusted yield with unparalleled favourable (under a different methodology for calibration) capital treatment, which does not seem to reflect any concerns about agency risk and originate-to-distribute business model, which regulators often voice when it comes to the securitisation of the same residential mortgage pool.

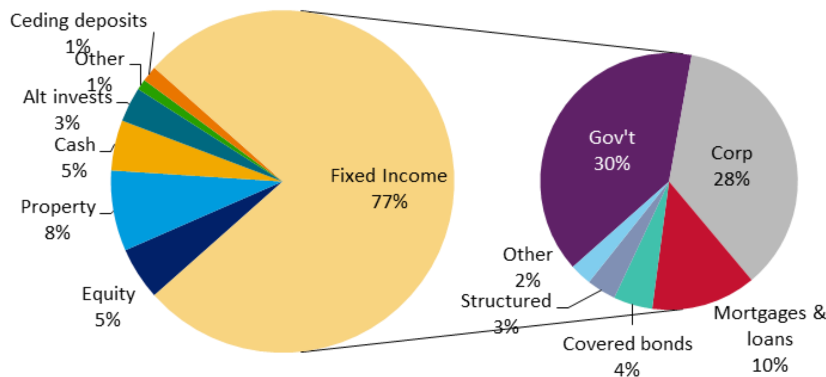
Figure 3.2.1 Largest European (re)insurers' investment portfolio by asset class – 2009 to 2022



Sources: BofA Global Research, Company Reports

Figure 3.2.2 details that the average composition of the 77% fixed income holdings in 2022: 30% in government bonds, 28% in vanilla corporate bonds, 10% in mortgages and loans, 4% in covered bonds, 3% in structured credit, and 2% in other asset types.

Figure 3.2.2 Largest European (re)insurers' investment portfolio split by asset class in 2022



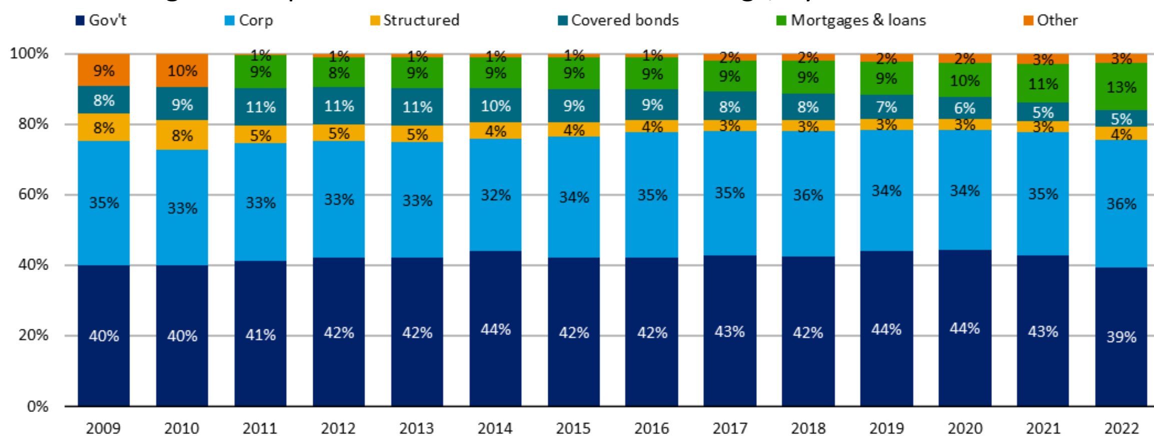
Sources: BofA Global Research, Company Reports

Figure [3.2.3] rescales the fixed income holdings and details its composition over time (each year summing to 100% of fixed income holdings). It shows the following:

- Covered bonds has the second largest share among alternative fixed income investments. Its share has halved over the last decade (11% in 2012 and 5% in 2022) even though covered bonds issuance has picked up significantly over the same period, the maturities have extended out to beyond 20 years and matched pairs are readily available (for insurers in countries where MA is allowed).

- Structured investments have remained flat over a decade and halved since the GFC (see Figure 3.2.3). The recent increase in share (to 4% in 2022 from 3% in 2021) may be due to changes in valuations (the fixed rate bond portfolios have lost more value than floating rate bond portfolios) rather than to a year-on-year increase in European (re)insurers' participation in structured finance.

Figure 3.2.3 Largest European insurers' fixed income holdings, by asset class – 2009 to 2022



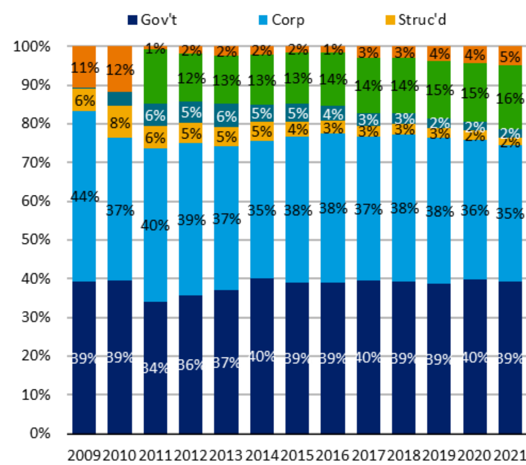
Sources: BofA Global Research, Company Reports

For completeness, Figure 3.2.4 shows the split between Life (Panel a)) and Non-life (Panel b)) (re)insurance companies.

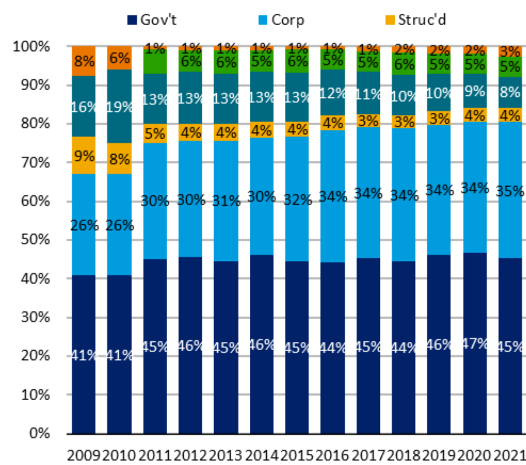
Figure 3.2.5 shows how (re)insurers, both Life (Panel a)) and Non-Life (Panel b)), switched their investment style post GFC to hold directly on their balance sheets untranched pools of mortgages and loans, at a time when it became clear that Solvency II was going to require lower capital charges on such pools compared to the far less-risky senior tranche of a securitisation of the same pools (a phenomenon that is not coherent). This was done in a European political context that was anti-securitisation post-GFC, and that did not differentiate between the quality of US subprime versus European prime assets, and that was concentrating the regulatory efforts in suppressing the securitisation technique itself. We no longer live in this post-GFC political environment, but Europe has not evolved and is implementing a policy for its economy devised more than 15 years ago.

Figure 3.2.4: Largest European (re)insurers' fixed income holdings – 2009 to 2022

Panel a) Life (re)insurers



Panel b) Non-Life (re)insurers

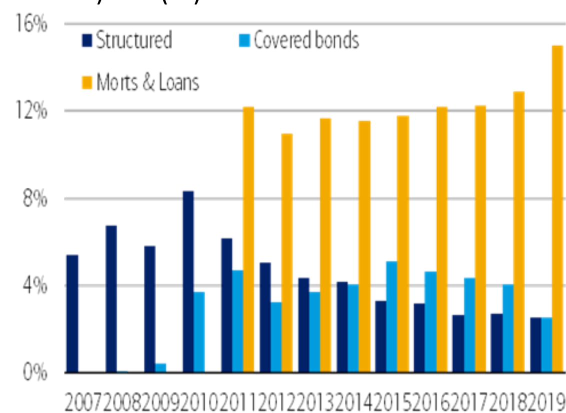


Source: BofA Global Research, Company Reports

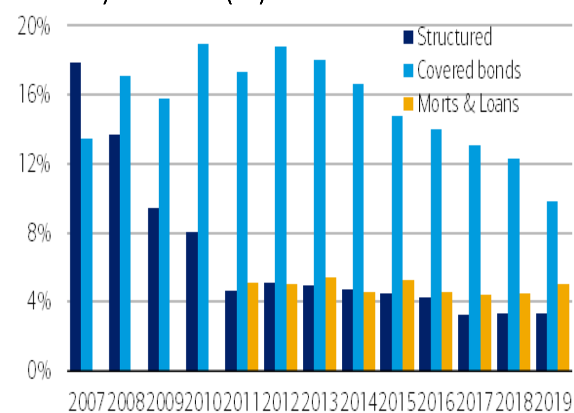
Figure 3.2.5 also shows that (re)insurers, like all investors, react to the announcement of a regulation (especially on the downside) (2009-2010) rather than wait for the final implementation of a regulation, as Solvency II only took effect in 2016.

Figure 3.2.5: Structured Finance, Covered Bonds, Mortgages & Loans, as % share of (Re)insurers' AUM – 2009 to 2022

Panel a) Life (re)insurers



Panel b) Non-Life (re)insurers



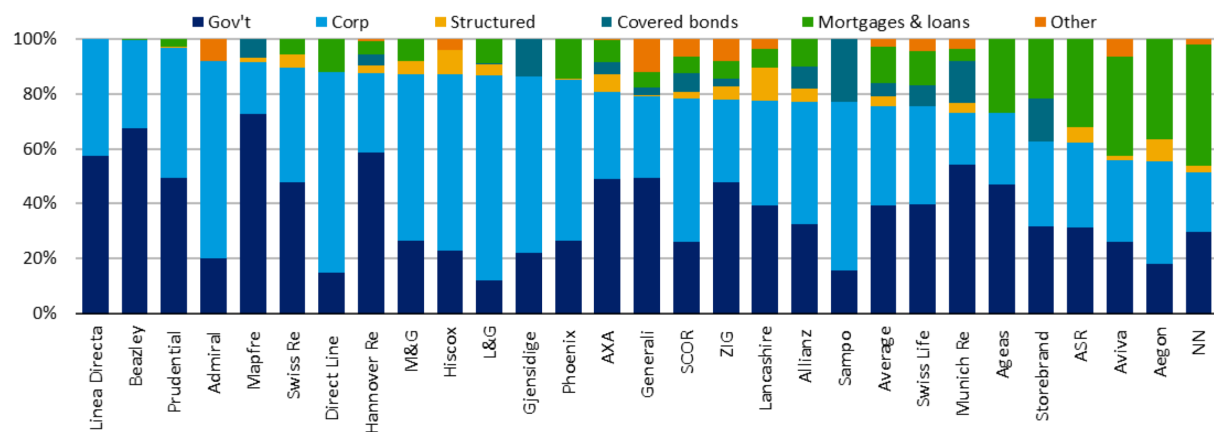
Sources: BofA Global Research, Company Reports

Note: It is interesting to see in the data that while the non-lifers' AUM share of structured finance declined during the GFC, the lifers' AUM share of structured finance increased during the GFC (buying at a discount to par).

Figure 3.2.6 shows that the structured finance capabilities are heavily company dependent, with close to half of the largest (re)insurers having no longer active structure finance teams (i.e., having lost the appetite to invest in this asset class), with some insurers having a clear preference for mortgages and loans and its preferential capital treatment. Out of 29 (re)insurers, 18 only invest in structured products. There is only one (re)insurer with structured holdings exceeding 10%, 11 (re)insurers exceeding 10% for mortgages & loans, and 4 (re)insurers exceeding 10% for covered bonds.

Bank of America Global Research noted that the (re)insurers active in the structured product space use internal models for all or for some of their structured investment to calculate their investments' contribution to their solvency ratio.

Figure 3.2.6: Largest European (re)insurers' fixed income holdings, by company in 2022



Sources: BofA Global Research, Company Reports

Another data source is provided by EIOPA via its consultation paper on the advice on the review of the securitisation prudential framework in Solvency II, published on 7th June 2022. It reviewed the participation of 250 EU smaller (re)insurers, defined as 'solo undertakings which use the standard formula since the introduction of Solvency II'[33], in the securitisation market. The key points of the study are summarised as follow:

- A small number of solo standard formula undertakings (12% in the EU for 2020, or 250 out of 2140 such undertakings) have investment positions on securitisation.
- Approximately 59% of those undertakings (or 150 out of 250) hold securitisation position below 1% of their total investment assets, around 27% hold investments between 1% and 5%, and only about 14% - more than 5%. The trend has been relatively stable since the introduction of Solvency II.
- Investments on securitisation have been relatively stable across Europe since the introduction of Solvency II (EUR12.8bn or 0.34% of total assets in 2020 numbers).
- Since the introduction of the STS label in 2019, a small decrease in investments can be observed in the STS segment of the securitisation market, which is partially offset by the increase in non-STS ('other securitisation') investments.
- Insurers in 14 EU countries had investments securitisation in 2020 with Ireland (2.53%) and Denmark (1.32%) standing out in terms of the share (for the remaining 12 countries the respective share is well below 1%).
- Approximately half of the securitisation positions are with the lifers, while the highest concentration of securitisation holdings is with the reinsurers.

What was missing from this study is an analysis of investment trends of solo undertakings prior to the introduction of Solvency II, as (re)insurers reacted to the announcement of Solvency II, as shown clearly in Figure 3.2.5. They did not wait for the introduction of Solvency II in January 2016 to disengage from structured products. Furthermore, no analysis was made regarding the impact of the high burden of due diligence under SECR (which applies to (re)insurers) and the related high degree of investor specialisation and investment management commitment to securitisation.

The European Commission should be deeply concerned that non-EU (re)insurance companies have been leading buyers of traditional securitisation exposures from EU issuers since the introduction of Solvency II. It should make an independent assessment as to whether it can achieve its economic goals while keeping the current calibration of Solvency II conceived almost 15 years ago, with minor

[33] We do not know whether there is overlap in names between Bank of America's 29-strong and EIOPA's 250-strong samples.

amendments made in the intervening years. It remains difficult to claim that Solvency II currently proposes a suitable calibration.

Firstly, for non-STS products (still the bulk of the market in Europe) it makes no difference between a senior tranche and a non-senior tranche. Knowing that the recovery rate is not the same between a senior and a non-senior tranche, and that market data reflects this basic financial fact, one cannot possibly conceive that calibrating on data would have resulted in having the same spread shock, and by consequence the same capital charge.

That lack of differentiation has deep consequences in terms of capital requirement. For example, given a modified duration of one year and a rating of AAA, a Non-STS senior tranche is 12.5 times more expensive than an STS senior tranche. For a modified duration of five or ten years and a rating of AA, a Non-STS senior tranche is respectively 10 and 11 times more expensive than an STS senior tranche.

Secondly, an unjustified gap exists between the calibrations used for Bonds and Loans and those designed for senior STS products. One could add that another unjustified gap exists between Covered bonds and senior STS products.

Those points can be illustrated by tables 3.2.1 and 3.2.2, for a 5-year and 10-year modified duration, respectively. The spread shocks are applied to the market value of the instrument and the values in the tables have been calculated based on the Delegated Regulation (EU) 2015/35, Article 178: Spread risk on securitisation positions: calculation of the capital requirement.

Table 3.2.1: Spread shocks for instruments with a 5-year modified duration, per rating

5-Year Modified duration	AA	BBB	B
	CQS 1	CQS 3	CQS 5
Covered bonds	4.5%	12.5%	37.5%
Bonds & Loans	5.5%	12.5%	37.5%
STS senior	6.0%	14.0%	47.0%
STS non-senior	17.0%	39.5%	100.0%
Non-STS senior	67.0%	98.5%	100.0%
Non-STS non-senior	67.0%	98.5%	100.0%

Table 3.2.2: Spread shocks for instruments with a 10-year modified duration, per rating

10-Year Modified duration	AA	BBB	B
	CQS 1	CQS 3	CQS 5
Covered bonds	7.0%	20.0%	58.5%
Bonds & Loans	8.5%	20.0%	58.5%
STS senior	9.5%	22.5%	73.5%
STS non-senior	26.5%	63.0%	100.0%
Non-STS senior	100.0%	100.0%	100.0%
Non STS non-senior	100.0%	100.0%	100.0%

Another risk that stems from the inconsistency of the calibration is the ‘label risk’ and its cliff effect, material for a portfolio manager. Indeed, it is possible to imagine the following scenario: a European SME transaction is labelled STS at closing and then later, it suddenly loses its STS label as one STS criteria is not satisfied, and the non-compliance leads to the removal of the label. From an investor point of view, the tranche that was invested in initially was STS, and is now suddenly classified non-STS. From one day to the next, the amount of capital is multiplied by a significant multiplier of 12.5. (Re)insurance

companies may be told by the securitisation manufacturers (mainly banks), the labellers (such as Prime Collateralised Securities (PCS) and STS Verification International (SVI)) or the regulatory authorities that the materialisation of a 'label cliff-effect' risk is low; but even a remote risk with such material consequences may be too high for the risk appetite of some (re)insurers. Indeed, while banks' will have a 50% increase in their capital charge in a (remote) event of losing the 'STS' label (the fixed value floor is 15% RW for Non-STS compared to 10% RW for STS), (re)insurers have +1150% increase. This can create financial instability induced by regulatory miscalibration.

Finally, while capital requirements between banking regulation (CRR) and (re)insurance regulation (Solvency II) may not be directly comparable (credit risk for the former, market risk for the latter), it is still possible to compare the relative coherence. And Solvency II calibration for securitisation instruments is lacking in that regard, leading to a 'non-investable' framework.

3.2.3 The cure: To bring back basic financial coherence to the calibration of the Solvency II capital charges

In the context of a will to develop the Capital Markets Union (CMU), we welcome that the Solvency II latest draft agreement in Parliament 23/04/2024 Plenary, includes a recital (105) aiming at giving the European Commission a clear mandate to assess the opportunity to adapt the calibration of securitised products.[34] The European Commission also included Solvency II into the perimeter of the consultation expected by this autumn. It appears that notwithstanding the status quo defended by the JC in December 2022, it exists a real will to develop securitisation in the Solvency II framework, both expressed by the market and by the economic institutions.

Paris Europlace proposes an alignment of prudential requirements for senior STS securitisations with bonds, loans and covered bonds rated CQS 0 & 1, as well as a differentiation of prudential requirements of non-STS tranches, by introducing a distinction based on seniority. Such distinction would allow for more granular and risk-adjusted prudential treatment. Those two proposals would facilitate securitisation investments, in a prudent and rationale way, by keeping a risk-based approach.

There are several approaches that can be taken to recalibrate coherently the capital charges of securitisation, which are outside the scope of this report. However, Tables 3.2.3 and 3.2.4 shows an example of how this could be done. The tables display the spread shocks per credit quality steps (ratings) et per year of modified duration, depending on seniority and STS classification.

Tables 3.2.3 shows the calibration as it is currently set in Solvency II regulation. The three basic problems are the following:

- Senior STS is more expensive (capital wise) than Covered Bonds or Bonds & Loans.
- Senior non-STS is up to an absurdly high 12.5 times Senior STS.
- There is no sensitivity to seniority in non-STS.

[34] "It should be ensured that the prudential treatment of investments in securitisation, including simple, transparent and standardised securitisation, appropriately reflects the actual risks, and that capital requirements associated with such investments be risk-oriented. To this end, the Commission should assess the appropriateness of existing calibrations for investments in securitisations that are set out in the delegated acts adopted pursuant to Directive 2009/138/EC, taking into account available market data, and their consistency with capital requirements that are applicable to investments in other fixed-income securities. Based on such assessment, and where appropriate, the Commission should consider amending the delegated act setting capital requirements applicable to investments in securitisation. Such amendments, which should be risk-based and evidence-based, could consist of introducing a more granular set of risk factors depending on the ranking of the securitisation tranches, or of differentiating different types of non-simple, transparent and standardised securitisation depending on their risks."

Table 3.2.3: Current Solvency II spread shocks, per rating, seniority, and STS classification

	Senior STS								Non-Senior STS							
	AAA	AA	A	BBB	BB	B	CCC	NR	AAA	AA	A	BBB	BB	B	CCC	NR
Year	CQS 0	CQS 1	CQS 2	CQS 3	CQS 4	CQS 5	CQS 6	NR	CQS 0	CQS 1	CQS 2	CQS 3	CQS 4	CQS 5	CQS 6	NR
1	1.00%	1.20%	1.60%	2.80%	5.60%	9.40%	9.40%	4.60%	2.80%	3.40%	4.60%	7.90%	15.80%	26.70%	26.70%	9.40%
2	2.00%	2.40%	3.20%	5.60%	11.20%	18.80%	18.80%	9.20%	5.60%	6.80%	9.20%	15.80%	31.60%	53.40%	53.40%	18.80%
3	3.00%	3.60%	4.80%	8.40%	16.80%	28.20%	28.20%	13.80%	8.40%	10.20%	13.80%	23.70%	47.40%	80.10%	80.10%	28.20%
4	4.00%	4.80%	6.40%	11.20%	22.40%	37.60%	37.60%	18.40%	11.20%	13.60%	18.40%	31.60%	63.20%	100.00%	100.00%	37.60%
5	5.00%	6.00%	8.00%	14.00%	28.00%	47.00%	47.00%	23.00%	14.00%	17.00%	23.00%	39.50%	79.00%	100.00%	100.00%	47.00%
6	5.60%	6.70%	8.80%	15.70%	31.10%	52.30%	52.30%	25.50%	15.60%	18.90%	25.30%	44.20%	87.80%	100.00%	100.00%	52.30%
7	6.20%	7.40%	9.60%	17.40%	34.20%	57.60%	57.60%	28.00%	17.20%	20.80%	27.60%	48.90%	96.60%	100.00%	100.00%	57.60%
8	6.80%	8.10%	10.40%	19.10%	37.30%	62.90%	62.90%	30.50%	18.80%	22.70%	29.90%	53.60%	100.00%	100.00%	100.00%	62.90%
9	7.40%	8.80%	11.20%	20.80%	40.40%	68.20%	68.20%	33.00%	20.40%	24.60%	32.20%	58.30%	100.00%	100.00%	100.00%	68.20%
10	8.00%	9.50%	12.00%	22.50%	43.50%	73.50%	73.50%	35.50%	22.00%	26.50%	34.50%	63.00%	100.00%	100.00%	100.00%	73.50%
11	8.60%	10.00%	12.60%	23.60%	45.70%	74.10%	74.10%	37.30%	23.60%	28.00%	36.10%	66.20%	100.00%	100.00%	100.00%	74.10%
12	9.20%	10.50%	13.20%	24.70%	47.90%	74.70%	74.70%	39.10%	25.20%	29.50%	37.70%	69.40%	100.00%	100.00%	100.00%	74.70%
13	9.80%	11.00%	13.80%	25.80%	50.10%	75.30%	75.30%	40.90%	26.80%	31.00%	39.30%	72.60%	100.00%	100.00%	100.00%	75.30%
14	10.40%	11.50%	14.40%	26.90%	52.30%	75.90%	75.90%	42.70%	28.40%	32.50%	40.90%	75.80%	100.00%	100.00%	100.00%	75.90%
15	11.00%	12.00%	15.00%	28.00%	54.50%	76.50%	76.50%	44.50%	30.00%	34.00%	42.50%	79.00%	100.00%	100.00%	100.00%	76.50%
16	11.60%	12.50%	15.60%	29.10%	55.10%	77.10%	77.10%	45.00%	31.60%	35.50%	44.10%	82.20%	100.00%	100.00%	100.00%	77.10%
17	12.20%	13.00%	16.20%	30.20%	55.70%	77.70%	77.70%	45.50%	33.20%	37.00%	45.70%	85.40%	100.00%	100.00%	100.00%	77.70%
18	12.80%	13.50%	16.80%	31.30%	56.30%	78.30%	78.30%	46.00%	34.80%	38.50%	47.30%	88.60%	100.00%	100.00%	100.00%	78.30%
19	13.40%	14.00%	17.40%	32.40%	56.90%	78.90%	78.90%	46.50%	36.40%	40.00%	48.90%	91.80%	100.00%	100.00%	100.00%	78.90%
20	14.00%	14.50%	18.00%	33.50%	57.50%	79.50%	79.50%	47.00%	38.00%	41.50%	50.50%	95.00%	100.00%	100.00%	100.00%	79.50%
21	14.60%	15.00%	18.60%	34.10%	58.10%	80.10%	80.10%	47.50%	39.60%	43.00%	52.10%	96.60%	100.00%	100.00%	100.00%	80.10%
22	15.20%	15.50%	19.20%	34.70%	58.70%	80.70%	80.70%	48.00%	41.20%	44.50%	53.70%	98.20%	100.00%	100.00%	100.00%	80.70%
23	15.80%	16.00%	19.80%	35.30%	59.30%	81.30%	81.30%	48.50%	42.80%	46.00%	55.30%	99.80%	100.00%	100.00%	100.00%	81.30%
24	16.40%	16.50%	20.40%	35.90%	59.90%	81.90%	81.90%	49.00%	44.40%	47.50%	56.90%	101.40%	100.00%	100.00%	100.00%	81.90%
25	17.00%	17.00%	21.00%	36.50%	60.50%	82.50%	82.50%	49.50%	46.00%	49.00%	58.50%	103.00%	100.00%	100.00%	100.00%	82.50%

STS

Source: Solvency II, Spread risk shocks, per year of modified duration and per credit quality step (CQS)

	Senior Non-STS								Non-Senior Non-STS							
	AAA	AA	A	BBB	BB	B	CCC	NR	AAA	AA	A	BBB	BB	B	CCC	NR
Year	CQS 0	CQS 1	CQS 2	CQS 3	CQS 4	CQS 5	CQS 6	NR	CQS 0	CQS 1	CQS 2	CQS 3	CQS 4	CQS 5	CQS 6	NR
1	12.50%	13.40%	16.60%	19.70%	82.00%	100.00%	100.00%	100.00%	12.50%	13.40%	16.60%	19.70%	82.00%	100.00%	100.00%	100.00%
2	25.00%	26.80%	33.20%	39.40%	100.00%	100.00%	100.00%	100.00%	25.00%	26.80%	33.20%	39.40%	100.00%	100.00%	100.00%	100.00%
3	37.50%	40.20%	49.80%	59.10%	100.00%	100.00%	100.00%	100.00%	37.50%	40.20%	49.80%	59.10%	100.00%	100.00%	100.00%	100.00%
4	50.00%	53.60%	66.40%	78.80%	100.00%	100.00%	100.00%	100.00%	50.00%	53.60%	66.40%	78.80%	100.00%	100.00%	100.00%	100.00%
5	62.50%	67.00%	83.00%	98.50%	100.00%	100.00%	100.00%	100.00%	62.50%	67.00%	83.00%	98.50%	100.00%	100.00%	100.00%	100.00%
6	75.00%	80.40%	99.60%	100.00%	100.00%	100.00%	100.00%	100.00%	75.00%	80.40%	99.60%	100.00%	100.00%	100.00%	100.00%	100.00%
7	87.50%	93.80%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	87.50%	93.80%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
8	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
9	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
10	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
11	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
12	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
13	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
14	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
15	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
16	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
17	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
18	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
19	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
20	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
21	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
22	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
23	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
24	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
25	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Non-STS

Senior

Non-senior

When one uses a heatmap to represent the data, a coherent solution comes naturally (to which further technical refinements can be added) as displayed in Table 3.2.4. This was obtained by the simple, coherent rules:

- New Senior STS is aligned to Bonds & Loans (one could argue that for CQS 0 and CQS 1, the alignment should be with Covered Bonds, or a value between Covered Bonds and Bonds & Loans).
- New Senior Non-STS shocks are set at 1.3 times the New Senior STS shocks.
- The New Non-Senior shocks are set at 1.5 times the New Senior shocks, and this is applied to both STS and Non-STS.

The multiplier of 1.3 and 1.5 are the combination of judgement and Risk Control's publications on Solvency II calibration.

For STS:

- Although limited evidence indicates that Senior STS tranches should have lower capital charges than CBs, we use the following conservative key finding in Perraudin and Qiu (2022) that implies that the Senior STS ratio to CB should be x1.3. Therefore, we align the Senior STS

heatmap with the Bonds and Loans heatmap. For the first 5 years, the new Senior STS CQS 0 charge-per-year-of-duration is 0.9%, compared to the CB at 0.7%. This is displayed in Table 3.2.4 on the top left side.

- To obtain the Non-senior STS heatmap, we multiply the new Senior STS heatmap by a ratio of x1.5, following the same logic. Even though the data in Perraudin and Qiu (2022) indicates that this ratio is lower at x1.3, we keep the same ratio as in the CRR (where the STS fixed value floor for non-senior tranches is set at x1.5 the STS fixed value floor for senior tranches). For the first 5 years, the new Non-senior STS CQS 0 charge-per-year-of-duration is 1.4%, compared to the new Senior STS value of 0.7%. This is displayed in Table 3.2.4 on the top right side.

Table 3.2.4: Example of a coherent calibration, per rating, seniority, and STS classification

	Senior STS								Non-senior STS							
	AAA	AA	A	BBB	BB	B	CCC	NR	AAA	AA	A	BBB	BB	B	CCC	NR
Year	CQS 0	CQS 1	CQS 2	CQS 3	CQS 4	CQS 5	CQS 6	NR	CQS 0	CQS 1	CQS 2	CQS 3	CQS 4	CQS 5	CQS 6	NR
1	0.90%	1.10%	1.40%	2.50%	4.50%	7.50%	7.50%	3.00%	1.40%	1.70%	2.10%	3.80%	6.80%	11.30%	11.30%	4.50%
2	1.80%	2.20%	2.80%	5.00%	9.00%	15.00%	15.00%	6.00%	2.70%	3.30%	4.20%	7.50%	13.50%	22.50%	22.50%	9.00%
3	2.70%	3.30%	4.20%	7.50%	13.50%	22.50%	22.50%	9.00%	4.10%	5.00%	6.30%	11.30%	20.30%	33.80%	33.80%	13.50%
4	3.60%	4.40%	5.60%	10.00%	18.00%	30.00%	30.00%	12.00%	5.40%	6.60%	8.40%	15.00%	27.00%	45.00%	45.00%	18.00%
5	4.50%	5.50%	7.00%	12.50%	22.50%	37.50%	37.50%	15.00%	6.80%	8.30%	10.50%	18.80%	33.80%	56.30%	56.30%	22.50%
6	5.00%	6.10%	7.70%	14.00%	25.00%	41.70%	41.70%	16.70%	7.50%	9.20%	11.60%	21.00%	37.50%	62.60%	62.60%	25.10%
7	5.50%	6.70%	8.40%	15.50%	27.50%	45.90%	45.90%	18.40%	8.30%	10.10%	12.60%	23.30%	41.30%	68.90%	68.90%	27.60%
8	6.00%	7.30%	9.10%	17.00%	30.00%	50.10%	50.10%	20.10%	9.00%	11.00%	13.70%	25.50%	45.00%	75.20%	75.20%	30.20%
9	6.50%	7.90%	9.80%	18.50%	32.50%	54.30%	54.30%	21.80%	9.80%	11.90%	14.70%	27.80%	48.80%	81.50%	81.50%	32.70%
10	7.00%	8.50%	10.50%	20.00%	35.00%	58.50%	58.50%	23.50%	10.50%	12.80%	15.80%	30.00%	52.50%	87.80%	87.80%	35.30%
11	7.50%	9.00%	11.00%	21.00%	36.80%	59.00%	59.00%	24.70%	11.30%	13.50%	16.50%	31.50%	55.20%	88.50%	88.50%	37.10%
12	8.00%	9.50%	11.50%	22.00%	38.60%	59.50%	59.50%	25.90%	12.00%	14.30%	17.30%	33.00%	57.90%	89.30%	89.30%	38.90%
13	8.50%	10.00%	12.00%	23.00%	40.40%	60.00%	60.00%	27.10%	12.80%	15.00%	18.00%	34.50%	60.60%	90.00%	90.00%	40.70%
14	9.00%	10.50%	12.50%	24.00%	42.20%	60.50%	60.50%	28.30%	13.50%	15.80%	18.80%	36.00%	63.30%	90.80%	90.80%	42.50%
15	9.50%	11.00%	13.00%	25.00%	44.00%	61.00%	61.00%	29.50%	14.30%	16.50%	19.50%	37.50%	66.00%	91.50%	91.50%	44.30%
16	10.00%	11.50%	13.50%	26.00%	44.50%	61.50%	61.50%	30.70%	15.00%	17.30%	20.30%	39.00%	66.80%	92.30%	92.30%	46.10%
17	10.50%	12.00%	14.00%	27.00%	45.00%	62.00%	62.00%	31.90%	15.80%	18.00%	21.00%	40.50%	67.50%	93.00%	93.00%	47.90%
18	11.00%	12.50%	14.50%	28.00%	45.50%	62.50%	62.50%	33.10%	16.50%	18.80%	21.80%	42.00%	68.30%	93.80%	93.80%	49.70%
19	11.50%	13.00%	15.00%	29.00%	46.00%	63.00%	63.00%	34.30%	17.30%	19.50%	22.50%	43.50%	69.00%	94.50%	94.50%	51.50%
20	12.00%	13.50%	15.50%	30.00%	46.50%	63.50%	63.50%	35.50%	18.00%	20.30%	23.30%	45.00%	69.80%	95.30%	95.30%	53.30%
21	12.50%	14.00%	16.00%	30.50%	47.00%	64.00%	64.00%	36.00%	18.80%	21.00%	24.00%	45.80%	70.50%	96.00%	96.00%	54.00%
22	13.00%	14.50%	16.50%	31.00%	47.50%	64.50%	64.50%	36.50%	19.50%	21.80%	24.80%	46.50%	71.30%	96.80%	96.80%	54.80%
23	13.50%	15.00%	17.00%	31.50%	48.00%	65.00%	65.00%	37.00%	20.30%	22.50%	25.50%	47.30%	72.00%	97.50%	97.50%	55.50%
24	14.00%	15.50%	17.50%	32.00%	48.50%	65.50%	65.50%	37.50%	21.00%	23.30%	26.30%	48.00%	72.80%	98.30%	98.30%	56.30%
25	14.50%	16.00%	18.00%	32.50%	49.00%	66.00%	66.00%	38.00%	21.80%	24.00%	27.00%	48.80%	73.50%	99.00%	99.00%	57.00%

STS

	Senior Non-STS								Non-senior Non-STS							
	AAA	AA	A	BBB	BB	B	CCC	NR	AAA	AA	A	BBB	BB	B	CCC	NR
Year	CQS 0	CQS 1	CQS 2	CQS 3	CQS 4	CQS 5	CQS 6	NR	CQS 0	CQS 1	CQS 2	CQS 3	CQS 4	CQS 5	CQS 6	NR
1	1.20%	1.40%	1.80%	3.30%	5.90%	9.80%	9.80%	3.90%	1.80%	2.10%	2.70%	5.00%	8.90%	14.70%	14.70%	5.90%
2	2.30%	2.90%	3.60%	6.50%	11.70%	19.50%	19.50%	7.80%	3.50%	4.40%	5.40%	9.80%	17.60%	29.30%	29.30%	11.70%
3	3.50%	4.30%	5.50%	9.80%	17.60%	29.30%	29.30%	11.70%	5.30%	6.50%	8.30%	14.70%	26.40%	44.00%	44.00%	17.60%
4	4.70%	5.70%	7.30%	13.00%	23.40%	39.00%	39.00%	15.60%	7.10%	8.60%	11.00%	19.50%	35.10%	58.50%	58.50%	23.40%
5	5.90%	7.20%	9.10%	16.30%	29.30%	48.80%	48.80%	19.50%	8.90%	10.80%	13.70%	24.50%	44.00%	73.20%	73.20%	29.30%
6	6.50%	7.90%	10.00%	18.20%	32.50%	54.20%	54.20%	21.70%	9.80%	11.90%	15.00%	27.30%	48.80%	81.30%	81.30%	32.60%
7	7.20%	8.70%	10.90%	20.20%	35.80%	59.70%	59.70%	23.90%	10.80%	13.10%	16.40%	30.30%	53.70%	89.60%	89.60%	35.90%
8	7.80%	9.50%	11.80%	22.10%	39.00%	65.10%	65.10%	26.10%	11.70%	14.30%	17.70%	33.20%	58.50%	97.70%	97.70%	39.20%
9	8.50%	10.30%	12.70%	24.10%	42.30%	70.60%	70.60%	28.30%	12.80%	15.50%	19.10%	36.20%	63.50%	100.00%	100.00%	42.50%
10	9.10%	11.10%	13.70%	26.00%	45.50%	76.10%	76.10%	30.60%	13.70%	16.70%	20.60%	39.00%	68.30%	100.00%	100.00%	45.90%
11	9.80%	11.70%	14.30%	27.30%	47.80%	76.70%	76.70%	32.10%	14.70%	17.60%	21.50%	41.00%	71.70%	100.00%	100.00%	48.20%
12	10.40%	12.40%	15.00%	28.60%	50.20%	77.40%	77.40%	33.70%	15.60%	18.60%	22.50%	42.90%	75.30%	100.00%	100.00%	50.60%
13	11.10%	13.00%	15.60%	29.90%	52.50%	78.00%	78.00%	35.20%	16.70%	19.50%	23.40%	44.90%	78.80%	100.00%	100.00%	52.80%
14	11.70%	13.70%	16.30%	31.20%	54.90%	78.70%	78.70%	36.80%	17.60%	20.60%	24.50%	46.80%	82.40%	100.00%	100.00%	55.20%
15	12.40%	14.30%	16.90%	32.50%	57.20%	79.30%	79.30%	38.40%	18.60%	21.50%	25.40%	48.80%	85.80%	100.00%	100.00%	57.60%
16	13.00%	15.00%	17.60%	33.80%	57.90%	80.00%	80.00%	39.90%	19.50%	22.50%	26.40%	50.70%	86.90%	100.00%	100.00%	59.90%
17	13.70%	15.60%	18.20%	35.10%	58.50%	80.60%	80.60%	41.50%	20.60%	23.40%	27.30%	52.70%	87.80%	100.00%	100.00%	62.30%
18	14.30%	16.30%	18.90%	36.40%	59.20%	81.30%	81.30%	43.00%	21.50%	24.50%	28.40%	54.60%	88.80%	100.00%	100.00%	64.50%
19	15.00%	16.90%	19.50%	37.70%	59.80%	81.90%	81.90%	44.60%	22.50%	25.40%	29.30%	56.60%	89.70%	100.00%	100.00%	66.90%
20	15.60%	17.60%	20.20%	39.00%	60.50%	82.60%	82.60%	46.20%	23.40%	26.40%	30.30%	58.50%	90.80%	100.00%	100.00%	69.30%
21	16.30%	18.20%	20.80%	39.70%	61.10%	83.20%	83.20%	46.80%	24.50%	27.30%	31.20%	59.60%	91.70%	100.00%	100.00%	70.20%
22	16.90%	18.90%	21.50%	40.30%	61.80%	83.90%	83.90%	47.50%	25.40%	28.40%	32.30%	60.50%	92.70%	100.00%	100.00%	71.30%
23	17.60%	19.50%	22.10%	41.00%	62.40%	84.50%	84.50%	48.10%	26.40%	29.30%	33.20%	61.50%	93.60%	100.00%	100.00%	72.20%
24	18.20%	20.20%	22.80%	41.60%	63.10%	85.20%	85.20%	48.80%	27.30%	30.30%	34.20%	62.40%	94.70%	100.00%	100.00%	73.20%
25	18.90%	20.80%	23.40%	42.30%	63.70%	85.80%	85.80%	49.40%	28.40%	31.20%	35.10%	63.50%	95.60%	100.00%	100.00%	74.10%

Non-STS

Senior

Non-senior

For non-STS:

- We use the New Senior STS heatmap, and we multiply by a factor of x1.3. The final logic would imply that a Senior Non-STS charge is above the Senior STS charge and below the Non-senior STS charge. (This is because the expected recovery rate of a senior tranche is higher than the

expected recovery rate of a non-senior tranche, and the market will reflect this phenomenon, especially in an economic downturn). Therefore, we choose the ratio has to be above x1.0 and below x1.5. The choice of x1.3 is deemed appropriate, although x1.4 is also a possibility. The choice of x1.1 or x1.2 do not put enough distance with the New STS calibration and have not been chosen. For the first 5 years, the new Senior Non-STS CQS 0 charge-per-year-of-duration is 1.8%, compared to the new Senior STS of 0.9%. This is displayed in Table 3.2.4 on the bottom left side.

- To obtain the non-senior non-STS heatmap, we multiply the new Senior Non-STS heatmap by a ratio of x1.5. For the first 5 years, the new non-senior non-STS CQS 0 charge-per-year-of-duration is 1.8%, compared to the new Senior Non-STS value of 1.2%. This is displayed in Table 3.2.4 on the bottom right side.

Last but not least, and as an additional safeguard, there should be no situations where the senior tranche should have a greater capital requirement than the underlying assets. This could occur as the shock applied to the senior tranche is not a proportion of the average shocks applied to the underlying assets. Therefore, a cap should be introduced.

3.3 Recommendation 5: Allow insurance companies to be eligible protection providers in unfunded synthetic STS

For insurers providing credit insurance through unfunded protection, on the liability side, make (re)insurance companies eligible as protection providers in unfunded synthetic STS transactions

3.3.1 Key takeaway

The synthetic STS framework introduced as part of the COVID Quick Fix has inadvertently fragmented further the investor landscape, by not allowing private companies to participate in this market on an unfunded basis, thus removing insurance and reinsurance companies from the STS market while enabling them to play their normal economic role as provider of credit protection in the non-STS market only.

This regulatory oversight can be fixed immediately if banks' letter of credit (LoC) are deemed suitable cash-like collateral for STS issuer. However, there is cost that is associated with a letter of credit.

Because (re)insurers are playing an increasingly important role in the protection of mezzanine tranches of SRT transactions which is expected to be growing further in the frame of the CRR regulation with thicker mezzanine size, Paris Europlace supports a 'quick win' to correct the initial omission in the 'Covid Quick Fix' by adding the missing word 'funded' in SECR Article 26e(10)(b), thus limit the scope of this paragraph to funded investors only.

Better would be a statement that transparently and explicitly mentions that European (re)insurers are welcome in the European SRT STS market on an unfunded basis. This would be achieved by adding a point (d) in Article 26e(8) to explicitly say that highly regulated and well-capitalised multiline (re)insurers (under Solvency II or equivalent) can provide banks with unfunded credit protections guarantees which can be eligible to the STS label.

3.3.2 The diagnosis: an investor fragmentation created by an omission in the legislative text

To have a thriving CMU, Europe needs to foster the building of competent teams in firms that can play a natural investor role. One of the aims of the CMU is to increase the investor landscape, not to fragment it further. It is thus surprising to see regulation that creates a fragmentation of the investor

landscape. This is what occurred with the introduction of the STS Synthetic framework. We believe that it was done inadvertently, as we have found no reasoned analysis showing that it was done on purpose.

In the investor landscape, one finds insurance and reinsurance undertakings (together the '(re)insurers'). Credit insurance providers play a vital role in the economic fabric, being central to trade finance, to banks' limit management on a single name basis, and increasingly on a portfolio basis with synthetic securitisation. Their participation in those markets is on a unfunded basis, with the (re)insurance companies settling in cash the claims. This is a fundamental tenet of insurance that its liquid assets, such as cash, is for honouring claims when they arise; it is not to be used as collateral against all potential scenarios of future claims.

Furthermore, most European (re)insurance companies providing credit insurance are highly regulated (subject to EIOPA rules), well capitalised (subject to the Solvency II regime), and well diversified (multi-lines). Their business model is explicitly allowed in point (g) of Article 201(1) of the CRR that stipulates:

> "CRR 201(1). *Institutions may use the following parties as* ***eligible providers of unfunded credit protection****: […] (g) other corporate entities, including parent undertakings, subsidiaries, and affiliated corporate entities of the institution, where either of the following conditions is met: (i) those other corporate entities have a credit assessment by an ECAI; […]"*

Article 202 of the CRR goes further in explaining that well capitalised should be understood as having an external rating equal or better than CQS2 when a transaction is signed, and that it should be maintained at CQS3 or better during the life of the transaction for the credit protection to remain unfunded.

The CRR has led to several CQS1- & CQS2-rated insurance companies taking an interest into providing credit protection to banks, not just on a single name basis, but also on a portfolio basis via synthetic securitisation. According to a survey conducted by the ECB, their 2022 market share had reached 5% of SSM-approved risk transfer market (ESRB report (Oct 2023)).

According to another survey done by IACPM (April 2024), the volume of transactions executed by (re)insurance companies in the classic unfunded format shrank in 2023 compared to 2022. Why? The reason is that the non-STS portion of the market is reducing, with the STS portion increasing, as policymakers intended. But not for (re)insurers who are limited to the non-STS portion on an unfunded basis. There are two separate issues to address.

The <u>first</u> issue is that Article 26e(8)(a) of SECR restricts the participation in the STS market in an unfunded form to a select few multilateral banks (EIB/EIF, EBRD, etc.). The article states (with emphasis added):

> *"SECR 26e(8). A credit protection agreement shall take the form of:*
>
> *(a) a* ***guarantee*** *meeting the requirements set out in Chapter 4 of Title II of Part Three of Regulation (EU) No 575/2013, by which the credit risk is transferred to any of the entities listed in points* ***(a) to (d) of Article 214(2)*** *of Regulation (EU) No 575/2013,* ***provided that the exposures to the investor qualify for a 0 % risk weight*** *under Chapter 2 of Title II of Part Three of that Regulation;*
>
> *(b) a guarantee meeting the requirements set out in Chapter 4 of Title II of Part Three of Regulation (EU) No 575/2013, which benefits from a* ***counter-guarantee*** *of any of the entities referred to in point (a) of this paragraph; or [...]"*

These two paragraphs can be translated in layman's terms as: a credit protection can be unfunded as it is already authorised in the CRR, on the condition that it is transferred to (a) a sovereign or central

bank, (b) a regional government or a local authority, (c) a public sector entity similar to a sovereign or (d) a multilateral development bank (MDB) that is 0% risk-weighted, and for STS only, the SECR adds a new restriction to ensure that those public entities mentioned in (a), (b), (c) need to be CQS1 (i.e., AAA or AA).

In other words, the SECR is splitting the European Union countries into 'good ones' (roughly speaking Northern Europe) that can provide unfunded guarantees for STS transactions and 'bad ones' (roughly speaking Southern Europe, and Central and Eastern Europe (CEE)) that cannot and, thus, need to be intermediated by MBDs such as the EIF or the EBRD. We view this state of affairs as regrettable and another example of fragmentation of the capital markets by the 'devil in the details' of the securitisation rules. Furthermore, economically speaking, it is difficult to comprehend as to why public entities in Southern Europe and in the CEE can provide guarantees for non-STS transactions, but not for STS transactions. To have those sorts of rules entrenched in the European legislation raises wider governance issues as to rulemaking in the ESAs, or as to the oversight of the European Commission or as to the scrutiny rights of the European Parliament.

Furthermore, points (a) and (b) of paragraph 26e(8) are only concerned with risk taking in an unfunded format by public institutions, while the private sector is handled in the next point (c), where the notion of risk weight of the counterparty is entirely ignored. And this raises the second issue. The point (c) states (emphasis added):

> *"SECR 26e(8). A credit protection agreement shall take the form of: [...](c) another credit protection not referred to in points (a) and (b) of this paragraph* ***in the form of a guarantee****, a credit derivative or a credit linked note* ***that meets the requirements set out in Article 249 of Regulation (EU) No 575/2013****,* ***provided that the obligations of the investor are secured by collateral*** *meeting the requirements laid down in* ***paragraphs 9 and 10 of this Article****.;"*

And paragraph 26e(10) states (emphasis added):

> *"Where another credit protection is provided in accordance with point (c) of paragraph 8 of this Article, the originator and the investor shall have recourse to high-quality collateral, which shall be either of the following: […] (b)* ***collateral in the form of cash held with a third-party credit institution with credit quality step 3 or above in line*** *with the mapping set out in Article 136 of Regulation (EU) No 575/2013."*

In essence, SECR invalidates the intention of the CRR. Indeed, this series of chained paragraphs can be translated in layman's terms as: (re)insurers can provide credit protection in the form of unfunded guarantee as it is explicitly allowed in the CRR (as Article 249(3) refers back to 201(1)(g) mentioned above), and then SECR overrides the CRR by saying that the obligations of the (re)insurers must be collateralised (i.e., funded). And wait, it gets better… At a time of signing under the CRR, the (re)insurer needs to be well capitalised because it needs to be CQS1 or CQS2 and not lower, but then it needs to immediately provide collateral to a potentially less well capitalised third-party bank as the latter can be CQS3. The 'Covid Quick Fix' has generated a situation for (re)insurers that is pure Kafka, both with a SECR that invalidates the intention of the CRR, and with the regulation that forces the financially stronger counterparty having to post collateral with a weaker counterparty. It is thus not surprising that highly regulated, well capitalised and well diversified (re)insurers are not participating actively in the STS market, remaining active in the non-STS space. It is a missed opportunity for the European Union that is unable to offer investment opportunities to European (re)insurers, and unable to make use of European (re)insurers capital deployment capabilities.

It is also a missed opportunity for European banks and STS verification agents, as several transactions that could qualify for the STS label are structured to avoid the STS label, enabling (re)insurers to

participate. In exchange, (re)insurers compensate the banks for the loss in capital relief efficiency that the use of the STS capital formulae provides by lowering their price. In economic parlance, it creates a situation where the allocation of scarce resources (bank capital for risk taking) is inefficient at a European level, and this affects directly the European competitiveness.

To put things into perspective, European (re)insurers could increase their yearly risk-taking capacity into the STS format to about EUR10bn per year (corresponding to approximatively EUR1.5bn in capital relief), but cannot at the moment as unfunded STS is not opened to them, because they have been omitted in SECR 26e(8) when this article was produced in a hurry during Covid, for the 'Capital Markets Recovery Package' (CMRP), also known as 'Covid Quick Fix'.

3.3.3 The cure: temporary and long-term fix

We assume that this sorry state of affairs is unintentional, and that SECR had never intended to push the unfunded STS securitisation market solely in the hands of multilateral banks (which are explicitly allowed to participate without the need for collateralisation). We will thus assume that there is a greater willingness to quickly fix the Kafkaesque situation in which (re)insurers find themselves in.

The 'fast route' (3 months): the ESAs Q&A process could enable an immediate fix (although at a cost to (re)insurers). Indeed, SECR Article 26e(10)(b) mentions "collateral in the form of <u>cash held with</u> a third-party credit institution". There is a legal argument that the wording cannot be interpreted in the literal sense, as security interest can only be applied in the form of bills and coins. So "cash held with" must be interpreted as "an undertaking to pay cash by" a third-party credit institution. The payment claim against the third-party institution, not the cash it owes, can legally be used as collateral. Therefore, a letter of credit in favour of the originator is even superior to a pledged cash deposit for both the investor and the originator, as the investor has no (repayment) credit risk on the third-party credit institution issuing the letter of credit (which it would have in the case of a cash deposit) and the originator has a direct claim against such credit institution without having to enforce a pledge. There are more legal arguments in favour of a letter of credit, but this report is not the place to describe them all. Needless to say, a positive answer to a question asking to treat a letter of credit from a third-party credit institution as satisfying the collateral requirement of SECR 26e(10)(b) would enable (re)insurers to participate in the STS market on an unfunded basis. This would help the STS market grow further.

The 'quick win' route (one year): the word "funded" (in bold) should be added back in point (c) of Article 26e(8) to remain fully compatible with the CRR Article 249, and to remove the Kafkaesque situation created by this missing word. It should be modified as follow:

> *"SECR 26e(8). A credit protection agreement shall take the form of: [...](c) another credit protection not referred to in points (a) and (b) of this paragraph in the form of a guarantee, a credit derivative or a credit linked note that meets the requirements set out in Article 249 of Regulation (EU) No 575/2013, provided that the obligations of the* ***funded*** *investor are secured by collateral meeting the requirements laid down in paragraphs 9 and 10 of this Article.;"*

But better, assuming that the European Commission supports the participation of private sector risk-taking, in particular highly regulated and well capitalised multiline (re)insurers' participation in the STS market on an unfunded basis, there could be an additional point (d) (in bold) in Article 26e8 that would state the following:

> *"SECR 26e(8). A credit protection agreement shall take the form of:* ***[...](d) another credit protection not referred to in points (a) and (c) of this paragraph in the form of a guarantee, a credit derivative or a credit linked note that meets the requirements set***

out in Article 249 of Regulation (EU) No 575/2013, provided that the investor is an insurance undertaking as defined in point (1) of Article 13 of Directive 2009/138/EC, or a reinsurance undertaking as defined in point (4) of Article 13 of Directive 2009/138/EC, provided that the exposures to the investor qualify for a CQS1 risk weight [20%] or CQS2 risk weight [50%] under Chapter 2 of Title II of Part Three of that Regulation;

This additional point (d) drafted above addresses the fact that the (re)insurers need to be 'highly regulated' by referring to the (Re)Insurance Directive, and they need to be 'well capitalised' (CQS1 or CQS2). A further condition on being 'well diversified' referring to the business model of multiline insurers, as opposed to monoline ones, could be added if the European Commission does not trust the post-GFC, ESMA-regulated ECAIs' assessment of monolines.

4 Policy Goal 3: Remove the disincentive for banks to invest in third-party securitisation, while improving market liquidity for all players.

4.1 Background

Banks could be legitimate and sizeable investors in senior tranches of third-party securitisation, as part of their High-Quality Liquid Assets buffer. However, they were crowded out of the market, given a combination of obstacles:

- the LCR treatment of senior securitisation tranches, even when STS, imposed a significant haircut, higher than covered bonds, which made them inefficient to play a role in the management of the liquidity buffer.
- The due diligence obligation at loan level is extremely time consuming and not efficient compared to other products (see Policy Goal 4)
- The RW applied to those senior tranches is not commensurate with the risk, affecting negatively the risk/return of the asset (See Policy Goal 1)
- There is no equivalence allowing EU banks to invest in non-EU securitisation (se Policy Goal 4)

Liquid assets eligible in the LCR are divided into various categories:

- Level 1 (the most liquid), such as coins and banknotes or assets guaranteed by the European Central Bank, national central banks or regional governments and local authorities; This category also includes Covered Bonds of "extremely high quality";
- Level 2A, such as assets guaranteed by regional governments, local authorities, or public sector bodies in the EU with a weighted risk of 20%; This category also includes other Covered Bonds;
- Level 2B, such as asset-backed securities, corporate debt securities, shares provided they meet certain requirements and certain securitisations which must satisfy a range of strict conditions to be accepted as a Level 2B asset, with a haircut of 25/35%.

Indeed, the haircuts are totally dissuasive, and according to EBA Risk Dashboard, Level 2A and 2B combined (the most granular figure published by EBA, which includes STS securitisation, represent on average only 4% of the Total HQLA portfolio for European banks, which amounts to EUR5.5tr.

Consequently, European banks are absent as investors in other banks' securitisation, whether cash of synthetic. In fact, their main exposure to securitisation is

- the senior retained tranches eligible to ECB refinancing
- the retained tranches from own account securitisation (schematically, senior tranches when the focus is risk transfer, junior tranches when the focus is funding)
- the exposures linked to corporate securitisation (liquidity lines, private transactions secured by a portfolio of receivables

and, for structuring banks, some warehousing exposure, and positions in their market making role.

4.2 Recommendation 6: Improve LCR classification of securitised products, and corresponding haircuts

The existing gaps with Covered Bonds in the Liquidity Coverage Ratio (LCR) classification of securitised products, and corresponding haircuts, should be reduced to unlock bank investments in third-party securitisation senior tranches, thus favouring prudent private sector risk sharing and financial stability.

4.2.1 Key takeaway

Currently, securitisations are treated unfairly in the LCR, which is unreflective of the true qualities of highly rated securitisations. An adjustment in the eligibility of different types of securitisations for LCR purposes and the applicable haircuts should also be considered. A study by Perraudin and Qiu (2022b) examines the relative liquidity of senior Asset Backed Securities (ABS) and Covered Bonds (CBs), and the evidence provided in it suggests that senior ABS should be included within higher LCR categories than is currently the case.

LCR eligibility is an important investment criterion for the banks but also for non-bank investors, who take this liquidity aspect into account in their investment decision.

Paris Europlace supports the previous proposal of the European Banking Federation (EBF). After considering the views of its members, the various national banking federations, the EBF proposed in October 2021 a concrete remedy, that still has relevance today:[35]

- To promote to Level 1 STS senior tranches backed by residential and auto loans, which are the most liquid types of securitisation;
- To promote to Level 2A the STS senior tranches backed by SME loans and other consumer loans;
- To allow qualifying non-STS securitisations to classify as Level 2B, with appropriate haircuts.

Work on eligibility criteria and alternative proposals is still in progress, and alternative proposals will be made shortly.

Improving LCR bracketing (and ultimately haircuts) would send a strong positive signal, encourage further investment, and help the dynamic of the secondary market. Such a treatment would remain prudent compared with the ECB collateral eligibility rules, which apply a mere 5% haircut on the best ABS categories.

It is also essential to restore eligibility at a single-A rating level (for senior tranches only), to make securitisations subject to sovereign rating ceiling eligible again and thus increase eligible volumes. Indeed, in addition to punitive haircuts, the lack of eligible paper makes the investment in LCR eligible securitisation uneconomical for many banks.

Finally, securitisation is discriminated against other products with the requirement of a 5-year maturity cap for LCR eligibility. This maturity cap clearly restricts issuance volumes for RMBS.

To note, from an operational perspective, the investment by banks in securitisation senior tranches will also require a simplification of the due diligence requirements and the improvement of the capital prudential treatment of the securitisation tranches bought. The recognition of EU equivalence of non-EU securitisations would also be of great help.

4.2.2 The diagnosis: inadequate liquidity treatment, not informed on data

All securitisation senior tranches, subject to specific liquidity-related criteria, were eligible as HQLA assets since LCR legal implementation. They were an important tool in the toolbox of bank treasurers for diversification and quality. The introduction of the STS label was supposed to improve the situation for such treasurers. As initially envisaged by the Commission, the now STS label should have provided 'upside' in terms of LCR recognition, rather than create a 'downside' for the non-STS market segment.

Unfortunately, on 13 July 2018, the Commission published the final text of revisions to the LCR

[35] Relaunching the European Union's securitisation market: What needs to be done in the context of the Capital Markets Union – technical paper. EBF_045363. 6 October 2021

Delegated Act (applicable as of April 30, 2020) which has fallen short of improving the treatment of senior STS tranches of securitisations. In addition, non-STS positions are fully disallowed from Level 2B.

The European authorities announced that the top two grades, HQLA-Level 1 ("extremely high quality") and HQLA-Level 2A ("high quality"), were going to be the preserve of covered bonds. The securitisation tranches could only remain HQLA-Level 2B if they were labelled STS, with an associated 25%/35% haircut, which makes them onerous and disincentivises demand from bank treasuries. In effect, if a securitisation tranche was not labelled STS, it would simply be disallowed, creating a cliff effect for positions previously held in bank treasuries. In effect, it was announced to bank treasurers that the STS label was no longer viewed as a carrot but as a stick. Non-STS tranches, even senior ones, are no longer part of the toolbox of bank liquidity management.

<u>Overview of eligible ABS and covered bond assets per category in the European Commission LCR delegated act:</u>

Asset type (HQLA)	Tier	Cap applicable	Haircut applicable
Covered bonds ECAI 1	1	70%	7%
Covered bonds ECAI 2	2A	40%	15%
Residential mortgage securitisation	2B	15%	25%
Auto loan securitisation	2B	15%	25%
Consumer loan securitisation	2B	15%	35%
Unrated high quality covered bonds	2B	15%	30%

Forgetting the lessons of the GFC, the Europe's regulatory dependence on external ratings was even reinforced. To be eligible, a Senior STS tranche had to be externally rated AAA or AA ('CQS1' in banking regulatory speak). This was later restricted to AAA by two rating agencies, later on, via the Q&A process. And by the way, there is no such restrictions on Covered Bonds (CBs). And the haircuts for CBs are also much more favourable. CBs are treated better, twice.

In addition, securitisation is the only product to feature a maturity cap for HQLA, which clearly affects RMBS (to be eligible the senior notes need to be callable after 5 years, while underlying assets are longer, which reduces the appeal of the securitisation product as matched funding).

Is there a justification for this sorry state of affairs? Could it be that the data used by the authorities had a 'period bias' to justify treating securitisation worse than CBs? The answer can be found in the Risk Control's paper entitled *Comparing ABS and Covered Bond Liquidity*.[36] Here is an extract: "*Our most important finding is that, in the sample period that we study which begins in 2012, CBs were more liquid for the first half of the period (during which the sovereign debt crisis occurred in southern Europe and the European Central Bank provided support to the CB market in the form of a substantial purchase program (see Smith (2020)). But senior ABS have been more liquid than CBs during most of the second half of the period (which includes the Covid 19 crisis).*" Not only the period bias is confirmed, it happens that part of the explanation of the greater CB liquidity is the ECB support of the CB market.

The authors of the paper, Perraudin and Qiu, concluded in April 2022: "*Key findings are that while CB were generally more liquid in the early 2010s, since 2016, senior ABS have been consistently and generally more liquid even in the 2020 Covid-19 crisis. The study builds on an earlier Risk Control analysis of ABS and CB liquidity, Perraudin (2014). Like that earlier analysis, we find that even in the European sovereign debt crisis period of 2011-14, the more liquid ABS were comparable in liquidity to the more liquid CB. The significance of these findings is that ABS and CB are treated very differently in the current regulatory rules on bank liquidity, specifically the eligibility criteria for inclusion in bank Liquidity Coverage Ratios. The evidence provided here suggests that senior ABS should be included*

[36] https://www.riskcontrollimited.com/insights/comparing-abs-and-covered-bond-liquidity/

within higher LCR categories than is currently the case."

Thus, academic research indicates clearly that the current LCR treatment of securitisation is unfair. And that despite unfavourable legislation, when no active central bank support is provided to the CB market, securitisation is more liquid or similarly liquid than CBs. Should the LCR treatment reflect this reality, bank treasurers would significantly invest in senior tranches of European securitisations, thus facilitating the capital flows between European countries, contributing materially to making the Capital Markets Union a reality.

Furthermore, it is important that the European authorities realise that liquidity regulation in the CRR does not affect only banks. It affects the investors' perception of the European securitisation market. For example, a (re)insurer is interested in knowing the bank liquidity treatment of a senior tranche, as in the even it needs to liquefy a senior tranche[37], its price will depend on whether banks can buy it at a fair price, which itself depends on the banks' LCR classification and haircut for that instrument, and potential ECB eligibility and repo-ability.

4.2.3 The cure

Paris Europlace, therefore, reminds the previous proposition of the European Banking Federation (EBF). After taking the views of its members, the various national banking federations, the EBF proposed in October 2021 a concrete remedy, that is still valid today:[38]

- To promote to Level 1 extremely high-quality STS senior tranches backed by residential and auto loans, which are the most liquid types of securitisation, with a haircut of 7%;
- To promote to Level 2A the senior tranches backed by SME loans and other consumer loans;
- To allow qualifying non-STS securitisations to classify as Level 2B, with haircuts aligned to those applying to CBs.

This would send a strong positive signal, encourage further investment, and help the dynamic of the secondary market. Such a treatment would remain prudent compared with the ECB collateral eligibility rules, which apply a mere 5% haircut on the best ABS categories.

Work on eligibility criteria and alternative proposals is still in progress, and alternative proposals will be made shortly.

In case the EBF proposal was to be adopted, it could be implemented through three simple amendments:

1. First amendment: *Article 10 of Delegated Regulation (EU) 2015/61*

   Level 1 assets
   "1. Level 1 assets shall only include assets falling under one or more of the following categories and meeting in each case the eligibility criteria laid down herein:
   (…)
   (h) exposures in the form of asset-backed securities where the following conditions are satisfied:

   — ***(i) the designation 'STS' or 'simple, transparent and standardised', or a designation that refers directly or indirectly to those terms, is permitted to be used for the securitisation***

[37] (Re)insurers invest their insurance premium into financial assets (such as sovereign bonds, covered bonds, etc.) with a view to sell those instruments in the event that insurance claims occur (e.g., earthquakes, flood, etc.). (Re)insurers assess the liquidity mechanisms of the instruments they invest in.

[38] Relaunching the European Union's securitisation market: What needs to be done in the context of the Capital Markets Union – technical paper. EBF_045363. 6 October 2021

in accordance with Regulation (EU) 2017/2402 of the European Parliament and of the Council and is being so used;

— ***(ii) the position has been assigned a credit assessment by a nominated ECAI which is at least credit quality step 7 in accordance with Article 264 of Regulation (EU) No 2017/2401 or the equivalent credit quality step in the event of a short-term credit assessment;***

— ***(iii) the issue size of the tranche shall be at least 500 million (or the equivalent amount in domestic currency);***

— ***(iv) the criteria laid down in the following paragraphs of Article 13 are met:***

a. paragraph 2 with the exception of (i) (ii) and (iv) of point (g)

b. paragraphs 10, 12 and 13

2. The market value of extremely high-quality covered bonds ***and extremely high-quality asset-backed securities*** *referred to in paragraph****s*** *1(f)* ***and 1(h)*** *shall be subject to a haircut of at least 7%. Except as specified in relation to shares and units in CIUs in points (b) and (c) of Article 15(2), no haircut shall be required on the value of the remaining level 1 assets.*

2. Second amendment: *Article 13 of Commission Delegated Regulation (EU) 2018/1620*

Level 2B securitisations

Paragraph 2 (a) of the Corrigendum to be amended as follows:

*"****the position has been assigned a credit assessment by a nominated ECAI which is at least credit quality step 10 in accordance with Article 264 of Regulation (EU) 2017/2401 or the equivalent credit quality step in the event of a short-term credit assessment****".*

Paragraph 2(a) of article 13 (from (EU) 2015/61) would become:

*"****the position has been assigned a credit assessment by a nominated ECAI which is at least credit quality step 4 in accordance with Article 264 of Regulation (EU) 2017/2401 or the equivalent credit quality step in the event of a short-term credit assessment****".*

Former paragraph 14 of Article 13 mentioned above to be replaced as follows:

*"****the market value of each of the Level 2B asset-backed securities shall be subject to a haircut of at least 30%.***

3. Third amendment: *Article 11 of Delegated Regulation (EU) 2015/61*

Level 2A assets

(…)

(h) exposures in the form of asset-backed securities where the following conditions are satisfied:

— ***(i) the designation 'STS' or 'simple, transparent and standardised', or a designation that refers directly or indirectly to those terms, is permitted to be used for the securitisation in accordance with Regulation (EU) 2017/2402 of the European Parliament and of the Council and is being so used;***

— ***(ii) the position has been assigned a credit assessment by a nominated ECAI which is at least credit quality step 7 in accordance with Article 264 of Regulation (EU) No 2017/2401 or the equivalent credit quality step in the event of a short-term credit assessment;***

— ***(iii) the issue size of the tranche shall be at least 500 million (or the equivalent amount in domestic currency);***

— ***(iv) the criteria laid down in the following paragraphs of Article 13 are met:***

a. paragraph 2 with the exception of (i) (ii) and (iv) of point (g)

b. paragraphs 10, 12 and 13.

Finally, as stated above, from an operational perspective, the investment by banks in securitisation senior tranches will not only be unlocked by a better treatment of senior STS and non-STS in the HQLA. The simplification of the due diligence requirements and the improvement of the capital prudential treatment of the securitisation tranches bought will also be decisive. The recognition of EU equivalence of non-EU securitisations would also be of great help. This is an example of why a package approach is necessary to revive the securitisation market.

5 Policy Goal 4: Facilitate access to market participants

5.1 Background

Beyond the prudential issues faced by issuers and investors, the scale-up of the securitisation market also requires a true market to develop, both primary and secondary. For this ecosystem to develop, the market should be open to a broader range of issuers and investors, including UCITS funds, to increase volumes, which requires reducing existing barriers to entry and unnecessary regulatory burden for issuers and investors. Policy makers should introduce proportionality in due diligence and reporting requirements, notably as regards senior high-grade transactions, private transactions, and involvement of EU players in third-country transactions.

5.2 Recommendation 7: Review disclosure and due diligence requirements for supervisors and investors

Policy makers should review the current disclosure and due diligence requirements in order to more accurately meet the supervisors' and investors' needs, while limiting the burden of completing the regulatory disclosure to what is actually necessary.

Simplifying the reporting process would also benefit less frequent European bank issuers, and to that end, one could explore the consolidation of the multiple reporting formats and obligations currently affecting issuers and investors into an integrated due diligence and disclosure framework, which would allow for proportionality as a function of the type of transaction, based on different criteria.

5.2.1 Indeed, it is essential to differentiate the due diligence obligations and disclosure templates according to different categories of issuers and investors, based on the different asset classes, types of transaction and types of placement, with a view to adapting the nature and extent of information disclosure and due diligence requirements to these different situations.

The prescriptive templates produced by ESMA for the purposes of the disclosure under Article 7 SECR ("ESMA Templates") have been largely discussed among the different market participants. Some question the relevance of such templates, as opposed to a principle-based approach, while other question the appropriateness of the format of the ESMA Templates as they stand.

While we understand that a certain degree of standardisation is required for supervision purposes, we believe there is a consensus about the fact that the current templates are too detailed and that neither the investors nor the regulators need such level of details. While transparency is key for investors, any overdetailed disclosure reporting is in our view an obstacle to the development of the securitisation market and a comprehensive review would therefore be highly necessary.

We, therefore, believe that the current templates should be reviewed in order to more accurately meet the regulators' and investors' needs, while limiting the burden of completing the disclosure to what is actually necessary. Simplifying the report process would also benefit less frequent European bank issuers, and to that end, one could explore the consolidation of the multiple reporting formats and obligations currently affecting issuers and investors into a single reporting document format.

A debate has been taking place as to whether the same template (or format) of reporting should apply to public and private securitisations. This debate has raised the question of the definition of public versus private transactions (which currently depends on whether a prospectus has been established or not), but the answer to this question has proved to be complex and raise other issues.

We thus think that this criterion should not be the only one taken into account to determine the reporting regime, and that there should be a gradation of reporting depending on a more nuanced list of categories of transactions.

While transactions for which a prospectus has been established would always be subject to the full ESMA Templates reporting, other transactions would be subject to a proportionate reporting format depending on (i) the granularity of the securitised assets, (ii) the type of investors (regulated or not, subject to other reporting obligations or not), (iii) the existence of a secondary market (which make more unlikely the existence of a direct relationship and disclosure channel between the originator and the investors, and may result in the transfer to non-regulated investors), and finally (iv) the existence of confidentiality issues (which may impose the privacy of a detailed disclosure).

These different criteria could determine (a) where a loan-by-loan disclosure is both useful and practical (e.g. for public transactions, or for securitisation of certain categories of assets), (b) where the investors would rely mainly on a standardised disclosure (e.g. in respect of securitisation for which an active secondary market exists, and investors need to process a due diligence on automated and comparable basis), or where the relevant ESMA Templates would be in priority for supervisory purposes, and therefore (c) whether the regulatory disclosure should be publicly available or limited to either (i) the supervisors and/or (ii) the relevant investors.

While a detailed and standardised loan-level reporting may be required for public securitisations or securitisations of certain categories of assets, for which an active secondary market exists, subject always to warrantying the necessary level of confidentiality, this is not the case in other situations; for instance:

- certain categories of investors do not rely on the ESMA Templates to carry on their own due diligence and monitoring, and agree directly with the originator upon the type of disclosure they need;
- regulators do not review detailed loan-by-loan data, but instead process aggregated reporting based on the existing reporting used for ABCP transactions;
- in any event, originators would have the option to use a more detailed reporting template if they deem it appropriate.

All in all, such gradation of the disclosure would allow for more adequate and proportionate due diligence requirements. On the one hand, whilst standardised disclosure would allow investors in tradable asset-backed securities to implement automated or formatted due diligence, more sophisticated investors in tailor-made transactions, based on a more direct and ongoing relationship with the originator, would be authorised to determine the extent and the nature of information and reporting process and format best adapted to their needs, while ensuring (i) processable reporting for supervision purposes and (ii) confidentiality of the disclosed information where needed for commercial or legal reasons. On the other hand, the type of disclosure, whether on a loan by loan or aggregate basis, should be adapted to the level of granularity of the different asset classes.

To reduce barriers to entry on the market, it is necessary to streamline ESMA disclosure templates and adapt the related due diligence requirements. ESMA disclosure templates are not fit for purpose for private deals and represent an unnecessary costly burden. When determining reporting requirements, a clear distinction should be introduced made depending on the role of the investor: long-term investment versus market-making or hedging.

5.2.2 The diagnosis

A comprehensive analysis of the collection, distribution, and processing of the information and data for a single securitisation transaction highlights a complex landscape. Current regulations and market requirements necessitate the involvement of up to six distinct categories of "Data Stakeholders."

These stakeholders are responsible for creating, reporting, using, or processing various subsets of transaction and information documents, which are often saved in at least six different file formats: Acrobat pdf, Word doc, Excel xls, Text csv, Hypertext html, Business reporting xbrl. Table 5.1.1 shows the diversity of such processes.

Table 5.1.1: Reporting Entities and their file formats

Data Stakeholders	**Reporting Entities**	**Authorised Verification Agents**	**Rating Agencies**		**Securitisation Repositories**		**Regulators** [(1)]		**Investors (incl. ECB & NCBs/)**
Action	Send	Receive	Receive	Send	Receive	Send	Receive		Process
Format	pdf doc xls csv	pdf doc xls csv	xls	pdf html	(*) 95% of submissions in xls & csv, less than 5% in (ESMA) xml	(*) 99% ESMA templates downloads in csv, less than 1% in (ESMA) xml	xbrl (COREP)	xml (ESMA)	csv & xls

(1) ESMA, SSM via COREP, National Competent Authorities, European Central Bank and National Central Banks
(2) Sources: ECB, ESMA, originators, investors, rating agencies contacts
(*) *Repository Insights ESMA Disclosure Templates – Usage and Data Quality*, European DataWarehouse, March 2024
Source: Storied Data's response to ESMA Consultation on Securitisation template disclosure

The proliferation of disparate file formats and the multiple reporting sequences mandated by overlapping regulatory requirements at European and National level impose unnecessary burdens on Reporting Entities on the one hand, and on Investors, Data and Documentation consumers on the other hand. This complexity compounds the reporting of securitisation transactions, particularly when underlying collateral comprises thousands of exposures.

On top of this issue, there are different disclosure requirements also from a timing perspective at issuance and thereafter on a monthly or quarterly basis for the documentation as well as the loan-level data reporting requirements under Article 7.

The current convoluted reporting requirements often force Data Stakeholders to undertake extensive Extract, Transform, Load (ETL) processes, data quality verification and integration processes, leading to substantial costs, operational risk and potentially reporting delays. Moreover, the development and maintenance of the necessary infrastructure create significant barriers to entry, disproportionately affecting both potential new originators and investors.

A comprehensive analysis of these intricate, costly, and burdensome requirements, along with their complex interactions, can be found in the thoroughly researched article "Reviving Securitisation in the EU: A Critical Analysis of the Reporting Requirement," authored by Mrs. Olivia Hauet, Principal Economist at the ECB.[39]

5.2.3 The cure: a proportionate and integrated due diligence and disclosure framework

The framework and its related ESMA Templates should aim at providing investors and supervisors with a sufficient and proportionate level of information. Unfortunately, it is currently mis-calibrated and too burdensome, as it does not take into account the diversity of the securitisation market.

This complexity has been recognized by authorities for some time, and efforts have been made to simplify by differentiating requirements between public and private transactions. However, this

[39] This article was published on 2nd July 2023 in the *Journal of Financial Compliance*.

distinction may be blurred and may not adequately achieve the right balance between the need for relevance for investors and the legitimate transparency goal.

In this context, Paris-Europlace is currently exploring a framework that would differentiate the requirements based on a multi criteria approach.

As an example of a “decision tree” to determine the most appropriate reporting format, the following questions would be applied to a given transaction:

1. Is there a EU Nexus (the Originator, the SSPE or the sponsor, [but not the Original Lender only] is located in the EU or a EU Prospectus is established in respect of the securities)?

2. What is the nature of the underlying? (RMBS /CMBS/Automobile/Leasing/Large corporate loans/Trade receivables/SME loans/Consumer/Credit Card/Esoteric/ABCP)

3. Is it a public operation (as defined in the Prospectus Directive)? What is the placement method (a “private” transaction may be listed for legal purposes)?

4. Is it a buy and hold operation or a trading operation? (this criteria could be defined as an accounting/booking criteria, there could also be a reference to any restriction to the transfer of securities on the secondary market)

5. Is the transaction STS or non-STS?

6. Is the issuer subject to loan origination regulation (prudential, Mortgage, Consumer…)? If a bank, is the transaction SRT or not?

7. Is the investor a frequent buyer of the product (Mezzanine/senior, cash/synthetic, asset class, jurisdiction)?

8. Is the transaction part of a regular program of issuance (repeat deal)?

etc.

We believe that a more tailored approach to due diligence and reporting requirements would be a powerful way to reduce barriers to entry and scale-up the various market segments.

As regards the technical framework, we would like to remind that on the current ESMA reportings using LLD, a file review between ESMA and the stakeholders for simplification purposes is still required. Recent software developments in file formats and dynamic data-centric publishing and distribution platforms now empower each Reporting Entity to consolidate all reporting obligations for a specific securitisation (and any asset-based financing) by extracting all necessary data from various databases, including the loan-by-loan dataset. Subsequently, such developments enable the Reporting Entity to compile and store instantly these datasets and relevant information into a single universal reporting file/data carrier.

This single universal reporting file/data carrier would also contain additional data-centric content and information provided by relevant External Credit Assessment Institutions (ECAIs), along with additional rating scenario information, where available.

Periodically, the Reporting Entity will update the single universal reporting file/data carrier with relevant data and information available on each investor report date, ensuring timely fulfilment of

reporting obligations to investors through the securitisation repository, as well as to regulators, third-party verification agents, and rating agencies.

The implementation of the single universal reporting file/data carrier as a simple, unified, and transparent interactive document process is poised to play a crucial role in eliminating existing barriers to entry for new or occasional securitisation issuers.

Furthermore, the single universal reporting file/data carrier empowers each Data Stakeholder involved in a single securitisation transaction to:

- Access the relevant datasets, including loan-by-loan data at the launch date and on each investor report date.
- Automatically download the datasets and required information in any widely used file format (such as in xml, json, csv, xhtml, xls and tagged xbrl) via a simple 1-Click operation.
- Utilise innovative and interactive embedded analytical tools provided by the Reporting Entity. These tools facilitate institutional investors' access to immediate insights into pool and risk drivers, eliminating the need to invest in large, dedicated securitisation analyst teams. As a result, this removes barriers to entry for new investors.

The single universal reporting file/data carrier significantly expedites the reporting process, allowing for the simultaneous release of both the investor report and the loan-by-loan dataset. This would occur as soon as the securitisation repositories have validated the completeness of the securitisation dataset, typically within an estimated 7 to 14 days after the updated dataset release date.

5.3 Recommendation 8: Make Europe a centre of international, not only regional, securitisation finance

Finally, policy makers should acknowledge the importance of the position of EU institutional investors and banks in the global securitisation market and avoid penalising them by replacing the current requirement to apply ESMA templates to non-EU transactions, by a framework of equivalence or a mutual recognition.

EU institutional investors have been questioning whether it is appropriate to impose ESMA Templates to non-EU transactions, including transactions from MDBs who at the behest of the G20 have been encouraged to use securitisation techniques. In practice, there are many circumstances where EU institutional investors would manage to obtain appropriate disclosure, but in a format that does not comply with the ESMA Templates. Given that the securitisation market is global, it is critical that EU institutional investors can access the market as a whole, on a same level playing field with other global market players. This is also essential for bank involved in securitisation on behalf of financial or corporate clients, for them to be able to compete in global markets, including accompanying their EU clients in their non-EU securitisation programs. Accessing the large US and Asian securitisation markets is also a pre-requisite for these EU banks to have the scale allowing them to maintain dedicated expert resources, and develop a viable business model.

We, therefore, believe that so long as they can obtain appropriate disclosure, they should not be expected to obtain it under the ESMA Template. They should rather make sure that they obtain all the information required to carry out proper due diligence, and it should be clarified that the ESMA Templates, proportionate to the sole supervisory purposes, could be produced by the EU institutional investor itself, instead of expecting non-EU entities to comply with an EU regulation that is not applicable to them.

This derogatory regime must be based on a clear definition of EU transactions subject to the ESMA Templates disclosure requirement, as discussed above, as opposed to non-EU transactions. We believe that the non-EU derogation should apply when an EU institutional investor invests in a transaction with no EU nexus, i.e., where neither the originator, the sponsor nor the SSPE is located in the EU and no prospectus has been established in respect of the securities.

A number of these targeted adjustments can be implemented, either in level 2 texts, or as a quick win, as was done for the Capital Markets Recovery Package. Such a quick win would provide a strong signal to market participants, broaden the offer and demand, and could generate a significant flow of funding and risk transfer. Some more fundamental review of the quantitative framework will require more work and can be part of a comprehensive review to come as a second step.

Complex due diligence requirements and overdetailed regulatory reporting requirements under prescriptive formats create unnecessary costs and reporting delays, effectively preventing public and private securitisation from achieving its full potential to transfer risk away from banks and enable them to provide more financing to the real economy.

To achieve its critical role and be more efficient, the securitisation market also needs new EU issuers and new EU and non-EU investors: they are currently deterred by the entry costs caused by such 'mille-feuille' reporting and due diligence requirements but also face high costs in building the large-scale issuance and/or research infrastructures to operate and comply with a uniquely complex regulatory environment.

In addition, EU-based institutional investors face specific difficulties investing in non-EU securitisation transactions as non-EU reporting entities cannot or are not willing to provide EU investors with the full article 7 templated disclosure: **the adoption of a less prescriptive regime (principles-based approach) should be privileged.**

Finally, **for Europe to attract international investors, they need to operate and invest seamlessly across the world's financial markets from their new European headquarters. International investors do not limit themselves to investing just in Europe. This means the due diligence regime needs to be streamlined with respect to content and formats to reflect needs and practices outside the European borders. Without reforms, the European Union will not be an attractive place for international securitisation investors.**

We recommend harnessing recent technological developments which support a radically simpler, comprehensive and integrated reporting and analytic framework for each public securitisation transaction in a timely and cost-effective manner.

Creating a single universal reporting file/data carrier for each securitisation transaction cuts drastically operating and reporting costs, reduce materially reporting delays and errors and eliminates existing barrier to entry to new issuers and investors. Furthermore, universal data download facilities and robust in-depth analytical capabilities augment transparency and greatly facilitate extensive due diligence and risk assessment, thus removing barriers to entry to new institutional investors.

Since time is of the essence, Paris Europlace proposes that **ESMA sponsors a European-wide private initiative involving representatives from all categories of Data Stakeholders (reporting entities, investors, regulators, securitisation repositories, authorised verification agents, rating agencies, and data providers) to streamline the Reporting Entity multiple reporting obligations for each securitisation transaction into single universal reporting file/data carrier**. This initiative might be modelled on the ECB's sponsorship of the private industry group initiative, titled "ECB ABS Loan-Level Initiative", which led to the successful and impactful creation of the European DataWarehouse.

To keep current regulatory disclosure requirements in perspective, the ESMA Article 7 consultation reports on page 29, paragraph 82, that "*the current transparency regime consists of 1350 fields, of which over 600 are unique, distributed across 14 distinct templates*". It will be critical to review which fields are deemed 'nice to have' (and thus non-mandatory) and only retain the essential data required for risk assessment for each designated asset class.

Under the current due diligence obligations regime, EU-based investors face particular difficulties investing in transactions where non-EU reporting entities cannot or are not willing to provide EU investors with the full Article 7 templated disclosure. This is an issue for the EU, which aims to attract international investors that need to invest across the world, not just in the EU; without reforms, international securitisation investors will not be able to invest outside the European securitisation markets from their newly established EU base.

Thus, Paris Europlace proposes the timely adoption of a principles-based disclosure regime applicable to non-EU securitisation enabling EU-based investors investing in non-EU securitisations to use "**substantially the same (or at least sufficient to perform their risk assessment)**" information as stipulated in EU securitisation disclosure templates applicable to that relevant asset class, thus acknowledging that disclosure may vary on some specific aspects, in accordance with local market practices, but that it should allow investors to make an informed risk assessment of the exposure.

For reference, the UK FCA & the UK PRA published on 30th April 2024 such due diligence principles-based rules applicable from 1st November 2024 onwards to UK-based investors investing in non-UK and non-EU securitisation, as outlined by law firm Freshfields in its May 15th "Introducing the new UK securitisation rules".[40]

"*Due diligence for institutional investors. A more principles-based approach has been applied to the disclosure institutional investors must obtain from manufacturers of securitisations.* ***UK institutional investors will no longer need to be concerned about what format reporting takes, provided they receive information sufficient to assess the risks of holding the securitisation position.*** *The disclosure will need to include certain types of information as prescribed at a high level in the rules and be provided in the required timeframes but will not need to be provided in templated format.*

This should make it easier for UK institutional investors to invest in non-UK securitisations. Note that UK manufacturers will still need to complete UK standardised disclosure templates to comply with the new UK securitisation rules. They may also need to provide EU standardised disclosure templates to any EU institutional investors investing in their securitisation (in line with the current EU rules)."

[40] https://transactions.freshfields.com/post/102j7q7/introducing-the-new-uk-securitisation-rules

6 Conclusion

This report identifies a number of targeted, prudent, risk-sensitive amendments that should be implemented as a quick win, for securitisation to develop early in the new legislative cycle play at full scale in the financing of EU ambitions.

Concerns expressed by some stakeholders should not be exaggerated:

- The remaining stigma from the Global Financial Crisis is largely undue as regards EU securitisation. EU securitisation credit performance has remained very good, through the cycle, on the back of responsible and prudent credit origination policies by banks[41]. In addition, a complete overhaul of the securitisation regulation has been implemented in the EU, for both STS and Non-STS transactions, addressing the flaws that led to the crisis (interdiction of re-securitisation, retention requirement, extensive due diligence and transparency requirements, regulation and oversight on rating agencies, etc.).

- **The change in the ECB monetary policy stance since 2022 will not suffice to revive the market.** From a pure funding perspective, Covered Bonds remain the most liquid and the cheapest secured funding market for EU banks. Hence, securitisation would not cannibalize the Covered Bonds market, but complement it, for banks that need to transfer risk, reduce capital requirements, and reinvest the freed-up capital into new business. This increased velocity of the balance sheet would in turn enhance profitability and competitiveness of banks, favouring banks' access to equity markets and consequently enhance their resilience.

- **A development of the EU securitisation market, from the current low base, would be far from generating excessive financial stability risks. Instead, it would rather contribute to financial stability by enabling a higher diversity of sources of capital to be channelled to financial institutions, thus contributing to more harmonized funding conditions for European businesses and households.[42]**

  - Looking at current issuance volumes in the EU, it is clear that securitisation issued by EU banks out of their own balance-sheet does not have the scale that may generate a systemic risk, and would have considerable room for growth before reaching a potentially worrying level. By end 2023, based on IACPM survey results, roughly EUR300bn of loans were securitised by EU banks in a synthetic format, with EUR24bn of first loss protection, out of a total of EUR5tr of loans carried by European banks on their balance-sheets. This volume can significantly increase, and benefit real economy growth in all members states.

  - According to research by BNP Paribas Exane[43], based on banks' Pillar 3 data, securitisation today reduces RWA of banks by 0 to 5%. This low level of risk transfer could be largely expanded before representing an excessive reliance on securitisation. In a scenario where this range were to increase to a 3% to 10% range, banks would save up to EUR50bn in capital requirement, representing up to 15% of their market capitalization, which would strengthen their resilience.

[41] See Appendix A4 - Credit performance of securitisation

[42] See Appendix A6 – Financial Stability

[43] BNP Paribas Exane European Research – Securitise to energise – 13 May 2024 – Restricted access – Bank data as of 31 December 2023 – BNP Paribas Exane estimates

Assuming that the saved capital would be reinvested in new lending, the amount of financing that could be unlocked could reach EUR2.9tr over time, or about 15% of EU GDP.

- Securitisation is a bridge between bank origination and market financing or risk taking. By developing securitisation, loan origination as performed by banks, under strictly regulated and supervised origination and monitoring frameworks, protects borrowers and investors/risk takers, and reduces the risk of weakening credit standards. In the context of a European economy largely financed by banks, developing securitisation is a way to avoid that the financing of the EU strategic ambitions be constrained by the capacity of banks to carry those additional exposures on their balance-sheets.
    - Enabling (re)insurers to grow their role as providers of credit protection further diversify the risk profile of the ultimate holders of risk, such as pensioners and therefore improves financial stability.
    - Securitisation (unlike covered bonds) is a way for issuing banks to cap their losses in extreme circumstances, which improves their resilience. It is also a safe way to develop private risk sharing, and enhance the resilience of the Euro area and the EU financial system as a whole.
- **The EU should not wait for the BCBS to solve its problems.**
    - The 2013 BCBS framework on securitisation has not been implemented in some jurisdictions, including the US.
    - The securitisation standard is not on the agenda of the BCBS, according to the most recent work programs and speeches.
    - The EU led the way to develop a Simple, Transparent and Standard (STS) framework, which was closely followed in Basel by a (much less restrictive) Simple, Transparent and Comparable (STC) framework. The EU could take the lead once again to design a new, more risk sensitive framework, supporting a prudent and responsible development of the EU securitisation market.

In order to ensure that the securitisation agenda achieves the overall goals set by the political leaders, in an efficient and timely way, Paris Europlace also sees several key success factors to consider.

First, **the Joint Committee on Securitisation should be empowered to drive the process in close liaison with DG-FISMA.** Securitisation is a technical, and multifaceted topic, as there are multiple legal and regulatory texts addressing various aspects or types of regulated entities. Therefore, the capacity to ensure consistency, in both substance and timeline, across the various regulatory bodies involved is key to ensure a proper implementation and achieve the targeted outcome. An evolution of the role and governance of the Joint Committees could be envisaged as part of the upcoming ESAs review.

Second, dialogue with practitioners is essential. This dialogue must be permanent, transparent, and constructive. It needs to include the whole ecosystem, from investors to issuers, but also rating agencies, label providers, law firms, accountants etc… Such a variety of expert profiles do not exist in the existing ESAs Stakeholder Groups. **A dedicated Securitisation Experts Group should be created to institutionalize the existing dialogue across various types of players, the Joint Committee and involved regulators.**

Third, **the targeted recommendations proposed in this report should be implemented as a package**, given challenges and solutions are different between transactions originated by banks, subject to CRR/CRD and other types of issuers, insurers offering funded or unfunded protection, subject to Solvency 2 and other types of investors, senior tranches of public transactions issued for funding purposes, of private Significant Risk Transfer (SRT) tranches of securitisations, and junior tranches, STS and Non-STS segments, noting also the different scopes of application of prudential regulations (EU banks, EU insurers), and of the securitisation regulation SECR (covering all transactions, STS and Non-STS, and all issuers and investors acting in the EU, including when involved in third country transactions).

A cherry-picking approach, consisting in favouring a specific market segment, would be counterproductive as it would not offer the critical mass that issuers and investors need to invest in resources. Indeed, for teams to originate, structure, analyse and monitor securitisation transactions a too small niche within the already subscale securitisation market is not sufficient. Examples of past attempts were to focus on SME securitisation, NPL securitisation, and now green securitisation. If the securitisation framework were to be appropriately repaired, there will be SME securitisations, NPL securitisations, green securitisations, and with much larger amounts than if sub-niches are addressed in isolation. Indeed, such niches in the niche cannot prosper without a dynamic overall securitisation ecosystem.

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All in all, policy makers should ponder the potential risks in an ambitious development of EU securitisation, with the likely consequences of <u>not</u> developing securitisation. Indeed, facing the competitiveness gap that the EU has let develop in the last decade, not acting urgently is actually taking a bigger risk than moving, as securitisation is one of the lowest hanging fruits in the renewed Capital Market Union agenda.

Concrete, targeted, risk-based and proportionate measures for reducing capital, liquidity and operational costs, bringing back investors (banks, insurers and funds) and issuers (banks and non-banks), as those proposed in this report, can be implemented quickly to scale-up volumes and improve market execution while maintaining financial stability.

In this context, we welcome the consultation by the European Commission announced by Commissioner McGuinness and expected by October 2024, covering both issuers and investors, and we stand ready to contribute to the discussion.

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7 Appendix A1: Key extracts from recent speeches and statements on securitisation

1. **A Kantian shift for the capital markets union – Speech by Christine Lagarde, President of the ECB, at the European Banking Congress[44]**
"Despite two European Commission action plans, Europe's capital market remains fragmented. […] A genuine CMU would mean building a sufficiently large securitisation market, allowing banks to transfer some risk to investors, release capital and unlock additional lending. In the United States, banks have access to a securitisation market that is three times the size of Europe's. This could be even more powerful in our bank-based financial system." (17 November 2023)

2. **Statement by the ECB Governing Council on Advancing the Capital Markets Union[45]**
"It is clear that the EU needs to move beyond broad statements and a piecemeal approach on CMU […]. Ensuring that the EU securitisation market can play a role in transferring risks away from banks to enable them to provide more financing to the real economy, while creating opportunities for capital markets investors. This requires understanding the supply and demand factors relevant for the development of the securitisation market, including (a) reviewing the prudential treatment of securitisation for banks and insurance companies and the reporting and due diligence requirements, while taking into account international standards and (b) exploring whether public guarantees and further standardisation through pan-EU issuances could support targeted segments of securitisation, such as green securitisations to support the climate transition." (7 March 2024)

3. **Statement of the Eurogroup in inclusive format on the future of Capital Markets Union[46]**
"*Develop the EU securitisation market to allow for the efficient and transparent transfer of risks to parties best equipped to carry those risks. We invite the European Commission to comprehensively assess all the supply and demand factors holding back the development of the securitisation market in the EU. This assessment should cover, inter alia, the adequacy of our toolbox, including the prudential treatment of securitisation for banks and insurance companies and the reporting and due diligence requirements. The European Commission should consider coming forward with corresponding proposals, taking into account international standards*." (11 March 2024)

4. **Prime Minister Enrico Letta's report "Much More Than A Market" – Speed, Security, Solidarity – Empowering the Single Market to deliver a sustainable future and prosperity for all EU Citizens[47]**
"Securitization acts as a unique link between credit and capital markets. In this sense, the securitization market offers significant potential. Increasing its utilization brings two key benefits: i) broadening and diversifying the pool of assets available for investment, and ii) unlocking banks' balance sheet capacity to facilitate additional financing. Moreover, the adoption of green securitization, whether through securitizing green assets or directing securitization proceeds towards green financing, holds promise as a significant contributor to the transition towards sustainability. Therefore, we advocate for reforms in the European securitization framework to enhance its accessibility and effectiveness. […]
Roadmap: By 2025: Revise the securitization framework to simplify the utilization of this instrument, crucial for diversifying asset investment and releasing banks' balance sheet capacity. This, in turn, will enable bank to offer additional financing." (17 April 2024)

[44] https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp231117~88389f194b.en.html

[45] https://www.ecb.europa.eu/press/pr/date/2024/html/ecb.pr240307~76c2ab2747.en.html

[46] https://www.consilium.europa.eu/en/press/press-releases/2024/03/11/statement-of-the-eurogroup-in-inclusive-format-on-the-future-of-capital-markets-union/

[47] https://www.consilium.europa.eu/media/ny3j24sm/much-more-than-a-market-report-by-enrico-letta.pdf

5. **Honorary Governor Christian Noyer's report on *Developing European Capital Markets to Finance the Future – Proposals for a Savings and Investments Union*[48]**
"The second key proposal is to finally revitalise the securitisation market, to back the lending capacities of European banks by deep capital markets. […] In reality, Europe has implemented a much more restrictive framework than other jurisdictions, especially the United States. While it has wisely prohibited potentially harmful securitisation practices (such as re-securitisation, securitisation without retention, etc.), it has maintained excessive prudential penalties and regulatory burdens, calibrated on practices that are no longer relevant.
In this context, it is imperative to quickly correct the regulatory and prudential framework for securitisation. The first priority should be to restore the investor base by correcting the prudential framework applicable to insurers and by extending eligibility to liquidity buffers for banks (LCR). The second priority is to simplify transparency rules to facilitate both the issuance and acquisition of securitised assets, particularly through a lighter content and better delineation of the scope of ESMA's disclosure templates. Finally, the banking prudential framework must be adjusted (particularly rebalancing the p-factor), even if this implies deviating from Basel rules, as other major economies, namely the US, already do and will continue to do. All these regulatory and prudential measures are now well identified and mostly consensual. The only missing element is a rapid implementation schedule." (25 April 2024)

6. **ESMA Position Paper on *Building More Effective and Attractive Capital Markets in the EU*[49]**
"Improving the functioning of the securitisation market can help enhance the symbiotic relationship between bank and market-based financing. […] Recommendation 10: Reviving the securitisation market in the EU:
The size of the securitisation market in the EU has decreased significantly since the Global Financial Crisis and continues to languish far behind global competitors. While the introduction of the Securitisation Regulation, as well as the Simple, Transparent and Standardised (STS) label for traditional securitisations, in 2019 represented an important step forward, the framework has not yet produced all the expected results.
The European Commission should put forward a proposal aiming to revitalise the EU securitisation market, on the basis of a holistic and comprehensive review of the current framework. While remaining conscious of potential risks to financial stability and investor protection this should particularly look at prudential treatments, due diligence rules for institutional investors, reporting requirements for certain types of assets, the consistency of STS criteria and the supervisory process. The ESAs will provide advice to the Commission in this respect in Q4 2024." (22 May 2024)

7. **FT Article by French President Emmanuel Macron and German Chancellor Olaf Scholz[50]**
"[…] our collective investment efforts, both private and public, must match our ambitions. We need to unlock the full potential of our capital markets […]. To mobilise the needed investments we have to get serious about a truly integrated European financial market with the banking and the capital markets union at its core, addressing fragmentation and ensuring global competitiveness of the European financial sector… In doing so, we will have to relaunch the European securitisation market […]." Extract from "Macron and Scholz: we must strengthen European sovereignty", *Financial Times* (27 May 2024)

[48] https://www.tresor.economie.gouv.fr/Articles/2024/04/25/developing-european-capital-markets-to-finance-the-future

[49] https://www.esma.europa.eu/sites/default/files/2024-05/ESMA24-450544452-2130_Position_paper_Building_more_effective_and_attractive_capital_markets_in_the_EU.pdf

[50] https://www.ft.com/content/853f0ba0-c6f8-4dd4-a599-6fc5a142e879

8 Appendix A2: Securitisation: an essential and diverse tool to finance the economy

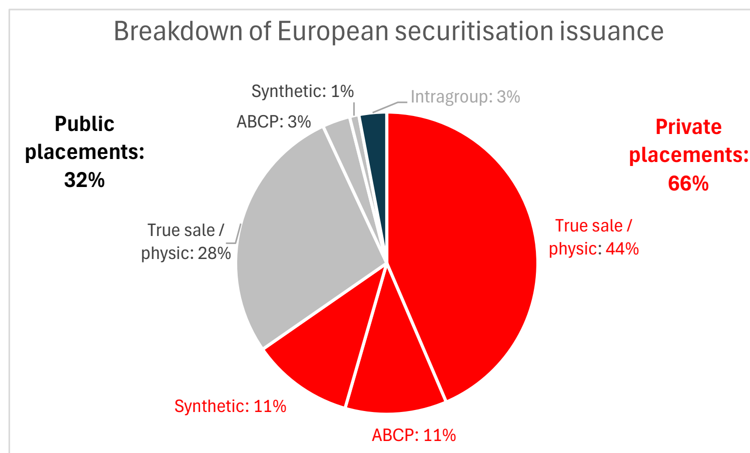
8.1 A diverse universe of securitisation instruments

Securitisation is an asset class serving a wide range of financing, risk management and investment needs. In other words, securitisation is **an essential tool to finance the economy**. It enables the efficient allocation of risk to investors best suited to bear it. Like covered bonds, securitisation can serve as a refinancing tool. However, unlike covered bonds, it can also allow for risk sharing, which allows to reinvest freed-up capital in new loans, increasing the velocity of the balance-sheet and allow for more efficient funding of the economy.

Securitisation is a mechanism by which the funding and/or the risk of illiquid credit portfolios, originated by banks or non-banks, are transferred to investors, namely asset managers, insurance companies, sovereign wealth funds, specialist credit funds, etc. That transfer occurs through the repackaging of these assets and dividing the resulting pool into tranches with different priority of payments, i.e., different risk profiles. Investors can choose the tranche(s) with the most appropriate risk profile for them, as a function of their credit preferences, investment policies and return targets, credit skills and liquidity requirements. Applicable prudential regulation is also a key driver of investor appetite, for prudentially regulated institutions, namely banks and insurance companies.

Securitisation can be used in various forms by different market players for numerous objectives. Market dynamics must be observed for each of the market segments and tailored solutions must address the existing obstacles in each market segment.

The following graph shows the diversity of the types of transactions in the European securitisation market:



Source: Joint Committee advice on the review of the securitisation prudential framework, Noyer report (2021 data)

It should be noted that the European Securitisation Regulation has an overly broad scope due to the definition of securitisation that captures (unintendedly) some transactions such as specialised lending financings. It applies to a much wider range of transactions than in other jurisdictions, where securitisation is more narrowly defined as transactions consisting of issuing a security, thereby excluding many types of private transactions.

This appendix explains how securitisation can answer the needs of a diverse universe of originators (Subsection 8.2), the needs of an even more diverse universe of investors (Subsection 8.3), and the dynamics for key market segments (Subsection 8.4).

8.2 A diverse universe of originators of securitisation transactions

Securitisation encompasses a broad universe of transactions with a variety of originator types and objectives. Indeed, originators can be any entity willing to raise secured financing, improve its balance sheet and/or transfer risk for capital purpose (regulatory or economic). Similarly, the legal execution and the format will vary depending on the nature of the transaction, the size of placed tranches (if any) and the distribution targets of the originator (or sponsor).

While banks and credit institutions, who finance a vast majority of the EU economy, naturally play an important role as issuers of securitisation transactions, both in cash and synthetic format, non-banks (private credit funds, digital lending platforms…) are also using securitisation as a source of funding, and Corporates are also traditionally very active in financing trade receivables and other portfolio of assets through securitisation, through public (ABCP) and private (secured lending) refinancing.

8.2.1 Banks

Securitisation portfolios are typically selected from their balance sheet. Securitisation allows the risks associated with such assets to leave the banking system partially or fully, and to be shared among multiple market participants according to their risk appetite. It, therefore, allows banks to free up capital hence providing them with more opportunities to extend funding to their clients, such as SMEs, which do not have individual direct access to capital markets.

Banks use securitisation as a funding tool, a portfolio management instrument for managing risk and/or capital, or both. Indeed, financing needs have a funding and a risk component. In the European market, the funding and the risk components of securitisations are increasingly managed as separate issues and are addressed by different markets. Full capital structure transactions are also becoming popular for retail assets such as consumer and auto loans, as originators are also using securitisation for funding (for instance specialised consumer lenders pertaining to banking groups). Regulatory constraints vary depending on the type of transactions.

Securitisation transactions from originating banks are structured as a function of the banks' funding, risk sharing, accounting treatment needs, and the sought objectives such as:

- **Financing**

  The European securitisation market began in the 1980s with originating banks issuing mostly public Residential Mortgage-Backed Securities (RMBS) and Asset-Backed Securities (ABS) for funding purposes. In such transactions, they can raise non-recourse secured debt from capital markets investors (other banks' treasuries, insurance companies, pension funds, specialised funds, etc.). As a result, they are able to diversify their funding sources.

  Given that investors have no recourse to the issuing banks, only to the underlying portfolios, this funding is generally more expensive for the issuing banks than covered bonds. Hence the preference given, when possible, to covered bonds in Europe as a secured funding tool.

  Nevertheless, there are circumstances where using securitisation for funding purposes makes greater sense, as:
    - it gives access to a different, potentially broader range of investors;
    - unlike covered bonds, the sold tranches are generally not included in the credit limit investors have on the issuing bank, freeing up room for such investors on other debt products from the issuing bank, including senior debt, MREL, AT1, etc.;
    - the type of assets that are eligible to covered bonds is limited, whereas all types of credit exposures can be theoretically securitised, with structures and pricing that obviously depend on the quality of the underlying portfolio.

When the objective is financing, the execution of traditional securitisations, also called funded or 'cash' securitisations, involves the 'true sale' of the securitised assets to a dedicated special purpose vehicle (SPV). Such SPV is bankruptcy remote from the originating bank, and issues in turn several tranches of securities. For retention purposes, the originating bank must retain some of the tranches, and for cost optimisation purposes, banks tend to retain the first loss/mezzanine tranches. As a result there is very limited risk transfer in those transactions, the Significant Risk Transfer (SRT) criteria are not met, and, assuming there is no accounting deconsolidation, the SPV is consolidated back on the bank's balance-sheet, and the securitised asset continue to be capitalised as before securitisation (similarly to a covered bond).

Transactions can be placed publicly or privately, depending on size and distribution objectives.

- When transactions are placed publicly, they are generally rated by at least external credit agencies, which are deeply involved in the structuring assessment and risk evaluation of the securitisation tranches.
- When transactions are placed privately (in a bilateral or club deal format), external ratings may or may not be needed (at least in public form), and investors are themselves in charge of the due diligence.

Given the high cost of raising cash through securitisation compared to central bank facilities (such as TLTRO), deposits or covered bonds, European banks tend to use 'cash' securitisation more for contingent liquidity management. In this situation, senior tranches of securitisations are not placed, but 'retained' by originating banks, contributing to the liquidity ratios. Such tranches can be used as collateral for repo financing with central banks[51] or private lenders, a cheaper source of funding than public placement. When not employed in collateral operations, they remain in a form that can be sold or refinanced more easily in case of liquidity stress; as such they contribute to the banks' liquidity buffers. Retained transactions represent approximately 50% of total issuance in cash format. In this case, the bank does not benefit from a "Significant Risk Transfer" assessment, and therefore continues to account for and capitalize for the securitised assets as if they were not securitized.

- **Risk transfer or risk sharing**

Financial institutions also use securitisation as a solution for managing their balance sheet, either for capital release or for risk mitigation purposes (e.g., reducing exposure to some sectors or regions). In this instance, banks will sell or protect primarily the junior and the mezzanine tranches of securitisations backed by loan portfolios.

This 'on-balance sheet' (OBS), unrated, private securitisation market has been developed in Europe in a synthetic format so that banks' credit portfolio managers are able to actively manage the capital absorbed and the return of the underlying assets relative to the risk. When such securitisations meet the regulatory criteria for Significant Risk Transfer (SRT), this frees up capital and new lending capacity, because banks can then release part of the capital they had to hold for the risks of the underlying assets. In this market, funding and risk are managed separately.

In synthetic securitisations, the securitised receivables are not transferred and thus remain on the balance sheet of the buyer of protection (the bank). It should be noted that the absence of "true sale" simplifies considerably the execution from a legal and operational standpoint, and enables also to avoid the establishment of a Special Purpose Vehicle. The bank simply purchases credit protection on a specified portfolio of loans from a third party (seller of protection) – for instance, an insurance company, a multilateral bank, an investment fund or a pension fund.

[51] See paragraph 1.2.1.2 for description of the ABS collateral policy of the ECB

Beyond the pure credit default swap structure, which is rarely used in Europe, various structures can be adopted, depending on investors demand of investing cash, or only providing unfunded protection, with consequences as well on the regulatory treatment:

- An SPV can be set up, raise cash from investors and act as seller of protection to the bank, with the issue proceeds being retained to collateralise the SPV obligations vis-à-vis the buyer of protection (in case the protection seller is called to indemnify losses).
- Credit Linked Notes with embedded guarantees – issued directly by the banks – or collateralised guarantees are most commonly used to combine funding and risk sharing and mitigate counterparty risk, without the operational burden of creating and managing an SPV.
- Unfunded credit insurance has also developed (see below).

When a bank issues a securitisation transaction for risk transfer purposes, in order to recognize the benefit of the transaction from a regulatory capital point of view, it needs to obtain a "Significant Risk Transfer" assessment from its Competent Authority. If this assessment is obtained, banks can derecognize the securitised portfolio from its RWA calculation, and replace it by a RWA calculation on the retained tranches, following the securitisation prudential framework as defined in CRR.

This recognition of Significant Risk Transfer is critical as, if the bank pays the cost of securitisation, including remunerating investors or risk-takers for the risk they take, without obtaining a commensurate reduction of its prudential capital requirement, the securitisation transaction is destroying value for the bank, and therefore, it just does not happen.

Consequently, in the decision-making process leading to issue a securitisation transaction, banks are carefully assessing the economic value of the transaction, which depends on one hand on the pricing of the tranches to be sold or protected, and on the other hand on the capital relief obtained. This analysis can be summarised by two fundamental metrics:

Decision Metric	Decision Threshold	Formula
Economic Value (EUR)	> 0	$\sum_{t=0}^{t=Clean-Up} Net\ Cost\ of\ Protection\ - Net\ Comparison\ Capital\ Cost$
Cost of Capital (transaction)	< Cost of Capital (Issuer)	$\sum_{t=0}^{t=Clean-Up} \frac{Net\ Cost\ of\ Protection}{Net\ CET\ 1\ Capital\ released}$

In simple terms, the issuance decision is a function of whether the capital released by the securitisation transaction can be reinvested in new capital allocation at a better return on capital. While the cost of securitisation is driven by the structure and the prices requested by the counterparts, the amount of capital relief is a direct function of the prudential framework applied to retained tranches, compared to the RWA of the portfolio before securitisation.

- **Accounting**

Securitisation transactions may also have an impact from an accounting standpoint.

In most cases, securitisation SPVs are not deconsolidated from the bank's balance sheet. This is due to the significant strengthening of IFRS consolidation rules which followed the GFC. In short, a bank can only deconsolidate a legal entity if it can demonstrate that it does not have the majority of the profits, risks, and control of the legal entity's assets. Such a demonstration is extremely difficult to argue, given retention rules, and the active role that the bank generally continues to play in servicing the portfolio, including NPL management (and the related incentives).

Consequently, in most cases, securitisation has no impact on the size of the banks' balance sheets (unlike pre-GFC where a lot of vehicles were deconsolidated, notably in the US, and had to be supported by their sponsor when the entity became unable to fund itself). This means that even when Significant Risk Transfer is achieved, allowing for some RWA savings, other non-risk-sensitive regulation continue to apply, such as the leverage ratio, the G-SIB scoring, the MREL/TLAC requirement, etc.

Only in case of 'true sale' where portfolios are sold to third parties or where most tranches are sold (subject to vertical retention) can the securitised loans be deconsolidated, and allow a reduction of the balance sheet. For example, securitisation of NPL portfolios has helped some EU banks to deleverage and accelerate the clean-up of their balance-sheet after the euro sovereign crisis.

8.2.2 Corporates

Corporates are also using the securitisation market to finance their real economy activities through numerous private and bilateral transactions with their banks, typically to finance trade receivables with securitisation programmes refinanced through Asset-Based Commercial Paper (ABCP). In this segment, aside from providing liquidity to the market, banks also have a vital role to play as sponsors or market-makers.

ABCP financing is an important source of funding for the real economy, especially corporates and SMEs. It is appropriate for financing critical activities such as vendor financing (leasing companies, autos, SMEs) and working capital needs (trade receivables).

Multiseller ABCP programmes refinance diversified portfolios of securitisation transactions (mostly senior exposures) via the issue of short term ABCP, mainly sold to money market funds in Europe, the UK, and the US.

In Europe, the vast majority of the programmes (if not all) are fully supported by liquidity lines granted by the banks sponsoring each programme. These lines guarantee the roll-over of the commercial paper at maturity, which results in the ABCP being rated at the level of the ratings of the sponsor bank. Sponsor support in ABCP can be seen as analogous to sponsor full support for covered bonds.

The most frequent assets to be securitised by corporates are trade receivables. Trade receivable securitisation has developed early (in the 80s), supported by large European banks setting up ABCP conduits. Automotive groups have also been early adopters through their captive finance arms. As the market has developed, originators have become more diverse in terms of profile.

Corporate companies (large or small) can raise financing on a revolving basis thanks to the securitisation of their trade receivables or sell them on a non-recourse basis to a dedicated programme, with the purchaser using securitisation for refinancing the purchased receivables. For instance, corporate companies can have programmes under which they will sell their entire trade receivables portfolios on a non-recourse basis and thus achieve off-balance sheet treatment (and financing) under the relevant accounting standard (also with rating agencies and financial analysts in some instances).

In this important market segment, and while corporates are not subject to prudential regulation, they are subject to the SEC-R legislation, and sponsor banks are subject to CRR securitisation framework.

While the corporates are not subject to prudential regulation, they are still subject to the Securitisation regulation, and one of the biggest challenges has been the difficulty to achieve an STS label for ABCP programs. As sponsors and market makers, banks also carry on their books liquidity lines and other types of credit exposures, as part of their traditional corporate lending business. Those lines are subject to prudential securitisation rules, which limits considerably their growth.

8.2.3 Non-banks

Securitisation is also used by specialist lenders, digital platforms, debt funds, private credit entities, which extend loans to certain types of individual or corporate borrowers, but have no access to deposits or covered bonds or senior debt market. This trend is a pure reflection of both innovation from Fintechs and the increasing disintermediation of the banking sector in recent years. Private credit now plays a dominant role in financing transactions for corporates such as debt refinancings, LBOs or acquisition finance.

Typically, NBFI issuers first use private securitisation on pools of small size (below EUR100Mio), which is structured to provide a financing framework that is scalable and can work at an early point in the business growth. After having accumulated data and sufficient experience, they can then establish capital markets presence on public markets with larger volumes, as business grows.

For these non-bank originators, securitisation is a key funding tool that is essential for managing their growth. Originators in this segment are typically not in the scope of prudential regulation, however, they still have to comply with regulations linked to their fields of origination. For instance, the consumer credit protection regulations or the European mortgage directive. In addition, they have to comply with the Securitisation Regulation (SECR), as regards reporting requirements, which act as a significant barrier to entry.

In the particular case of financial receivables, non-bank lenders have recently developed the following process. In the early stages of their development, initial funding is provided by venture capital and or private equity sponsors. Once the business model is more established and origination volumes are growing, banks typically provide private securitisation funding for the senior part with the originator providing the equity funding. In a third stage, once the portfolio has reached a critical mass and the originator is ready to be introduced to the public securitisation market, banks refinance the warehoused portfolio through a public market issuance. This enables non-bank lenders to obtain more efficient funding costs from public market investors. The funding lifecycle of these non-banks clearly show the interlinkage between the private securitisation market and public one. It is thanks to the private warehouse market financed mostly by banks, that new innovative non-bank originators can access the public securitisation market. To develop the supply side of the public securitisation market an active private securitisation market is thus needed in Europe. However, there remains many constraints for the private securitisation market namely excessive capital on senior tranches provided by banks and rigid and unnecessary due diligence and reporting requirements.

Insurance companies have also trialled securitisation as a reinsurance solution for selected underwriting risks (e.g., earthquakes) in their books.

Issuers in this segment are typically not in the scope of prudential regulation, however, they still have to comply with the Securitisation Regulation, as regards reporting requirements, which act as a significant barrier to entry.

8.3 A diverse universe of investors and risk takers

On the investment/risk taking side, a wide range of market players intervene, or could intervene in the securitisation market, with a wide range of mandates, risk appetite, and approach to investment.

Tracking the development of investor demand by the respective sector is therefore essential to understand market dynamics, and potential obstacles to development.

Among the key trends we note: the continuing but diminished role of ECB in public securitisation, given the end of ABSPP and the continued high utilisation of repo, the strong role of specialist funds and the increasing role of insurers in synthetic securitisation, the stagnation of investor base for senior tranches of traditional securitisation limiting cash market growth.

8.3.1 The ECB

8.3.1.1 The ABS Purchase Program (ABSPP) did not support securitisation…

Since 2011, the Eurosystem has been developing tools to facilitate banks' funding, notably by accepting senior securitisation tranches as collateral for monetary operations.

The ECB's asset purchase programme (APP) started as part of a package of non-standard monetary policy measures that also included targeted longer-term refinancing operations, and which was initiated in mid-2014 to support the monetary policy transmission mechanism and provide the amount of policy accommodation needed to ensure price stability. The Eurosystem started to purchase securities under the asset purchase programmes of its APP in October 2014. Securitisation is in the ABSPP.

The stated objectives of the purchase programme were to:

- further enhance the transmission of monetary policy
- facilitate the provision of credit to the euro area economy
- ease borrowing conditions for households and firms
- contribute to a sustained adjustment in inflation rates.

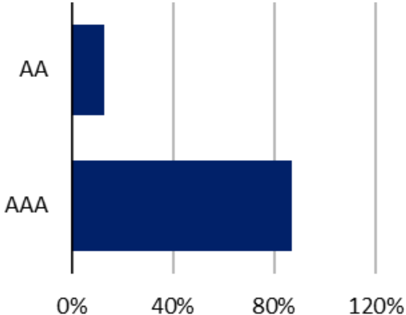
The ABSPP also aimed at helping banks to diversify funding sources and stimulated the issuance of new securities which ultimately facilitated the provision of credit to the real economy.

As of July 2023, the Eurosystem no longer conducted direct purchases of asset backed securities. At this date, the total outstanding of the ABSPP was only EUR16bn, out of a total of EUR3.1tr APP, or a minimal share of 0.5%. This compares with close to EUR300bn of Covered Bonds (CBPP3), close to EUR335bn of Corporate Sector bonds (CSPP), and EUR2.5tr of Public Sector bonds (PSPP).

This ABSPP portfolio is characterised by (as end of Q3 2023):

- A very high quality: AAA tranches represent 87% of the portfolio and AA the remaining 13% (see Figure A2.3.1)
- A concentrated portfolio by country, with Germany and the Netherlands representing close to 50% of the total, and 5 countries (adding France, Spain and Italy) representing 90% of the total (see Figure A2.3.2 Panel a))
- RMBS and Auto loans represent 80% of the total (see Figure A2.3.2 Panel b).

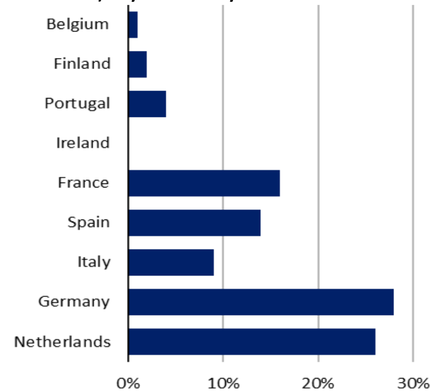
Figure A2.3.1: Composition of the ECB holdings under ABSPP, by rating (Q3 2023)



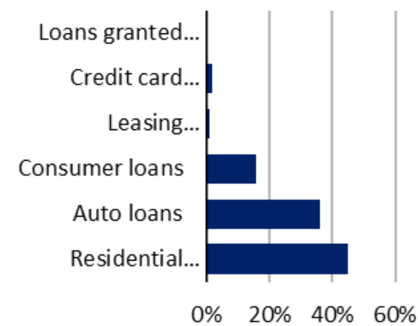
Sources: ECB, Bloomberg, BofA Global Research, company publications.
Note: 'AA' contains credit ratings from AA- to AA+, 'A ' contains credit ratings from A- to A+, 'BBB' contains credit ratings at or below BBB+. Credit rating distribution based on second-best rating consistent with collateral eligibility.

Figure A2.3.2: Composition of the ECB holdings under ABSPP

Panel a) By country



Panel b) By asset class



Sources: ECB, Bloomberg, BofA Global Research, company publications.
Note for all tables: The universe is a theoretical measure of the purchasable senior tranche securities eligible as Eurosystem collateral outstanding at the end of Q3 2023. For further information please see Box 2 entitled "Providing additional transparency on aggregate APP holdings", Economic Bulletin, Issue 2, ECB, 2019, pp. 79-81.

Given the current pace of negative net purchases (redemptions exceeding reinvestments), we expect that the portfolio will be fully amortise by the summer of 2025. By comparison, the weight of CSPP and CBPP will be maintained in the 9-10% range and the programmes will remain outstanding beyond 2025, thus continuing to support the corporate bonds and Covered Bonds market.

Overall, the ECB quantitative easing ABS Purchase Program did not support the securitisation, while it provided a large support to Covered Bonds.

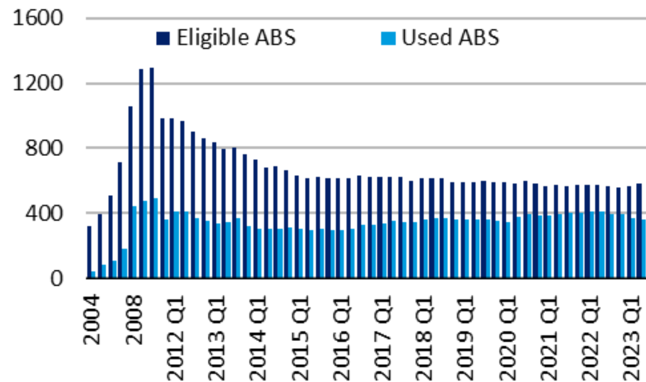
8.3.1.2 … but the ABS collateral used in ECB repo remains consistently high

The ECB today plays a much more important and critical role in accepting ABS as collateral in monetary policy operations, despite ABS eligibility criteria and haircuts being stricter than for other asset classes:

- Homogeneity of cash flows
  - Homogeneous loans
  - No credit-linked notes, swaps or other derivatives instruments, synthetic securities or similar claims in the pool
- Credit quality
  - 2 ratings by 2 distinct ECAI
  - A-/A3 minimum
- Geographical restrictions
  - On the SPV, originator, and debtors
  - EEA cash-flow generating assets governing law
- Restrictions on Retained ABSs
  - Related to the size of cash and liquidity reserves in certain cases
- Loan by loan reporting
  - Periodical reporting based on a pre-defined template
- New Issuer Report
  - NIR publication at issuance
  - Surveillance reports throughout the life of the tranche
- True Sale
  - The acquisition of the cash-flow generating assets by the SPV shall be governed by the law of a Member State
- Restrictions on investments
  - No investments on tranches of other ABSs, credit-linked notes, swaps or other derivative instruments, synthetic securities.

Figure A2.3.1 shows that he volume of eligible ABS trended down and its use – up.

Figure A2.3.1: Eligible vs used ABS, EURbn



Sources: ECB, BofA Global Research

Figure A2.3.2 shows that the growth in eligible marketable securities is driven by central government securities.

Figure A2.3.2: Eligible marketable assets, EUR bn

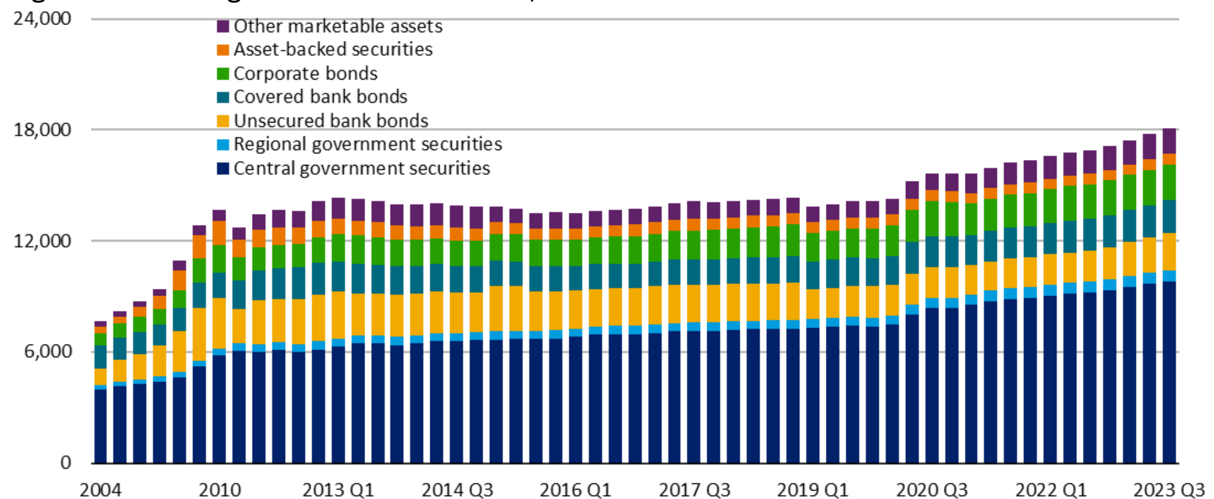
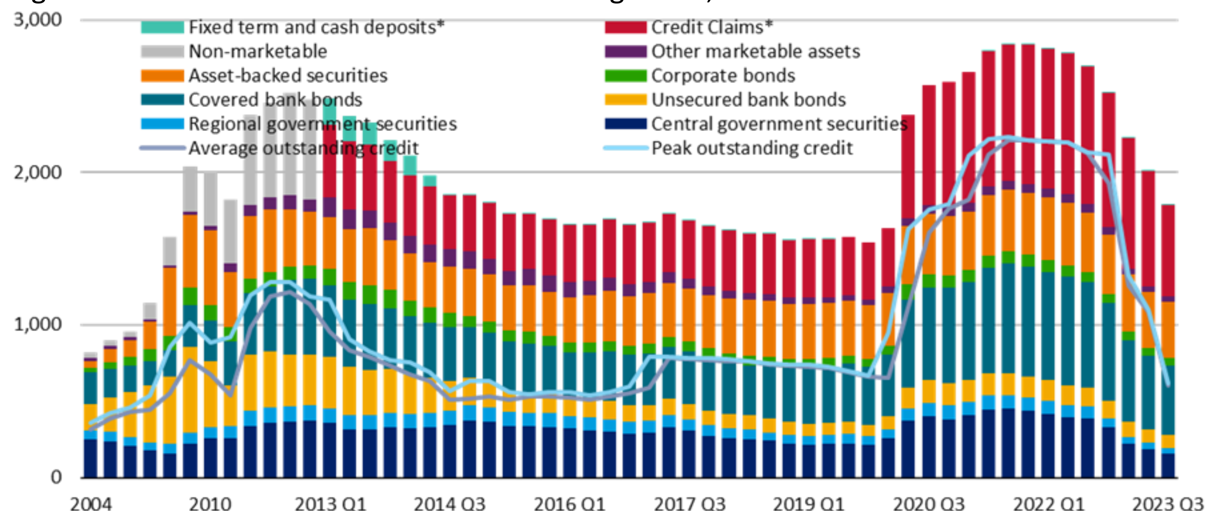


Figure A2.3.3: Use of collateral and outstanding credit, EURbn*



Sources: ECB, BofA Global Research. *Note: EURbn after valuations and haircuts. Use of collateral: averages of end of month data over each time period. Credit: based in daily data. Since Q1 2013, the category 'Non-marketable assets" is split into two categories: 'Fixed term and cash deposits' and 'Credit claims'.

Figure A2.3.2 shows that the growth in eligible marketable securities is driven by central government securities.

While the ABS portfolio represented only 3.3% of the total euro area eligible marketable assets in Q3 2023) (see Figure A2.3.2), or EUR598bn, it represented more than 20% of the total collateral mobilised by banks, or EUR365bn (see Figure A2.3.3).

This means that 60% of outstanding eligible ABSs is used as a collateral at the ECB (see Figure A2.3.1). This is the reflect of the banks' strategy, consisting in issuing securitisation not for the purpose of placing the tranches in the market, but retaining the tranches and using them as collateral at the European Central Bank.

8.3.2 Other Public sector investors/risk takers

Other public sector institutions play an important role in the securitisation market.

This is in particular the case of the European Investment Fund, often together with the EIB. The EIF designs financial instruments that absorb part of the risk that is taken by banks, guarantee institutions, microfinance lenders and funds when they finance small businesses, individuals, and infrastructure projects. This encourages funds to invest, banks to lend, and private investment to be crowded in, creating a more sustainable financing ecosystem for Europe's small and medium-sized enterprises (SMEs).

Resources invested by the EIF include the EIF's own funds as well as resources entrusted by the EIB and the European Union (EU), national and regional institutions, and other public bodies, or private capital.

The EIF provides unfunded protection in SRT synthetic securitisation originated by partner banks, covering mainly mezzanine tranches.

In 2023, the EIF has boosted its securitisation efforts. According to EIF Annual report[52] *"In the course of 2023, one tool that has emerged as particularly impactful has been securitisation. As we continue to experience the effects of climate change, it has been very encouraging to see the impact that securitisation transactions can have, most notably as a tool to drive the green transition, with many deals aimed at generating fresh financing for energy efficiency initiatives, CO2-emissions reduction efforts, and other sustainability-related efforts.*

Securitisation is proving to be an important tool to hedge risk, manage balance sheets, and generate the flexibility needed to allow our partners to target specific market segments like those relating to the green transition.

In total, the EIF signed tranches in 21 securitisation transactions across nine countries for a total investment amount of around EUR3bn during this past year – representing one-fifth of EIF's annual commitments. That has meant that partners have committed to deploying a combined amount of EUR5.7bn in the form of new lending for the real economy, of which at least EUR2.4bn will be dedicated to green projects. In addition, the EIF also worked on the structuring of the EIB's direct investments in cash securitisations amounting to EUR2.8bn in 2023. These investments will generate new lending of EUR5.2bn, of which EUR1.4bn will contribute further to the EIB Group's Climate Action target.

Securitisation has also made an important contribution to our cohesion and market-building targets, with a total of EUR1.7bn invested in securitisation transactions in Central and Eastern Europe, a region with a relatively nascent securitisation market. This investment represents 56% of our total securitisation efforts for 2023. »

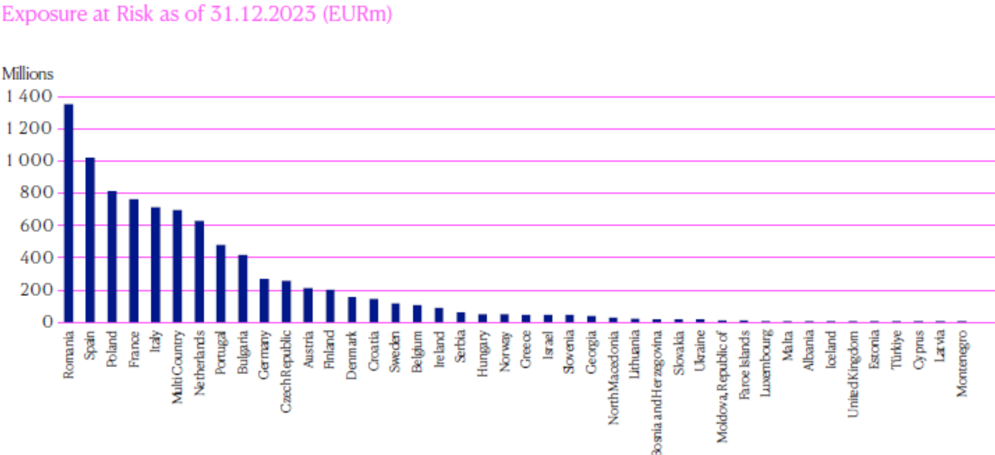
[52] https://www.eif.org/news_centre/publications/eif-annual-report-2023.pdf

This role of capacity building in member states with nascent capital markets is particularly relevant to ensure that the Capital Market Union benefits to all EU citizens.

As of 31 December 2023, the EIF's financial guarantees were spread over 41 countries.

Figure A2.3.4 shows the geographic distribution of the EIF's financial guarantees for Exposure at Risk (EUR8.97bn as of 31 December 2023) showing that the largest weight is to Romania with 15.0%, followed by Spain with 11.4% and Poland with 9.1%.

Figure A2.3.4: Geographic distribution of EIF financial guarantees



Source: EIF

8.3.3 Private sector investors

8.3.3.1 ABS/MBS investor distribution

Based on public information about deal distribution statistics, the pie charts (Figure A2.3.5) highlight STS securitisation investor bases for a sample of 14 STS EU securitisations, the majority of which are auto loan ABS. Banks and Asset managers vie for STS ABS share along with official institutions. It is unclear whether the EU STS deals can be comfortably placed without UK based investor demand.

Figure A2.3.5 – EU STS ABS investor base (14 deals)

Panel a) by investor type | Panel b) by country

Source: BofA Global Research

8.3.3.2 CLO investor distribution

As for CLO investor base, we use the table A4.3.1 from BoA Global Research. A positive feature of the table is that information is shown by tranche and investor type. A few clarifications are in order:

- A negative feature of the table is that some investors (i.e., banks) may be buying on behalf of smaller institutional investors (the European securitisation laws allow outsourcing and delegating ABS investments to EU institution regulated under CRR and Solvency II).
- A substantial portion of the purchases by pension funds and insurance companies (as well as banks) is generated by US institutions. Very few EU insurers participate in the CLO market. The lack of granularity of information regarding investor type by region is hampering a full understanding of the EUR CLO investor base.

Banks CLO purchases may be for their own and their client's account, as well as part of their treasury and their investment book.

Table A4.3.1 – Indicative (direct and third-party) investor distribution for EUR CLO, by investor type and region

Investor type	AAA	AA	A	BBB	BB	B	EQ
Asset Managers	41.8%	68.5%	63.3%	65.6%	55.6%	45.2%	72.5%
Banks	49.3%	10.4%	10.4%	5.6%	7.5%	5.0%	0.0%
Hedge funds & other	2.0%	7.7%	6.0%	13.2%	26.6%	43.4%	17.8%
Pension Funds & Insurance	6.9%	13.4%	20.3%	15.6%	10.3%	6.5%	9.7%
Region	AAA	AA	A	BBB	BB	B	EQ

Source: BofA Global Research

8.3.3.3 Synthetic securitisations investor distribution

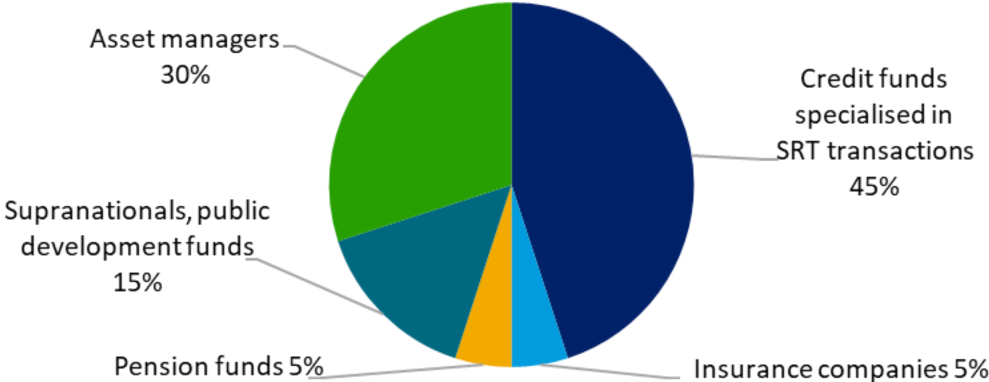
While for ABS/MBS and CLO investor distribution, BoA Global Research derives its information from public sources, it relies on the ESRB report[53] to understand the investor base and other aspects of the development of the EU SRT market (see Figure A2.3.6).

Because of the nature of the underlying risk, there are significant differences in the composition of the investor base for traditional vs. synthetic securitisations, among them two distinctive features: the material presence of credit funds specialised in SRT transactions (nearly half of the investor base), the large presence of supranational public development funds (e.g. EIB and EIF or the IFC) and significant presence of [large] insurance companies (most likely taking the risk in the form of guarantees).

About half of the SRT transactions are absorbed by specialist credit funds.

[53] ESRB (2023) "The European significant risk transfer securitisation market", Occasional Paper Series N°23, October (Here)

Figure A2.3.6 – SRT investors: Key investor categories active in the SRT market



Source: Survey ECB data (June 2023), BoA Global Research

According to the global IACPM survey referenced in the supply section of this report, before 2022 the protection providers were predominantly specialised investment funds (same as chart above) and pension funds (ESRB gives them only 5% market share), while from 2022 onwards the share of the credit arms of non-life (re)insurers started to increase.

8.3.3.4 Banks as investors

Banks as investors in third party securitisation transactions were partially crowded out of the market, as the LCR treatment of senior securitisation tranches, even when STS, imposed significant haircuts, higher than covered bonds, which made them inefficient to play a role in the management of the liquidity buffer.

Liquid assets eligible in the LCR are divided into various categories:

- Level 1 (the most liquid), such as coins and banknotes or assets guaranteed by the European Central Bank, national central banks or regional governments and local authorities. This category also includes rated Covered Bonds of “extremely high quality”;

- Level 2A, such as assets guaranteed by regional governments, local authorities or public sector bodies in the EU with a weighted risk of 20%. This category also includes other rated Covered Bonds;

- Level 2B, such as asset-backed securities, corporate debt securities, shares provided they meet certain requirements and certain securitisations which must satisfy a range of strict conditions to be accepted as a Level 2B asset, with a haircut of 25/35% (see below).

Indeed, the haircuts are totally dissuasive, and according to EBA Risk Dashboard[54], Level 2A and 2B combined (the most granular figure published by EBA, which includes STS securitisation, represent on average only 4% of the Total HQLA portfolio for European banks, which amounts to EUR5.5tr.

[54] https://www.eba.europa.eu/risk-and-data-analysis/risk-analysis/risk-monitoring/risk-dashboard

Overview of eligible ABS and covered bond assets per category in the European Commission LCR delegated act

Asset type (HQLA)	Tier	Cap applicable	Haircut applicable
Covered bonds ECAI 1	1	70%	7%
Covered bonds ECAI 2	2A	40%	15%
Residential mortgage securitisation	2B	15%	25%
Auto loan securitisation	2B	15%	25%
Consumer loan securitisation	2B	15%	35%
Unrated high quality covered bonds	2B	15%	30%

Consequently, European banks are not very significant as investors in other banks' securitisations.

Their main exposures to securitisation are:

- the retained tranches of securitisations that are set up to be eligible to ECB refinancing (for the senior tranche)
- the retained tranches from own account placed securitisations (schematically, senior tranches when the focus is risk transfer, junior tranches when the focus is funding)
- the exposures linked to client securitisation and market activity on primary and secondary markets (liquidity lines, private transactions secured by a portfolio of receivables

and, for structuring banks, some warehousing exposure, and positions in their market making role.

8.3.3.5 Insurers and Reinsurers

(Re)insurers can play **two complementary roles** in securitisation, and are the only "non-banks" which are in the scope of **prudential regulations** (Solvency II) and supervisory oversight dedicated to their investments/risk taking in securitisation transactions.

1. As **funded investors** on the asset side of their balance-sheet, they can hold bonds issued by the SPVs in true sale securitisations, and credit linked notes issued by the SPVs or directly by the banks in synthetic on balance-sheet securitisations.
   - From a bank's prudential perspective, such a credit risk mitigation technique is viewed as a funded credit protection (FCP).
   - From an insurer's prudential perspective, these investments are treated as "market risk" (Spread risk) in Solvency II regulation.
   - From a SecReg (SECR) perspective, transactions can qualify as STS if they comply with the STS requirements for true sale or synthetic securitisations, and benefit from a less unfavourable prudential treatment in insurers' prudential regulations.
   - In the event of an insurer defaulting, the issuing bank is protected by the cash received from the bondholders or posted as collateral via the credit linked notes. This implies that the bank does not have a counterparty risk on the (re)insurance company.

2. As the credit insurance arm of multiline non-life insurers or reinsurers, (re)insurers can also sell **unfunded credit protection** from the liability side of their balance-sheet, and cover losses in specific tranches of securitisations. Contracts can take the form of credit insurance policies, non-payment insurance, risk participation agreements or guarantees.
   - From a bank's prudential perspective, such a credit risk mitigation technique is viewed as an unfunded credit protection (UFCP).
   - From an insurer's prudential perspective, these contracts are treated as "Non-life underwriting risk" in Solvency II regulation.

- From a SecReg (SECR) perspective, transactions covered by (re)insurers cannot qualify as STS, as the regulation requires funded protection of all tranches. This is major issue for this market.

In the event of an insurer defaulting, these protections are – by Solvency II – senior to bondholders and other non-insurance credit obligations of the insurer. Thus, in Europe, their recovery rates in Europe should be high. As **funded investors**, and given the treatment for STS securitisations under Solvency II, insurers' appetite for securitisation investments has reduced and remained low since the announcement of Solvency II. Five years post the regulatory change, traditional securitisations are an immaterial asset class (0.33%) for the average European insurer. This is to be compared with, on one hand, with the portfolio allocation by European insurers before the introduction of Solvency II, on the other hand, with the share of securitisation in insurers portfolios in other jurisdictions. To note, EU insurance companies have barely invested in senior securitisation exposures from EU issuers since the introduction of Solvency II.

The December 2022 report by the Joint Committee (JC) of the European Supervisory Authorities (ESAs), following the public consultation on securitisation, made the following key findings from the JC's advice on the regarding the investment behaviour of insurance undertakings:

- approximately 12% of European standard formula insurers have investments in securitisation, with around 60% investing below 1% of their total assets.
- the introduction of STS securitisations in 2019 has not had a positive impact on insurers' investment behaviour.
- while 37% of respondents express an intention to increase securitisation investments in the next three years, the majority foresee no change.

As the Solvency II framework did not appear to be a significant driver for insurers' investment activity in EU traditional securitisation, the JC recommended maintaining the status quo within the Solvency II framework for insurers' investments in securitisation, as proposed changes may not be effective or justified at this time, considering the complexity of the existing framework and the low volume of investments in the securitisation market by insurers.

EIOPA remained convinced that the calibration of the shocks was not the leading reason that prevents insurers from investing in securitised products: the reluctance of the insurers would mainly stem from the mismatched risk-return profiles of the products and from their asset-liability management preferences.

On our side, we believe that ESAs decision contradicts the fact that the current calibration finds its roots in work initiated in 2009, in the immediate aftermath of the height of the Global Financial Crisis. In addition, the JC did not take into account research papers such as the academic approach presented in Perraudin and Qiu (2022) which proposes a sound and robust calibration of securitisation under Solvency II.

However, based on interviews conducted by the IACPM more specifically on insurers' appetite for credit linked notes issued on first loss and mezzanine tranches of synthetic securitisations, it appears that the Solvency II framework is indeed the most significant driver for insurers' lack of investment activity in CLNs on junior tranches of securitisations, because of the 100% Risk Weight, similar to private equity.

As **unfunded sellers of credit protection**, insurers' unfunded protection on tranches of synthetic securitisations is limited to non-STS transactions, where their market share has been increasing mostly on mezzanine tranches. Annual surveys conducted by the IACPM since 2019 specifically on insurers' SRT activity show that the appetite of non-life (re)insurers is even higher than what banks can supply due to their preference for issuance of STS transactions.

SRT and loan-by-loan credit insurance production remain however a marginal part of the underwriting book of multiline (re)insurers, enabling to benefit from the risk diversification advantage recognized in Solvency II.

Banks are also interested to grow unfunded risk sharing with well capitalised, highly rated and prudentially regulated private credit insurers due to:

- their appetite for the senior mezzanine risk, when thicker tranches have to be protected after Basel 3 implementation, which is increasing RWA on corporate credit assets and establishing an output floor, and
- the diversification of counterparty risk offered by insurers, increasing the robustness of the package of protection sellers (investors and insurers) on the tranches aiming at significant risk transfer (SRT).

Therefore, (re)insurers offer robust counterparty diversification and provide greater opportunities for banks to manage credit risk, counterparty limits and capital, and ultimately undertake further lending. However, the STS framework for on balance-sheet synthetic securitisations requires either funded credit protection (by way of cash collateral or 0% risk-weighted debt securities) or unfunded credit protection provided by a limited number of potential counterparties (e.g., 0% risk-weighted multilateral development banks).

To appeal to the widest range of appropriate investors, notably private credit insurers and re-insurers, the STS requirements should be amended so as not to limit the availability of a key distribution channel that is currently available to banks in respect to on balance-sheet securitisations.

We conclude that the (re)insurance industry has the capacity to contribute significantly to securitization market growth and robustness in the EU, but the current regulatory landscape in Solvency II and in the securitisation regulations are refraining this growth.

8.3.4 Asset Managers

Fixed income investors play a key role in placed public securitisations, notably the senior tranches. They can also invest in mezzanine tranches under more illiquid investment strategies.

Securitisation brings significant benefits to fixed income investors. It provides diversification to the risks typically held in their portfolios, are attractive in terms of relative value, and represent a safe investment for senior positions.

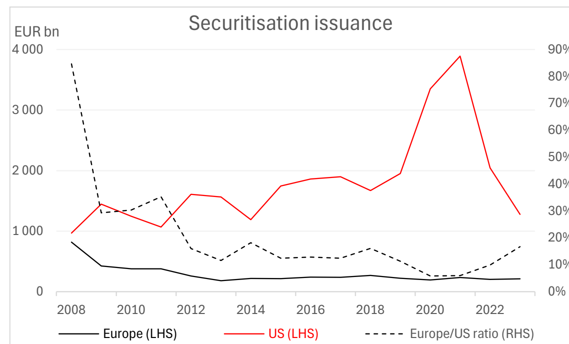
However, the largest European funds (in particular the UCITs) are constrained by stringent limits on their investments (in relative size and in terms of maturity profile). In addition, due to prescriptive due diligence requirement imposed by the EU securitisation regulation, they cannot invest in high quality non-EU securitisation markets. This limits investment opportunities and reduces diversification possibilities for European institutional investors.

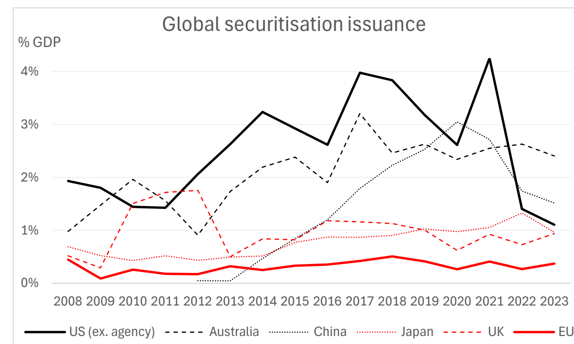
From an investor perspective, we welcome that STS transactions become in 2024 eligible to ELTIF 2 (20% maximum). This goes in the right direction. However, many improvements are necessary to make it workable: the improvement of the STS prudential treatment (e.g., Solvency 2) and the introduction of more proportionality in the STS due diligence process.

9 Appendix A3: Securitisation market trends

9.1 A market collapse, but only in Europe

Since the Global Financial Crisis, **the securitisation market has collapsed in Europe,** particularly the segment of publicly placed issuances. Between 2007 and 2023, total annual issuance volumes of securitised assets dropped in Europe from EUR407bn to EUR213bn, a decrease of 48%, a trend which was not observed in other jurisdictions. In addition, the ratio of the European to the US issuance has remained below 20% since 2012.





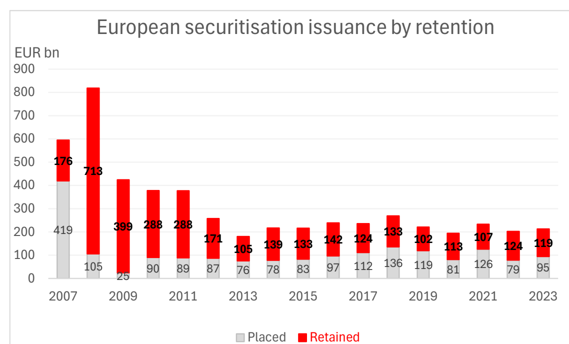
Source: AFME

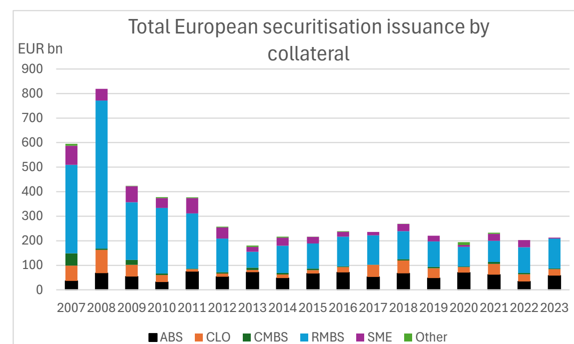
In a 2023 non-paper, the Commission services emphasized that the EU securitisation market has only experienced a moderate growth in the 2016-2021 period (EUR280bn issuance in 2021 o/w EUR100bn synthetic transactions). Importantly, 40% to 60% of the volume of traditional (cash) securitisation issued were not placed in the market, but rather retained by originators and used as collateral to secure central bank liquidity, which suggests a much smaller size for the placed market than it would appear at first look.

In contrast, the American market and other international markets have resumed a growth trajectory.

9.2 Issuance Volumes in Public transactions vs other regions

In Europe, the share of the retained securitisation strongly dropped in recent years, from 74% on average over 2010-2012 to 54% over 2021-2023, while the placed securitisation has remained broadly stable since the global financial crisis.



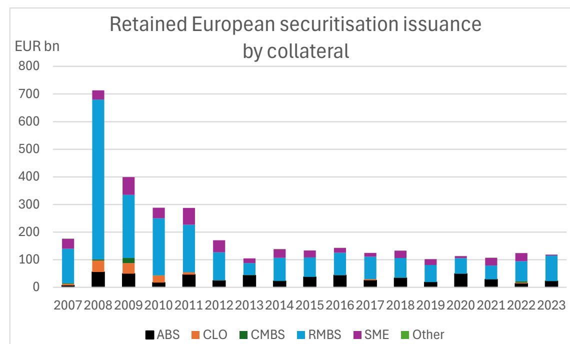


Source: AFME

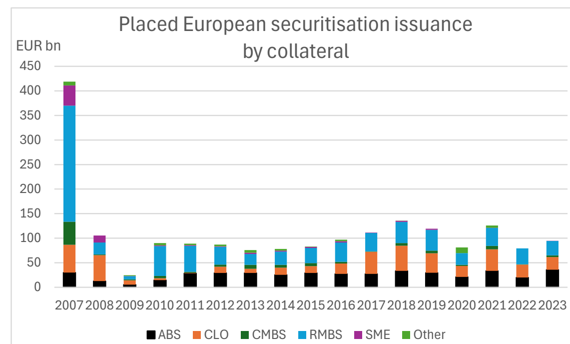
Sources: AFME, SIFMA, Bank of America, JP Morgan

Regarding collateral, RMBS represented around 52% on average of the total European issuance (including UK) over the 2007-2023 period.

This key role of RMBS is even more pronounced for retained securitisation (where RMBS averaged 60% of the total) than it is for placed volumes.



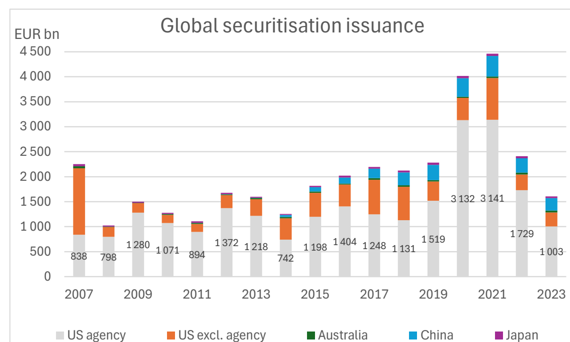
Source: AFME



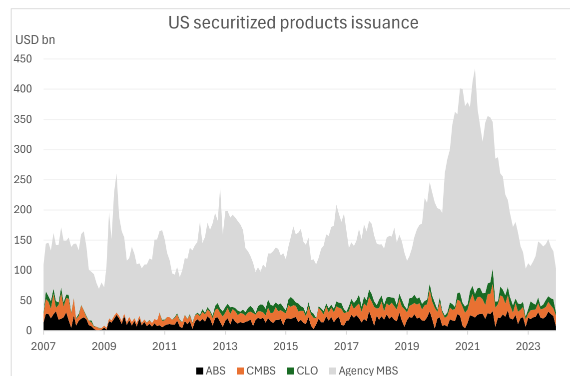
Sources: AFME, SIFMA, Bank of America, JP Morgan

Indeed, concerning placed securitisation in Europe, ABS and CLOs have played a more significant role in recent years relatively to RMBS.

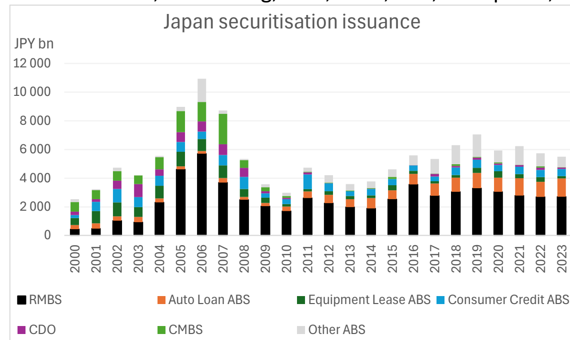
When it turns to other regions in the world, the US securitisation market looks preeminent, totalling at least 80% of the non-European volumes over the period 2007-2023. Also, it is worth noting that 76% of the US total issuance has been done by US agencies.



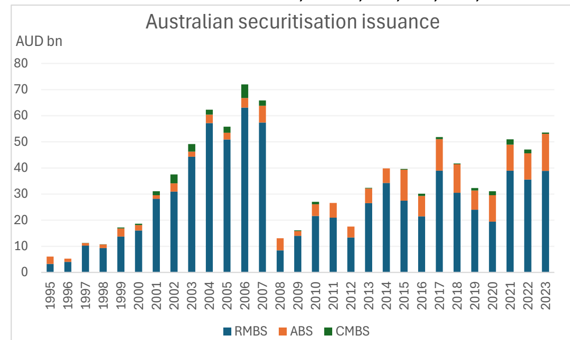
Sources: AFME, Bloomberg, NAB, JSDA, S&P, Macquarie, SIFMA



Sources: BoA Global Research, Intex, FN, FH, GN, Bloomberg



Source: BoA Global Research



Source: BoA Global Research

Importantly, this considerable place occupied by agencies in the US securitisation market is especially visible during the pandemic period and via MBS products.

When it comes to other regions, and as in Europe, RMBS appear to be crucial products, in particular in Japan and in Australia.

Noteworthily, while for Japan RMBS represented 48% of the total over the last five years, this share stands at 72% in Australia over the same period.

9.3 Issuance Volumes in synthetic securitisation

A reverse trend has been noticed in synthetic SRT transactions, with a growing volume of securitized assets year after year, from a low base, and as SRT securitisation became progressively recognised as a reliable tool in bank's capital management toolkit, also in the wake of ongoing increases in the prudential regulatory and supervisory pressure, which has taken place since the Global Financial Crisis.

The growth in SRT market accelerated – from a low base- in recent years as the SRT assessment process improved, and as synthetic securitisation obtained access to the STS label in the Capital Market Recovery package.

As illustrated by the volumes for **synthetic securitisations** issuance globally and in the EU as per the IACPM 2016-2023 survey collecting data from 40 global and regional banks:

Global - €bn		Inception	YE 2023
Underlying pools of loans	2016-2023	1,024	614
	2023	207	197
Protected tranches	2016-2023	82 (8.0%)	55 (8.9%)
	2023	18.5 (8.9%)	18.2 (9.2%)

EU - €bn		Inception	YE 2023
Underlying pools of loans	2016-2023	572	299
	2023	102	98
Protected tranches	2016-2023	42 (7.3%)	24 (7.9%)
	2023	7.5 (7.3%)	7.3 (7.5%)

Source: IACPM Synthetic Securitization Market Volume Survey 2016-2023

The year 2023 highlighted the same growth as in 2022, with more EUR200bn new issuance globally. By the end of 2023, more than EUR600bn of bank loans were covered by EUR55bn (close to 9%) of tranches attaching generally at 0%.

Unlike "true sale" securitisation, the EU represents half of the global synthetic securitisation market. Similar to 2022, 2023 issuance of EU SRT transactions (EUR102bn) – half qualified as STS transactions - exceeded the volume of placed true sale issuance (EUR94.7bn). A growing number of trades (50% vs 33% in the prior two years) qualify as STS to benefit from the more favourable capital treatment. By the end of 2023, close to EUR300bn of EU bank loans were covered by EUR24bn (close to 8%) of first loss and mezzanine tranches protected by investors and insurers on a funded or unfunded basis.

Such developments are encouraging, and show the positive impact on issuance volumes of the recent reduction in capital charges. However, the 300bn of loans protected by securitisation represent only a fraction of the total loans carried on balance-sheet by EU banks, which slightly exceed EUR5tr. There is clearly significant room for a bold scale-up of the volume of SRT transactions, in the face of the significant impact of CRR3 on capital requirement on one hand, and of the EU massive financing needs.

While dominated by European banks in the past with over 80% market share, banks domiciled in the US, Canada and other regions, as well as smaller institutions continue to enter the market at scale, reducing EU banks' share of the market.

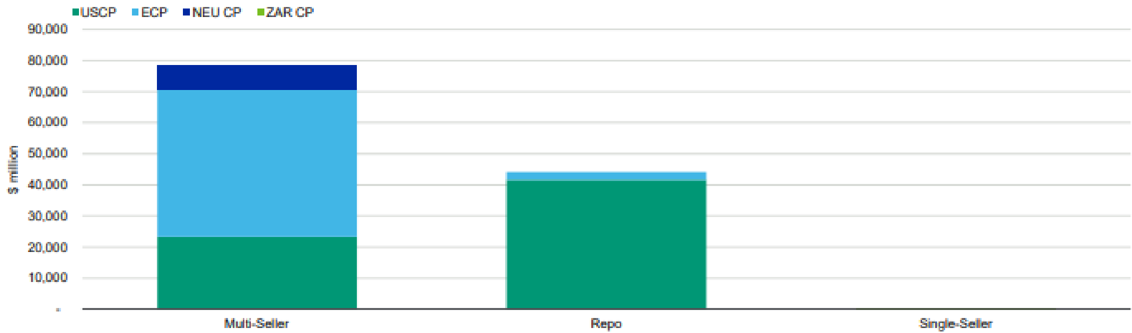
9.4 Key facts and figures on the European ABCP market[55]

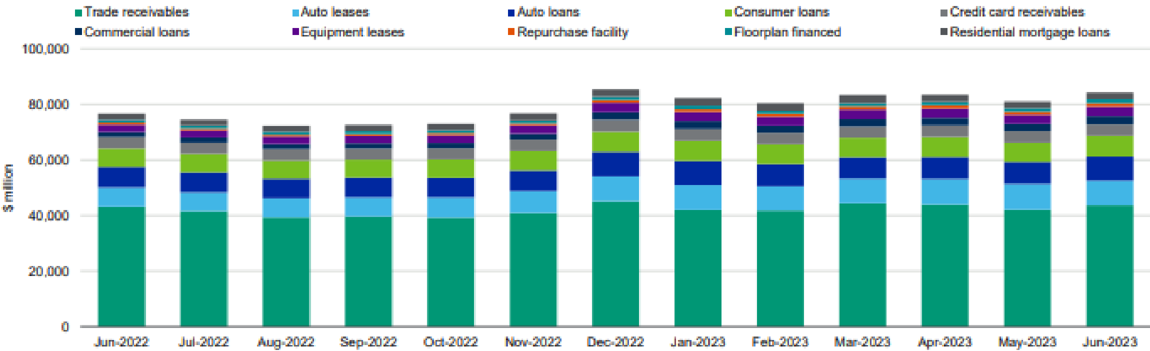
In Europe, 32 ABCP conduits are rated by Moody's, of which 31 fully supported.

Multiseller conduits represent 64% of the market, the remaining 36% being repo conduits.

These conduits are refinanced equally through US and Euro Commercial Paper.

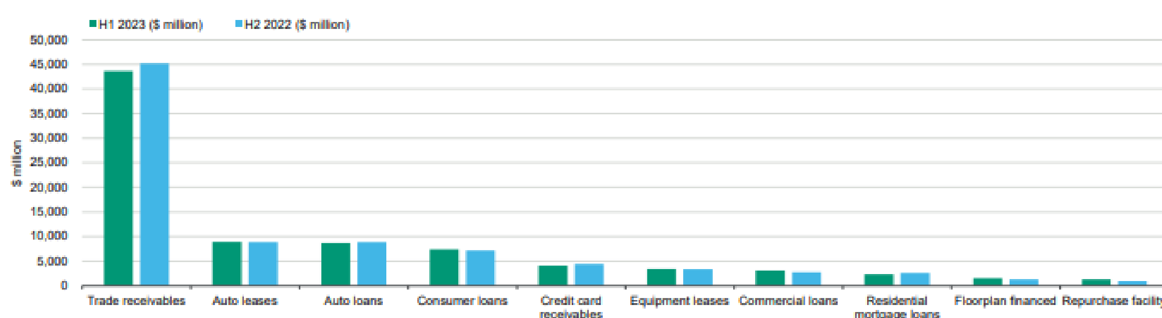
Trade receivables represent the dominating asset type in EMEA ABCP multi-seller portfolios, followed by auto leases and auto loans.





[55] Source : Moody's

Asset type breakdown in top 10 multi-seller programmes
As of 30 June, 2023



Source: Moody's Investors Service

Top European multiseller conduits (H2 2023)

Programme name	Sponsor Bank	Purchase limit 2023-H2 ($ millions)	2023-H2 Asset Outstanding ($ millions)
LMA S.A. / LMA Americas LLC	Credit Agricole Corporate and Investment Bank	26 960	20 960
Matchpoint Finance plc/Matchpoint Master Trust	BNP Paribas	18 796	14 291
Antalis S.A./Antalis U.S. Funding Corp.	Societe Generale	15 876	13 493
Romulus Funding Corporation	Intesa Sanpaolo Spa	9 835	7 600
Arabella Finance Designated Activity Company/Arabella Finance LLC	UniCredit Bank AG	6 424	5 210
Weinberg Capital Limited / Weinberg Capital LLC	Landesbank Baden-Württemberg	6 220	3 953
Magenta Funding ST / Magenta Funding LLC	Natixis	4 962	3 922
Satellite	Crédit Industriel et Commercial	5 225	3 680
Albion Capital Corporation S.A	MUFG Bank, Ltd.	6 038	4 811
Cancara Asset Securitisation Limited / Cancara Asset Securitisation LLC	Lloyds Bank Plc	6 132	1 753
Mont Blanc Capital Corporation	ING Bank	3 568	1 581
Regency Markets No.1 LLC/ Regency Assets Limited	HSBC Bank plc	3 430	2 382

Source: Moody's Investors Services

10 Appendix A4: Credit performance of securitisation

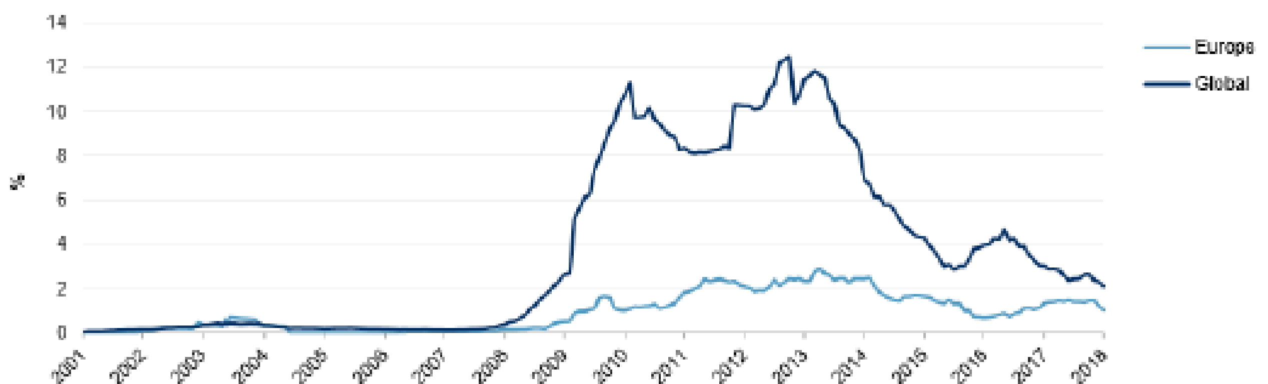
10.1 Securitisation: a stigma from the Global Financial Crisis

Due to the poor quality of assets (sub-prime residential lending, mostly originated by mortgage brokers having no “skin in the game”) and complex and opaque structures (such as re-securitisation), in the US, securitisation as a fixed income asset class remains perceived as one of the primary drivers of the Global Financial Crisis.

Contrary to what a persistent stigma might suggest, securitised assets issued in Europe have demonstrated resilience over the long term. The 2008 crisis stemmed from poor origination practices of mortgage loans in the United States, not from issues affecting securitisation in Europe. In fact, default rates observed in Europe have remained very low (see Figure A4.1.1)

Figure A4.1.1 – US vs. Europe – Structured Finance Annual Default Rates

European Structured Finance 12-Month Trailing Default Rates



Source: S&P Global Fixed Income Research.

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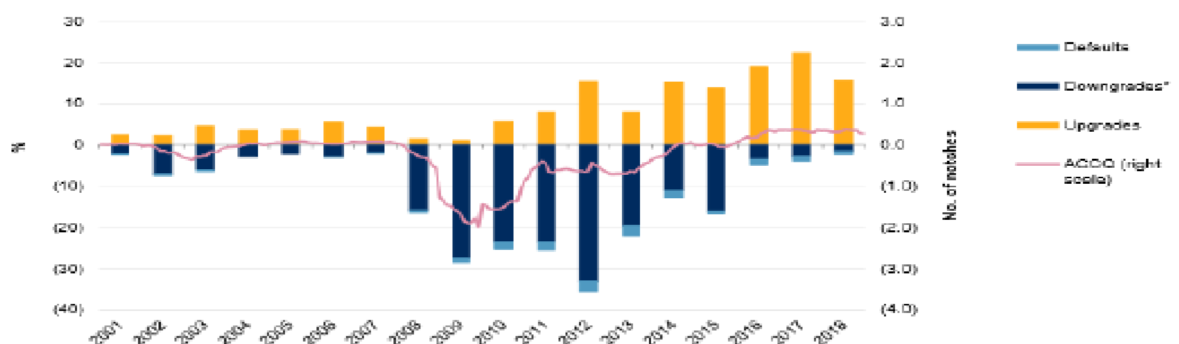
During the global financial crisis, and the Eurozone crisis, European securitisation faced more limited downgrades (in % and in number of notches), compared to US ones. Many downgrades in Europe were connected to the downgrade of the sovereign where the securitisation assets were located (see Figure A4.1.2), rather than with the credit quality of such assets such as for US RMBS (see Figure A4.1.3).

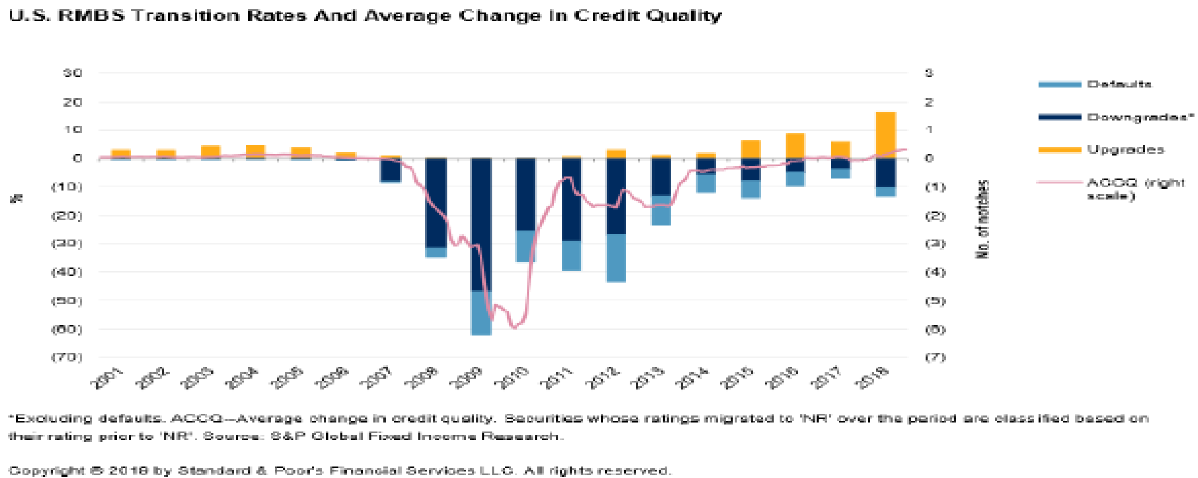
Figure A4.1.2 – EU Rating Migration

European Structured Finance Transition Rates And Average Change In Credit Quality



Source : S&P

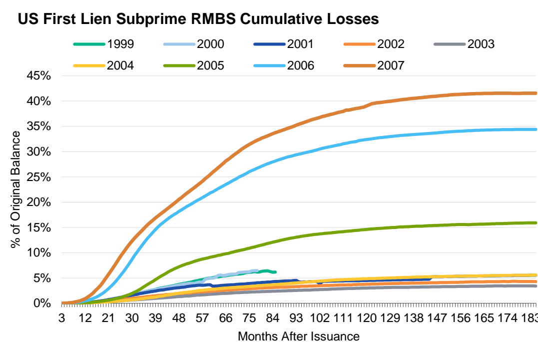
Figure A4.1.3 – US Rating Migration for RMBS



10.2 Losses observed EU vs US

Among the numerous factors that led to the financial crisis in the US, we observed a progressive increase in the cumulative losses posted by subprime RMBS products, above 40% for the 2007 issuance. This is shown in Figure A4.2.1.

Figure A4.2.1 – Cumulative losses (US Subprime)

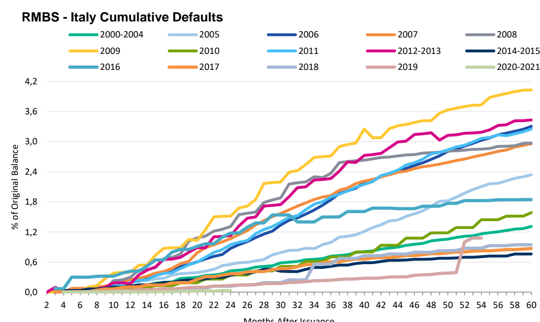


Sources: Moody's Investors Service, Moody's Analytics

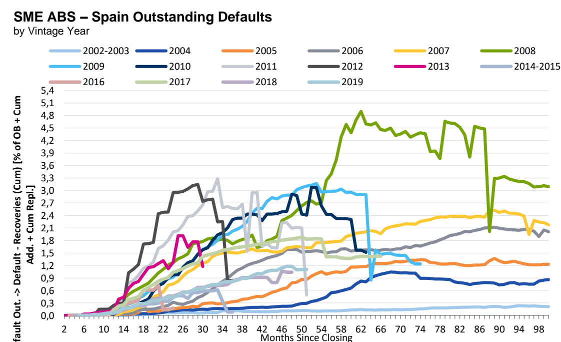
In comparison to the US figures, European ones are much lower. Among various possible examples to illustrate this, the cumulative defaults in the Italian RMBS market, as shown in Figure A4.2.2 Panel a) remained more than ten times lower at least (as cumulative losses are even less than cumulative defaults, after taking recoveries into account). The same type of conclusion also applies for the Spanish SME ABS, as shown on Figure A4.2.2 Panel b).

Figure A4.2.2 – Cumulative Defaults Sources: Moody's Investors Service, periodic investor/servicer reports

Panel a) RMBS (Italy)



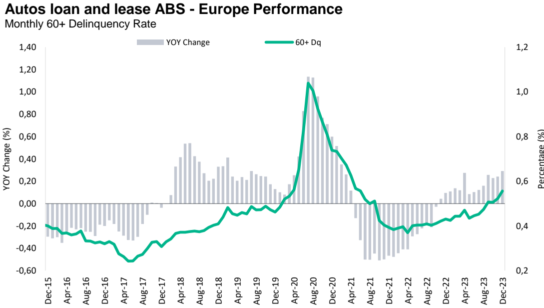
Panel b) SME (Spain)



Sources: Moody's Investors Service, Moody's Analytics

At a European level, recent data on the auto loans and lease ABS market show a rise in the delinquency rate during the beginning of the pandemic, but starting at an historically low point and peaking at around 1% and then decreasing (see Figure A4.2.3).

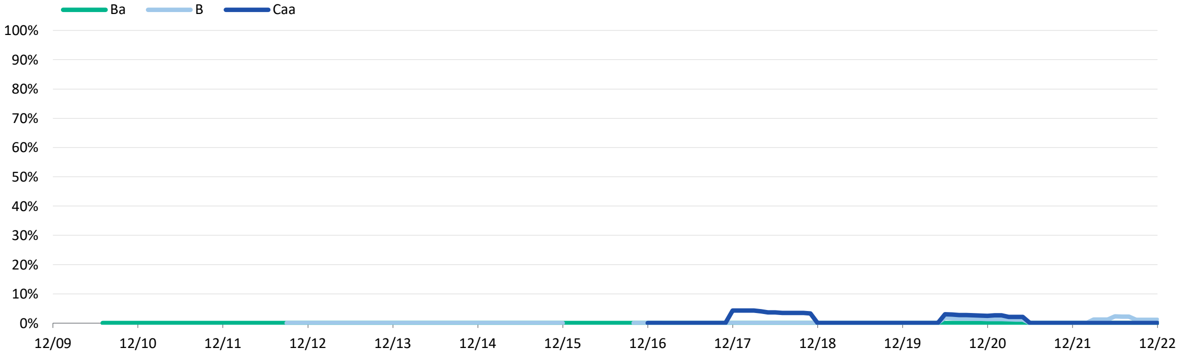
Figure A4.2.3 – European Autos performance



Sources: Moody's Investors Service, periodic investor/servicer reports

Even when adopting a broader approach than default, thus considering 12-month impairment rates for EMEA ABS, CMBS and RMBS by cohort rating (Ba, B, Caa), we still note low levels of risk in the rated universe (see Figure A4.2.4).

Figure A4.2.4 – EMEA ABS, CMBS, RMBS impairment rates for Non-IG tranches



Source: Moody's Investors Service

All in all, adding in particular sub-investment grade tranches, cumulative loss rates for these EMEA products at a multi-year horizon seem not significant from a financial stability perspective (see Table A4.2.1). In any case, this is more than largely offset by the remuneration required by investors (mainly, the spread on the securitisation tranches).

Table A4.2.1 – EMEA ABS, CMBS, RMBS – Cumulative loss rates

EMEA ABS, CMBS, & RMBS, Estimated multi-year cumulative loss rates by cohort rating, 2009-2022										
		Horizon year								
	Avg initial cohort size	1	2	3	4	5	6	7	8	9	10
Aaa	435	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%
Aa	261	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%
A	213	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%
Baa	150	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%
Ba	78	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%
B	38	0,12%	0,26%	0,51%	0,84%	0,84%	0,84%	0,84%	0,84%	0,84%	0,84%
Caa	23	0,27%	0,54%	0,54%	0,54%	0,54%	0,54%	0,54%	0,54%	0,54%	0,54%
IG	1 059	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%
SG	139	0,08%	0,16%	0,22%	0,29%	0,29%	0,29%	0,29%	0,29%	0,29%	0,29%
All	1 197	0,01%	0,02%	0,03%	0,04%	0,04%	0,04%	0,04%	0,04%	0,04%	0,04%

Source: Moody's Investors Service

In comparison and turning to global CLOs, figures look quite higher by cohort rating, exceeding 15% for sub-investment grade Ba-rated tranches at an eight-year horizon (see Table A4.2.2).

Table A4.2.2 – Global CLOs - Cumulative loss rates

Global CLOs, Estimated multi-year cumulative loss rates by cohort rating, 2009-2022											
		Horizon year									
	Avg initial cohort size	1	2	3	4	5	6	7	8	9	10
Aaa	903	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	
Aa	534	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%			
A	458	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%		
Baa	445	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	
Ba	458	0,02%	0,15%	0,37%	0,81%	2,06%	5,27%	10,31%	15,63%		
B	259	0,09%	0,30%	0,81%	1,95%	5,23%	9,69%	11,79%	12,58%		
Caa	38	3,57%	7,10%	18,05%	31,72%						
IG	2 231	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	0,00%	
SG	722	0,15%	0,38%	0,75%	1,49%	3,52%	7,25%	11,05%	14,72%		
All	2 855	0,03%	0,09%	0,20%	0,43%	1,29%	3,48%	5,65%	7,20%	7,20%	

Source: Moody's Investors Services

11 Appendix A5: Recent prudential developments for banks

The European Commission proposal for Capital Markets Recovery Package (CMRP) for securitisation[56] has introduced a new framework for STS synthetic securitisation and amendments to the treatment of NPL securitisations as well as several mandates for the ESAs to draft further Level 2 legislation.

The CRR3 includes two measures: (i) targeted provisions for the prudential treatment of securitisation (these are however transitionary and only address the deterrent effects of the Basel III output floor on securitisation of IRBA portfolios, without introducing any actual improvements to the existing capital requirements), and (ii) an EBA mandate for a report on the comprehensive review of the prudential treatment of securitisation transactions, expected in 2026 and a basis for a potential legislative proposal by 31 December 2027 only.

We welcome CRR3 addresses the issue of the Output Floor via article 465 (5). Indeed, as explained in recital 36, the introduction of the output floor could have a significant impact on own funds requirements for securitisation positions held by institutions using the Securitisation Internal Ratings Based Approach (SEC-IRBA). The introduction of the output floor could affect the economic viability of the securitisation operation because of an insufficient prudential benefit of the transfer of risk. This would come at a juncture where the development of the securitisation market is part of the action plan on capital markets union and also where originating institutions might need to use securitisation more extensively in order to manage more actively their portfolios.

However, this "quick fix" is transitional, until 2032. During this transitional period, institutions using the IRB Approach will be able to apply a favourable treatment, with a p-factor divided by 2, to their both STS and non STS securitisation positions when calculating their output floor.[57]"

The benefits in terms of RWA of this specific measure for securitisations concretely materialise if, and only if, the total consolidated output floor (OF) is breached. As such, it does not correspond to any decrease of the RWAs for securitisation compared to the CRR2 treatment.

Simplified bank (theoretical figures)	Before OF (a)	SA without quick fix (b)	72.5% OF (c)	Final RWA Max (a; c)	SA with quick fix (d)	72.5% OF (e)	Final RWA - Max (d; e)
Securitisation SEC-IRBA (eg. Non-STS)	70	120 p-factor 1	87		80 p-factor 0.5	58 *potential* benefit 29 quick fix	
Portfolio other IRBA	100	150	108.75		150 unchanged	108.75 unchanged	
Total RWA	170	270	195.75 OF breached	195.75	230	166.75 OF breached	166.75 *real* benefit 29 quick fix

[56] Published on 9 April 2021

[57] [..] for exposures that are risk-weighted using the SEC-IRBA or the IAA in accordance with Art. 92(4), where the part of the standardised total risk-weighted exposure amount for credit risk, for dilution risk, for counterparty credit risk or for market risk arising from the trading book business is calculated using the SEC-SA pursuant to Articles 261 [non-STS] or 262 [STS], institutions shall until 31 December 2032 apply the following p-factors: (a) p = 0,25 for a position in a securitisation to which Article 262 applies; (b) p = 0,5 for a position in a securitisation to which Article 261 applies."

Otherwise benefits remain virtual/potential ones.

Simplified bank (theoretical figures)	Before OF (a)	OF without quick fix (b)	72.5% OF (c)	Final RWA - Max (a; c)	OF with quick fix (d)	72.5% OF (e)	Final RWA - Max (d; e)
Securitisation SEC-IRBA (eg. Non-STS)	70	120 p- factor 1	87		80 p-factor 0.5	58 *potential* benefit 29 quick fix	
Portfolio other SA	100	100	72.5		100 unchanged	72.5	
Total RWA	170	220	159.5 no OF breach	170 no OF impact	180	130.5 no OF breached	170 Zero *real* benefit quick fix

Another recent regulatory development is the new voluntary EU green bond standard (EU GBS) which offers a framework to contribute to the green securitisation market attractiveness, with the possibility for the originator to invest at least 85% of the use of proceeds in assets aligned to the European Taxonomy (provided that this type of assets is available in the economy).

12 Appendix A6: Impact of potential market development on financial stability risks

Some policy makers may be reluctant to allow regulatory reforms reducing the disincentive for issuing and investing in securitisation for EU banks and insurance companies, with the view that such disincentive is an intended policy goal to avoid the build-up of excessive financial stability risks, and a possible repeat of the Global Financial Crisis.

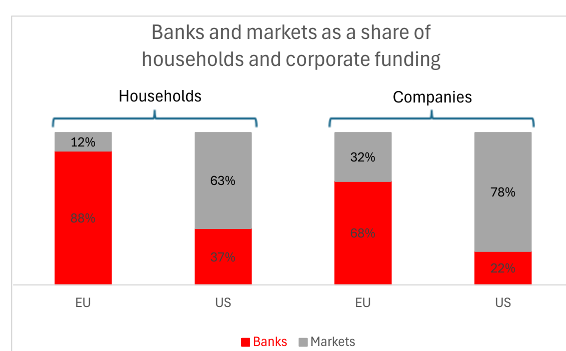
Paris Europlace believes that such concerns are not valid anymore, given:

- The positive role that securitisation of EU-based assets can play in contributing to achieve the European policy goals, despite regulatory constraints on banks' capital and underdeveloped Capital Markets, leveraging on the safe and highly supervised loan origination and monitoring process.
- The minimal starting point in Europe of securitized assets outstanding, suggesting that there is ample room for development before the market growth may become a concern from a financial stability perspective.
- The positive effect of post crisis regulatory reforms as implemented in Europe, which have put an end to some structures and practices which led to the contagion observed during the GFC, such as re-securitisation, absence of skin in the game, etc…)
- And an opportunity to reinforce EU resilience by encouraging a responsible private risk sharing between banks, investors and insurers.

12.1 A safe way to contribute to the CMU and the EU strategic priorities

Today, the European economy is mostly financed by banks. Although non-banks are also progressing, especially on some segments like corporate leveraged loans.

This dominance can clearly be seen in the liabilities of economic agents: in the EU, banks account for almost 90% of household debt and 70% of business debt. By comparison, these figures are close to 40% and 20% respectively in the United States. Banks therefore meet the vast majority of financing needs in Europe, whereas the markets play a prominent role in the United States.



Source: Noyer report

While reducing the excessive reliance on bank funding has been a stated objective of the CMU project, Paris Europlace believes that an efficient financing of the European economy should rely on both Banks and capital markets. Securitisation acts as a bridge between bank lending and capital markets, and can be a very effective lever to change the balance between banking and market funding in the EU.

Indeed, such complementary vision would allow to rely on the existing safe and highly supervised origination by banks, while providing investors with reliable investible assets in which they would not

have accessed otherwise, at the level of seniority and yield that corresponds best to their risk return appetite. Thanks to securitisation, investors have access to unique opportunities in terms of exposure type and in terms of risk/reward spectrum. They can obtain exposure to sectors of the economy that can hardly be reached otherwise (SME and consumer loans) and have a very granular approach to the level of risk they want to be exposed to with the tranching technique.

Bank origination remain the dominant model in the EU, especially as regards households and SMEs, even if some non-bank lending develops in the digital world. Banks have a very dense network of presence in the territories across the 27 member states, have a direct knowledge of their customers and manage their relationships in a long-term view.

Importantly, they are subject to a wide range of regulations in their origination activities, as summarized in the EBA Loan Origination and Monitoring guidelines. Not only are they expected to carefully assess the credit risk of their borrowers over the medium term, but they are also subject to consumer protection rules, Know Your Customers, ESG assessments, granular reporting of their risks, on-going monitoring through time, etc… And their capacity to comply with this wide range of rules is supervised by the SSM and NCAs on an ongoing and intrusive basis across the Union.

By contrast, non-bank lenders are subject to much less regulation although they are also subject to consumer legislation (if applicable) and rules on lending (e.g., on responsible lending) and are not under a similar supervisory oversight.

Maintaining the pressure on bank capital requirements without giving the possibility to banks to share the risks with investors thanks to an efficient securitisation framework, would further grow the share of non-bank origination, which was at the roots of the US securitisation crisis, as sub-prime mortgages were mainly originated by mortgage brokers.

All in all, not only the development of securitisation in Europe would not increase financial stability risks, but **the lack of securitisation may be a financial stability risk in itself**, as shown in the recent publications by the IMF, the FSB and other policy makers trying to assess and address the financial stability risks of so-called “Non Bank Financial Intermediation” or NBFI.

Furthermore, the fact that EU banks are not able to turn-over their balance-sheets, or increase the velocity of their balance-sheet, has a significant impact on their RoE. In 2023, the average RoE of EU banks was 7.6%, compared with 9.9% for their US counterparts. This underperformance, partially due to the absence of a scalable securitisation market, also translates in a continuous decline in valuation, which in turn prevents banks to attract fresh equity capital in the market. This lack of profitability and investor appetite for bank stocks is a European vulnerability, and the development of securitisation would contribute to improve bank valuations and access to capital, therefore increasing their resilience and their shock absorbing facility.

Finally, risk sharing through securitisation by construction reduces the risk of credit losses by the issuing bank in case of downturn, therefore increasing their resilience. Depending on the nature of the tranches sold, this benefit can be described differently, but in all cases, it is reducing vulnerability:

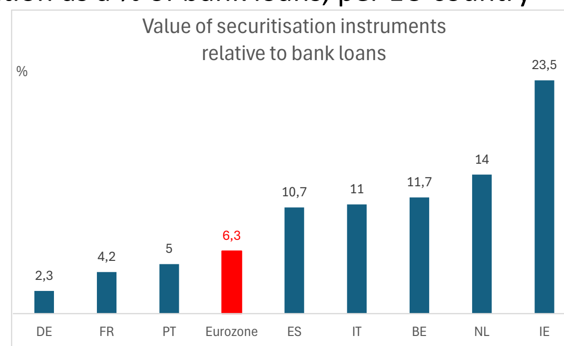
- When selling all or part of the first loss and mezzanine tranches in an SRT transaction, and keeping the senior tranche, the probability that the portfolio losses will exceed the first loss and mezzanine is minimal, whereas, the bank would be fully exposed if this portfolio had not been securitized (or issued in a covered bond format)
- When keeping the first losses and selling the senior tranche in a cash securitisation with an exclusive funding objective, and even if the SRT is not obtained, the issuing bank will have capped its losses and protected itself against a low probability, extreme loss in the portfolio.

12.2 What-if market development scenarios: We are far from excessive EU market development; not an immediate concern for Europe

Looking at current issuance volumes in the EU, it is clear that securitisation issued by EU banks out of their own assets does not have the scale that may generate a systemic risk, and would have considerable room for growth before reaching a potentially worrying level.

The predominance of the banking model to finance the real economy through loans kept on balance sheet rather than by securitising them can be illustrated by the ratio of securitisation instruments to bank loans. Excepted in Ireland, this ratio stands below 15% for many EU countries, including the largest ones (see Figure A6.2.1).

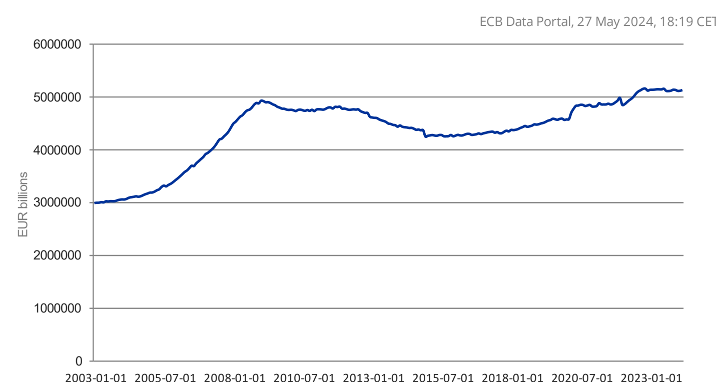
Figure A6.2.1: Securitisation as a % of bank loans, per EU country



Source: European Commission (2022 data)

As per data in ECB portal, total loans granted by EU banks slightly exceed EUR5tr (see Figure A6.2.2). AFME and IACPM 2023 surveys identified respectively EUR95bn of loans placed in the market via true sale securitisations, and EUR107bn of loans protected by synthetic on balance-sheet securitisations.

Figure A6.2.2: Total loans granted by EU banks

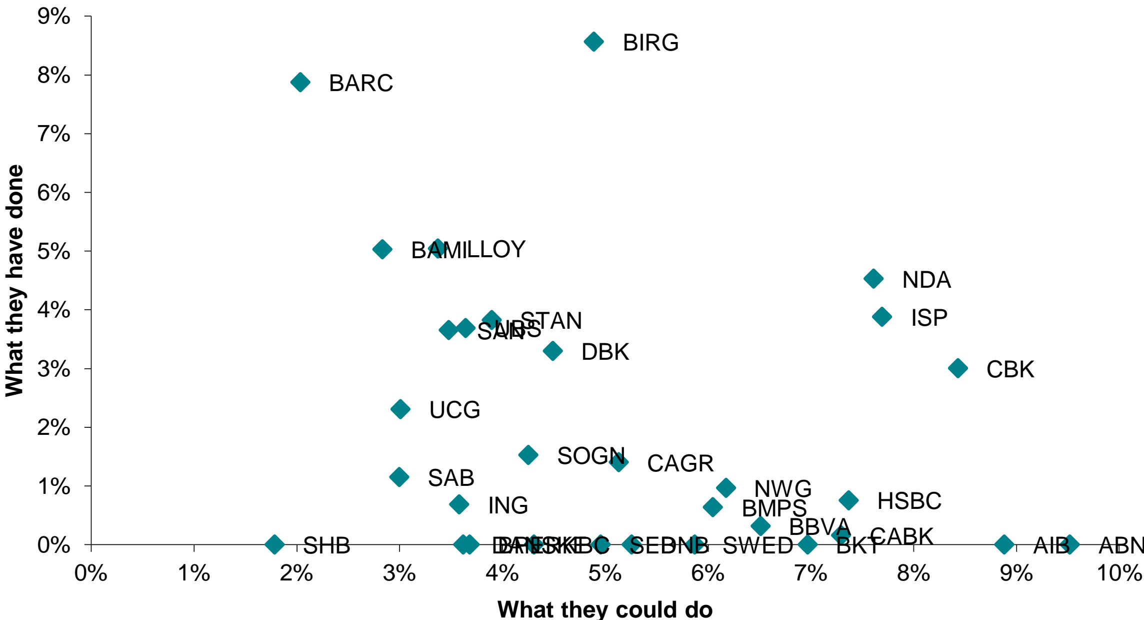


As per the ECB portal, total equity of SSM banks by end 2023 amounted at EUR1,769bn, while only EUR55bn of first loss and mezzanine tranches were protected by banks synthetic on-balance-sheet securitisations (*Source: IACPM 2016-2023 synthetic securitisation survey*).

According to the latest AFME CMU report[58], EU securitisation issuance adjusted by GDP continues to languish far behind global competitors. In the first half of 2023, EU issuance was equal to 0.3% of EU GDP which compares with 0.7% in the UK, 1.1% in the US (excluding issuance guaranteed by the government agencies), 2.6% in Australia, 1.4% in Japan and 1.5% in China.

According to research by BNP Paribas Exane[59], based on an analysis of EU banks Pillar 3, the RWA savings currently obtained by EU banks represent between 0% to 5% of their total RWA (see Figure A6.2.3).

Figure A6.2.3 Risk-weighted assets: current and potential savings



Note: the vertical axis represented the current RWA savings (in % of the total RWA). The horizontal axis is an estimated savings based on an estimate of assets which could be securitised. Sources: Company data, BNP Paribas Exane estimates.

Table A6.2.1: Potential boost to lending capacity through securitisation

EURm	
Corporate EADs of the banks we cover	4 961 903
of which EADs > 40% density	1 810 673
Average density of those	57%
RWA of corporate EADs>40% density	1 036 118
Assumed proportion securitised	50%
Gross RWA pre SRT (75% SRT, 25% retained)	518 059
For reference 75% saved by the banks	**388 544**
Gross up to reflect amortisation of securitised exposures	832 257
Gross up by 75% to capture non-covered, non-listed banks	1 456 449
Assumed RWA density	50%
Implied lending capacity freed-up	**2 912 899**

[58] Capital Markets Union - Key Performance Indicators – Sixth Edition - European Capital Markets: scaling up capital markets - November 2023

[59] BNP Paribas Exane European Research – Securitise to energise – 13 May 2024 – Restricted access – Bank data as of 31 December 2023 – BNP Paribas Exane estimates

Based on extrapolation on the structure of individual banks balance sheets and the proportion of "securitisable" assets, BNP Paribas Exane believes that the expansion of securitisation in Europe could reasonably be expected to increase this range between 3% and 10% of RWA. Such an acceleration would save up to EUR50bn of capital, or the equivalent of up to 15% of the sector's market capitalisation. Assuming that the saved capital would be reinvested in new lending, the amount of financing that could be unlocked could reach EUR2.9tr over time, or about 15% of EU GDP (see Table A6.2.1).

In the US, where retention rules have been implemented, but where the prudential treatment has remained basically local, as BCBS reforms (STC and prudential rules) have not been implemented, the "true sale" securitisation market promptly restarted after the GFC, and is now much bigger compared to pre GFC levels, without having generated any systemic risk concern during the recent episodes of turmoil, linked to COVID, the US Treasury market issues, the Russian war in Ukraine, or the recent regional banks failures. The synthetic on-balance-sheet market also revamped in 2023 in the US after the Federal Reserve accepted to release capital from Credit Linked Notes directly issued by banks, and transactions of a scale much bigger than EU ones have been issued by US banks.

All in all, unlocking securitisation, from the current low base, would not create a financial stability risk, but even with prudent growth assumption, could significantly boost the EU economy.

12.3 Limited financial stability risks

There is no doubt that US securitisation has represented a major systemic risk during the Global Financial Crisis, as a factor of contagion across various types of market participants and across geographies.

However, it should be noted that:

- The European securitisation market performed much better during the GFC and did not contribute to the crisis in any significant way. This being said, some EU-headquartered banks and investors suffered significant losses due to their investments in non-EU (namely, US) originated transactions.
- At the time, the « originate and distribute » framework represented a significant moral hazard issue, which has since been solved in particular by (i) the retention rules, which ensure « skin in the game » by the originator, as implemented in Dodd Frank and in the EU Securitisation, and 2) the due diligence requirements imposed to investors, which imposes a comprehensive risk assessment of the risks embedded in the underlying portfolios and in the waterfall structure, as implemented in EU securitisation regulation.

Following the global financial crisis, the regulators adopted strict market and prudential regulations meant to address the main factors that caused the 2008 crash:

- Bank liquidity is now heavily regulated and speculative short-term market funds such as arbitrage vehicles have disappeared.
- Rating agency activities have been regulated to address conflicts of interest and with greater scrutiny of credit rating models. Market, regulators, and credit-rating agencies have adjusted market practice.
- Balance-sheet "synthetic" securitisations are done for proper risk-transfer purposes. The new securitisation law effectively bans re-securitisation and black-box structures in the EU.
- Risk retention rules have been put in place ensuring originators to have "skin in the game", thus realigning the interest between issuers and investors.

The drivers that explain the role of securitisation in the past crisis have therefore been addressed at both EU and international level. Regulatory reforms that enabled to strengthen financial stability should not be unravelled, but the overreaction should be curtailed and overlapping regulations should be streamlined. The regulatory process has to be completed based on the accumulated both regulatory and market experiences by making regulatory framework even more risk-sensitive and promoting established best practices.

Paris Europlace welcomes the consultation launched by the FSB in 2023 about whether the G-20 reforms on securitisation have reached their goal.

In this context, post-GFC reforms aimed at improving disclosures and facilitating standardisation have been a mixed blessing. While they have partially achieved their initial objectives, due to material regulatory frictions, they are now seen as market-distorting factors, impeding entire sectors of the economy from being financed; the lack of financial flexibility that they create can morph into future financial stability issues. Paris Europlace believes that there is a role for the FSB to evaluate how rules set by key 4 Public Standard Setting Bodies (BCBS, IOSCO, IAIS) and their European counterparts (EBA, ESMA, EIOPA) for securitisation are creating regulatory frictions that impede the appropriate financing of the economy. Such frictions can be within a regulatory silo (such as BCBS-EBA) or inter-silos (such as BCBS-EIOPA, BCBS-ESMA).

We note that in July 2022, the European Systemic Risk Board (ESRB)[60] published its *Monitoring systemic risks in the EU securitisation market* report. The focus of the analysis was solely on the RMBS segment, being historically the largest of the EU, the other segments being less significant in terms of size and far less relevant from a macroeconomic / systemic perspective. Nevertheless, asset classes such as auto loans and leases, consumer credit and trade receivables, financed publicly or privately (including through ABCP conduits) also play an important role in the financing of the real economy. On the largest segment, the ESRB did not identify any substantial systemic risks emanating from the RMBS portion of the EU market. According to the ESRB, there are four important reasons for this:

1. The EU RMBS market has shrunk in recent years and remains small within the EU financial system and from a global perspective.
2. The credit quality of EU RMBSs, as reflected by external credit ratings and historical performance, has remained high and stable even during the COVID-19 pandemic.
3. The leverage indicators for EU RMBSs in the form of DTI, LTV and debt service-to-income (DSTI) ratios do not appear excessive, which reflects the conservative approach on mortgage lending in most EU jurisdictions.
4. EU banks, which are the main originators and holders of EU securitisations, are better capitalised than before the GFC.

Practitioners and investors are fully convinced that traditional (also called 'cash' or "true sale") and On-Balance-Sheet (also called 'synthetic' or "SRT") securitisations, including non-STS ones, add value in financing the European economy both by enhancing capital allocation efficiency and by diversifying funding sources for segments of retail and non-retail markets that otherwise are not able to access traditional bank lending.

[60] https://www.esrb.europa.eu/pub/pdf/reports/esrb.report_securisation.20220701~27958382b5.en.pdf

13 Appendix A7: Ideas for the STS framework

13.1 Review the treatment of non-STS transactions

We also strongly advocate for an extension of less stringent prudential treatment to non-STS transactions.

While we fully support the European STS framework, we also note that it is impossible for a great proportion of the market to meet the demanding 100+ STS criteria. This is in particular the case for real economy assets such as trade receivables, SMEs, corporate loans or revolving credit facilities, infrastructure financing, commercial real estate loans, aviation and ship financing, cross-border commercial loans…

Therefore, focusing prudential improvements on STS alone will not have sufficient impact on the market and will leave entire segments of the potential scope on the side-lines.

Total (placed and retained) Simple Transparent and Standardised (STS) securitisation issuance, for the 2023 Full Year, totalled EUR75.7bn, and constituted 35% of total securitisation issuance (STS & Non-STS) of EUR213.3bn. Out of the EUR75.2bn in STS issuance, EUR44.1bn was placed on the market, representing 46 % of total placed issuance in 2023 Full Year (EUR94.7bn).

Focusing prudential improvements on STS alone will not have a sufficient impact on the market and will leave entire segments of the potential scope stifled:

- Some portfolios or transactions cannot meet all the STS criteria by nature (granularity etc): trade receivables, SMEs, corporate loans or revolving credit facilities, infrastructure financing and energy-based financing that are critical to the green energy transition agenda, commercial real estate loans, aviation and ship financing, cross-border commercial loans, …
- Some issuers have structural difficulties to achieve the STS label, e.g. new companies (such as Fintechs) that cannot meet the 5 years historic data requirement, or smaller banks that, by construction, handle smaller pools and fail to achieve the granularity or homogeneity criteria.
- Some underlying assets are not eligible to STS label because of the STS criteria "repayment not predominantly based on sale of assets"; this is the case for the certain types of real asset financing (e.g. car fleet and car rental deals).
- Some securitisation structures may not necessarily meet the STS criteria, while contributing to the efficient financing of the economy: warehouse financing to third party non-bank lenders which are keen to develop their ability to issue STS labelled securitisations through the capital markets; SRT securitisations tailored to specific investors constraints and needs, such as synthetic unfunded securitisations directly protected by Solvency 2 regulated insurers.

Crucially, let's keep in mind that the EU Securitisation Regulatory framework also applies to Non-STS transactions, with more stringent rules than required by Basel principles such as: (i) 5% risk retention; (ii) prohibition on re-securitisation; (iii) highly detailed disclosure obligations on sell–side parties; (iv) EU institutional investor due diligence; (v) credit-granting standards; (vi) prohibition or limits on sale of securitisations to EU MiFID retail clients; (vii) adverse selection restriction; (viii) prohibition of establishment of SSPEs in 3rd countries blacklisted for AML/CTF. In addition, for Significant Risk Transfer (SRT) securitisations, the CRR requirements, as enforced by EU supervisory authorities and equally applicable to both STS and Non-STS transactions, provide an additional level of safety. Therefore, the de-risking of securitisation market achieved by all those reforms also applies to non-STS transactions and therefore would justify, from a risk-based and financial stability perspective, a better prudential treatment. By the way, this is consistent with the rating agencies' approaches, which assess the credit worthiness of a transaction on its intrinsic risk characteristics, whether or not it complies with the STS framework. From thar perspective, two tranches having the same rating should have the same risk-

based capital treatment, as they are expected to carry the same potential losses, whether or not they are STS.

Practitioners and investors are fully convinced that cash and synthetic non-STS securitisations add value in financing the European economy both by enhancing capital allocation efficiency and by diversifying funding sources for segments of retail and non-retail markets that are not otherwise able to access traditional bank lending.

13.2 The need for simplifying the Simple, Transparent and Standardised (STS) label

13.2.1 Key takeaway

The Simple, Transparent and Comparable (STC) securitisation concept was promoted by the European Central Bank and the Bank of England as a reaction to the problematic calibration of the Basel Committee in 2012 and 2013. It was developed in 2014 and 2015 under the co-sponsorship of IOSCO. The Basel Committee agreed on reducing the capital surcharge (via the p-factor and the risk weight floor for senior tranches), as long as eligible traditional securitisations satisfied a certain number of criteria. The European Supervisory Authorities gold-plated the STC concept and labelled its legislative implementation as Simple, Transparent and Standardised (STS) and its application occurred in 2019 for traditional securitisations, and developed a Basel-inspired STS framework for synthetic ones in 2021. The most important impact of such legislation was to remove the stigma associated with the catastrophic loss history of securitisations backed by pre-GFC US assets that had distorted deeply the European political perception of this instrument, and its relevance for the European economy when it is backed by European assets. Nevertheless, five years after the implementation of the STS framework for traditional securitisations, it is time to take stock, to see whether STS is the European success story envisaged by the Authorities. Spoiler alert! Not so much for traditional securitisation, but a notable success for synthetic ones, although the latter has fragmented the European investor landscape. It has not succeeded in relaunching the EU securitisation market in terms of issuance volume. Paris Europlace thus proposes improvements that ought to be implemented to ensure that the STS securitisation framework develops while remaining robust, as with the right targeted legislative adjustments, its long-term legacy as a tool for the European construction can be assured.

13.2.2 The diagnosis

STS transactions remain excessively burdensome and Malthusian for both originators and investors, as they require implementing new appropriate procedures and internal controls (e.g., on STS notification), developing dedicated IT systems and reporting, and implementing additional audits for synthetic transactions.

The STS Regulations[61] were intended to serve as a catalyst for revitalising the European securitisation market, thereby providing essential financing for the European economy. They fell short of this key objective. In stark contrast, the post-GFC strategy employed in the United States yielded significantly better results, even without implementing the international Simple, Transparent and Comparable (STC) securitisation label, particularly in terms of issuance volume and overall market activity.

The majority of STS transactions are very straightforward in the determination of their STS status. However, the intersection of the number of STS criteria – over 100 – with the multiplicity of assets,

[61] The regulation (EU) 2017/2402 of 12 December 2017 laying down common rules on securitisation and creating a European framework for simple, transparent, and standardised (STS) securitisation (the Securitisation Regulation) and a regulation amending Regulation (EU) No. 575/2013 (the CRR) (the CRR Amendment Regulation and, together with the Securitisation Regulation, the Regulations) came into force on 17 January 2018 and became effective from 1st January 2019.

lending practices and European jurisdictions not infrequently lead to fine interpretative judgements as to whether a particular securitisation does or does not meet a given criterion. The legislation has provided a path to clarifying such uncertainties: the EBA Q&A process. This process, when it is completed, has generated helpful clarifications. Nevertheless, it is almost never used. This is because the average time for a response is over 18 months and oftentimes over 24 months. It is not possible for market participants to proceed with a transaction knowing that they will not receive an answer for two whole years. As a result, market participants have little choice but to fall back on their own interpretations assisted by legal firms and third-party verification agents. When in doubt, they may simply elect not to go the STS route or, in some cases, not to proceed at all.

We recommend that the EBA should commit to providing a response to Q&As within a fixed and short period of time – three months (save in exceptional circumstances where data or modelling work requires additional time). This would provide the certainty needed for originators and investors to move forward with transactions that may otherwise be undermined and prevented by uncertainty.

While STS transactions have developed, some aspects remain burdensome and costly, as new appropriate procedures and internal controls (e.g., on STS notification or on STS due diligence) are required:

- developing IT reporting, in addition to existing reporting (maintained);
- implementation of dedicated systems and procedures, additional audits for synthetic transactions

The STS framework has 100+ criteria. But it only covers some asset classes (e.g., residential mortgages, consumer loans, retail SMEs, etc.), and it excludes others mechanically as it is easy to fail on one or several of those 100+ criteria.

For example, the 2% granularity criterion requiring a minimum of 50 names minimum, or the homogeneity criterion, will fail many portfolios backed by trade receivables, wholesale SMEs, corporate loans or revolving credit facilities, infrastructure financing and energy-based financing that are critical to the green energy transition agenda. The European Authorities should be transparent as to which asset class they intend to economically exclude from the STS framework. Furthermore, it is an undesirable outcome that European-designed criteria (not Basel-designed ones) result in an incentive to reduce the amount of cross-border financing in the EU. It goes against the objectives of the European Commission if green energy transition assets cannot access the benefits of the STS framework.

Some issuers have structural difficulties to achieve the STS label, e.g. new companies (such as Fintechs) that cannot meet the 5 years historic data requirement.

Some smaller banks, by their nature, handle smaller pools and fail to achieve the granularity or homogeneity criteria.

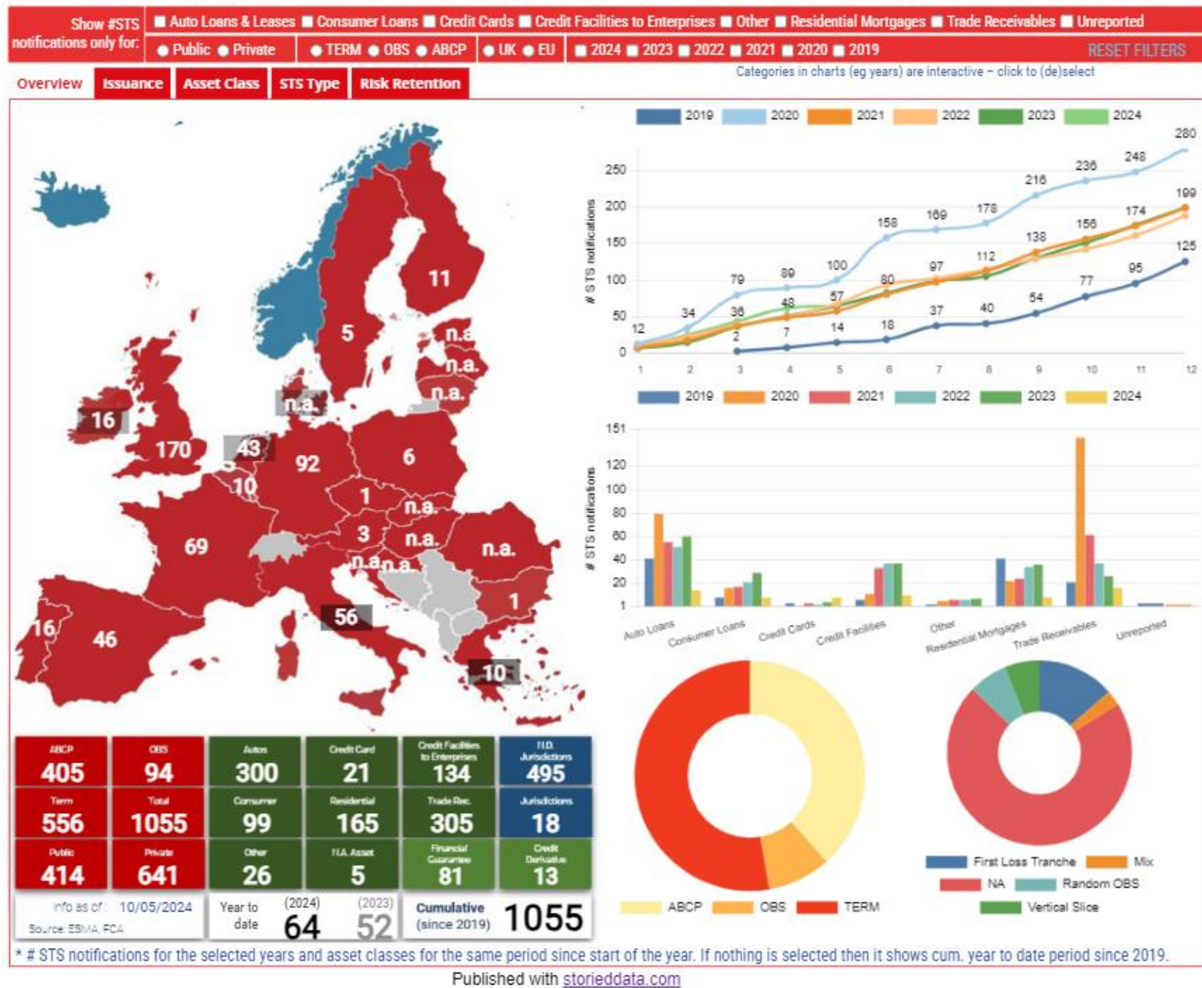
In addition, some securitisation structures may not necessarily meet the STS criteria, while contributing to the efficient financing of the economy:

- Revolving warehouse financing the assets funded before the first payment is made;
- SRT securitisations tailored to specific investors constraints and needs, such as synthetic unfunded securitisations by highly regulated, well capitalised and well diversified insurers (see Recommendation 5 of this report).
- From an investor perspective, it is worth mentioning that STS transactions become in 2024 eligible to ELTIF 2 (20%); however, many areas to improve: the STS eligibility criteria themselves, better STS treatment for all investment products (through the reviewed Solvency II for instance, which currently does not mention the securitisation in recitals or articles) and the introduction of more proportionality in the due diligence process.

For private ABCP corporate securitisations, the requirements and responsibilities falling on corporate clients go much beyond other financial products backed by the same assets (e.g. factoring). For instance, retention obligations, liabilities linked to the originator role, reporting requirements such as Annex 9 for non ABCP transactions.

Lastly, if any modification or new interpretation of the STS framework occurs, maintaining the STS label should always be assessed through a grand-fathering clause.

Simple transparent visualisation of STS transactions verified by PCS across asset classes and countries freely accessible on https://pcsmarket.org/the-great-library/sts-market-data/



On the buy side perspective, we recognise that the benefit of the STS label is the harmonisation of definitions. However, issuers in practice have to implement two investor reports (one required by the regulator and one required by the rating agencies and the investors, the latter allowing more flexibility and being more adapted to investors' needs). The change that STS transactions become in 2024 eligible to ELTIF 2 (20% maximum) goes in the right direction. However, many improvements are still necessary to make it workable: the improvement of the STS prudential treatment (e.g., Solvency II) and the introduction of more proportionality in the STS due diligence process.

13.2.3 The cure

a) We would suggest:

- A recognition of the UK STS label (equivalence regime) would be welcome for EU institutional investors (currently facing a competitive disadvantage).

- The territoriality provision in article 18 (originator, sponsor and SSPE in the EU) is too restrictive for private pan-European securitisations. We suggest enabling the transactions with non-EU sellers (such as from the UK) or assets to be eligible to EU STS label if the transaction fits the other criteria.
- The introduction of a grand-fathering concept by which non ABCP STS transactions refinanced by conduits are automatically considered as ABCP STS (no specific declaration from the conduits and no WAL criteria).
- A revision of the 2% granularity threshold (in CRR article 243) since it's too demanding.

In addition, for the derogative treatment, the CQS2 threshold may be a concern for some banks whose rating is limited by the country rating ceiling (e.g., Italian banks). This should be captured for instance as a Minimum (CQS2, country rating). The Italian Consob has just used the derogation allowed under the CRR and the Italian banks can have a lower CQS threshold.

Lastly for debt securities as collateral: more flexibility would be appreciated regarding the maximum maturity (currently three months); instead, we could contemplate longer securities subject to higher over-collateralization level, agreed between the parties (or any other security agreement to remove the counterparty risk for the investors).

b) With regards to the STS criteria

- Section 1
  - Article 20.7 (No Active Portfolio management): To be qualified to authorise partial and/or successive sale of the SPV's assets in the context of allowing for successive refinancing operations including public transactions.
  - Article 20.8 (On Homogeneity): Criteria is prone to restrictive interpretations, which especially impacts smaller specialised-lender originators by preventing them to reach critical mass for public transactions. For instance, could Consumer Loans and Auto Loans which do not benefit from the pledge of the vehicle constitute an homogenous asset class? Same question for German and French portfolios originated by a single Fintech or regular Residential Loans backed by a mortgage mixed with Residential Loans guarantees by other financial assets (Lombard loans). At the very least, market participants should have the ability to receive guidance from the EBA on these subjects within a reasonably short timeframe. Relative size of sub-portfolios in question should also be considered, to avoid that fringe questions on homogeneity affecting 10% of a pool jeopardize the STS status of the entire transaction.
  - Also, compatibility with pan European programs shall be clarified with the supervisor. For instance can we bundle French and German consumer loans originated by the same sponsor?
  - Article 20.12 (At least one payment has been performed): May be interesting to find a solution in order to alleviate this criterion, especially for players such as small Fintechs (for instance by confirming that any upfront payments made would qualify. Alternatively, a solution could be to indicate that a transfer to the SPV would be possible as long as the corresponding asset would only be eligible for the purpose of trigger and/or credit enhancement calculations, once a payment as indeed been made).

- Section 2
  - Article 24.7: cf comment Article 20.7.
  - Article 24.9: cf comment Article 20.11.
  - Article 24.10: cf comment Article 20.12.
  - Article 24.15 (On Homogeneity): cf. comment Article 20.8.

- Article 24.15 (Maximum WAL of Assets): 1yr-WAL criteria is way too short, and does not relate to any Simple Transparent nor Standardized consideration. This may make sense as an additional criterion in order to obtain STS treatment for program wide ABCP exposures (such as the CPs for instance), but not for deal specific ones.

Exemption for Auto loans and all leases is also too limited and does not reflect the evolution of the market. Not clear as too why Consumer loans should be treated differently from auto exposures.

- Article 24.15 (No residential and commercial mortgages): As mentioned above the objective of this criteria is not clear as liquidity issues are addressed by other means within the CRR regulation (as they should).

In all cases, this prevents using short term refinancing in relation to RMBS warehouses which are really in essence short term exposures.

- Section 2a
    - Pool homogeneity (criterion 26.b.8) is a strong requirement that can lead to limitation for certain businesses (despite the relevant RTS on homogeneity), e.g., excluding very diversified trade finance portfolio including Corporate & Financial Institutions borrowers.
    - The requirement to specify the servicing procedures that apply to the underlying exposures (criterion 26.c.7) is burdensome, as the bank usually needs to draft a specific document as a synthesis of servicing procedures with a focus on the relevant asset class, while the topic is usually fully addressed during the on-site due diligence performed by the investors.
    - Criterion 26 d.2 requires an ex-ante audit on a sample to check the assets eligibility by an external verification agent: this is demanding, must be anticipated and represents an additional cost, while it does not seem to be really relevant for synthetic securitisations (without back-to-back of the cash flows).
    - Criterion 26.e.4: exhaustive check of the Eligibility Criteria by the Verification Agent is a challenge regarding some criteria that are not 'factual'. We would rather have this addressed by representations made by the bank.
    - Art 26.d.5: compliance with article 7 (including ESMA report) is clearly the main challenge and a huge brake on STS eligibility.
    - Criterion 26.e.10: the requirements on the collateral are too demanding.
        - We would suggest reversing the exclusion of unfunded protection by (re)insurers from the STS (the interim credit protection payment should be viewed as sufficient to secure the payment under the credit protection, while it does not really make sense for funded credit protection).
        - We would suggest a carve-out for unfunded upper mezzanine tranche when low mezzanine and first loss ones are funded.
        - In addition, for the derogative treatment, the CQS2 threshold may be a concern for some banks whose rating is limited by the country rating ceiling (e.g., Italian banks). This should be captured for instance as a Minimum (CQS2, country rating).
        - Debt securities as collateral: more flexibility would be appreciated regarding the maximum maturity (currently three months); instead, we could contemplate longer securities subject to higher over-collateralization level, agreed between the parties (or any other security agreement to remove the counterparty risk for the investors).

14 Appendix A8: Private securitisation operations

14.1 Specific streamlining of private securitisation operations

Regulators recognise that "*investors have shown that they utilise consolidated due diligence practices primarily relying on customised and bilateral information*"[62]. In fact, Reporting Entities engaging in private securitisation transactions enter with investors into specific deal reporting agreements to enable them to meet their initial and ongoing due diligence as required under Article 5 of the SECR, as specified in the transaction documentation.

In addition, the reporting entities are subject to multiple overlapping reporting obligations to meet fragmented supervisory information requirements and including notification to SSM.

To streamline supervisory reporting requirements and remove barriers to entry to new reporting entities, the introduction of a single universal reporting file/data carrier based on the format and frequency of the SSM template should be introduced to replace all existing private securitisation reporting requirements to all National Competent Authorities (NCAs), and including ECB and SSM.

A solution, which would have the advantage of facilitating supervisors' desire to be able to monitor private transactions while requiring only a limited number of operational adjustments (information systems) for originators, sponsors or SSPEs, would be to use simple, aggregated reporting based on the reporting used for ABCP transactions (see appendix 1).

In addition, simple revisions to reporting models, such as (i) simplification of the ND ("No Data") field, with a proposal to reduce the number of cases from five to two ("not applicable" or "not available"), (ii) a dynamic approach for improving the reporting models, for instance, if a significant number of reporting entity systematically indicate the "not applicable" for certain fields, and (iii) verification of the fields relevance at supervisor level (since the global information is located in their tools), rather than at the implementation level, would improve the current reporting templates as well.

14.2 Proposed amendments to SECR articles 5 to 7

- **Article 5.**
  - Investments in third country operations.

    On October 10, 2022, the European Commission published its report on the functioning of securitisation regulation.

    According to the Commission, the ESMA reporting requirement set out in article 5.1 e) of RecReg would apply to third-country originators, sponsors or SSPEs, while recognizing this constraint as a "competitive disadvantage for EU institutional investors".

    The Commission believes that the measures envisaged to amend the technical standards specifying transparency requirements could help reduce this competitive disadvantage for European institutional investors wishing to participate in transactions initiated by third-country originators/sponsors.

    The industry noted that this new interpretation of SecReg represented such a competitive disadvantage, with third-country originators potentially subject to European implementations

[62] *Consultation Paper on the Securitisation Disclosure Templates* (europa.eu) page 43, paragraph 130-ii.

and declarations, that it could prevent European investors from accessing certain third-country markets.

The industry has therefore (i) requested that ESAs issue guidance to national supervisors on the application of Article 5(1)(e) during the transitional period, and (ii) proposed a dedicated reporting based on aggregated data, to be used for public and private operations when originated in third countries and provided by the European investors.

In its October 11, 2023 response, even though ESMA acknowledges that the European Commission's assessment, included in its October 10, 2022 report on the functioning of the European "STS" regulation requires adaptations, " it would be premature to issue a JC enforcement guidance to NCAs at this point in time" and that “in the absence of Level 1 changes, the fundamental issues around third-country securitisations could not be fully addressed". Against this background, ESMA is "considering what can be done in the absence of Level 1 changes in terms of reviewing the reporting templates for securitisations".

Given the materially adverse consequences of this requirement, the industry would welcome any clarification that could address the issue until a Level 1 review.

The due diligence is not proportionate and should be more principles based than overly prescriptive.

- **Article 6.**

  - Statement of the problematic:

Article 6(1) of the Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation (the "Securitisation Regulation") provides that the originator, sponsor or original lender of a securitisation (as such terms are defined in its article 2) shall retain on an ongoing basis a material net economic interest in the securitisation of not less than 5%. Article 6(4) of the SR further specifies that, in the context of a securitisation of financial assets, the retention requirement may be satisfied by the originator or the sponsor on the basis of the consolidated situation of the parent institution, financial holding company, or mixed financial holding company established in the European Union ("EU"), provided that the credit institutions, investment firms or financial institutions which created the securitised exposures comply with the requirements set out in Article 79 of Directive 2013/36/EU[63].

The Securitisation Regulation therefore allows, in the context of the securitisation of financial assets, the risk retention requirements to be complied with by the originator at the level of the consolidated group head, provided that (i) the parent or holding company is located in the EU, and that (ii) the entities which created the securitisation exposures comply with applicable prudential regulatory requirements.

  - This statutory framework calls for the following observations:

This ability is not available to European centric corporate groups involved in securitisation transactions of trade receivables or operating lease receivables arranged by French and/or European credit institutions.

[63] Directive 2013/36/EU of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.

However, and unlike financial receivables securitisations, it is very common to have several originators participants to a securitisation of trade receivables or operating lease receivables.

Yet, in practice, it is quite common that these corporate groups have a centralised management of the cash flows and management. In this context, it may be appropriate, whether for economical or operational purposes, to centralise the retention of material net economic interest in the securitisation with the holding entity of the group, which would typically be the entity that centralises the cash flows and management for the group, which would also centralise the cash flows for the purposes of the securitisation transaction.

- We therefore propose extending the ability to comply with the retention requirements at a group level to European consolidated corporate groups.
- As a result, and similar to financial consolidated groups, European consolidated corporate groups would be able to designate a centralizing entity located in the EU that would comply, at a group level, with the risk retention requirements and, as applicable, the transparency requirements under respectively Articles 6 and 7 of the Securitisation Regulation.

This would certainly facilitate the organisation of the risk retention within the group, as well as simplify the structure of the securitisation transactions and the cash flows. It may also, subject to conditions to be further investigated, allow these transactions to qualify for the designation "simple, transparent and standardised securitisation (STS)" where certain subsidiaries are located outside of the EU, but the consolidating holding company is located in the EU.

- Proposed framework:

Securitisations of both financial and trade receivables would comply with Article 6 of the Securitisation Regulation under the following conditions:

(A) The consolidated situation of the parent company or institution, corporate or financial holding company, or mixed financial holding company established in the European Union:

(1) Would be directly responsible for complying with the obligations laid down in Articles 6 (and, as applicable, Article 7) of the Securitisation Regulation; and
(2) In the event of breaching the related requirements, would be held accountable under these Articles.

(B) As a result of the above, European consolidated corporate groups would be able to (i) centralise the responsibilities under the Securitisation Regulation at a group level and may thereby (ii) enable the transaction to qualify as an STS transaction within the meaning of the Securitisation Regulation.

- **Article 7.**

In October 2022 the European Commission published a report on the functioning of the Securitisation Regulation, identifying several targeted improvements in its functionality.

Among the areas marked for improvement, the European Commission recognised the necessity for a series of measures to improve the functioning of the transparency requirements and invited ESMA to review the technical standards pertaining the disclosure framework.

The industry welcomes the acknowledgement of the need to an improved reporting framework.

- Public and Private securitisations.

  The paradigm set by the United States in the realm of asset-backed securities is a very useful comparison point. Under the Regulation AB regime, "gold" standard is set but only for US Sec-registered ABS. This framework is characterised by its stringent and comprehensive disclosure, reporting, and additional mandates. It is important to note that adherence to this regime is not compulsory; rather, it is an elective system activated solely when an issuer aspires to secure full registration with the U.S. Securities and Exchange Commission (SEC). In contrast, for ABS transactions that remain private and outside the SEC's registration purview, the regulatory landscape is less rigid. In such cases, SEC-related stipulations are typically invoked indirectly, when lawyers issue a 10b-5 opinion with regard to material disclosures.

  In a separate vein, the disclosure, reporting, and other practices within the U.S. are significantly influenced by industry norms and the expectations set forth by established standards. These standards are frequently the product of the influential trade organizations that operate within the sector. For instance, within the spheres of U.S. Commercial Mortgage-Backed Securities (CMBS) and Commercial Real Estate (CRE) finance, the Commercial Real Estate Finance Council (CREFC) plays a pivotal role. The CREFC promulgates guidelines and recommendations, including a comprehensive investor reporting package, which both investors and issuers are anticipated to adopt and implement as a matter of course. This approach, steered by industry bodies in shaping best practices, is not an anomaly in Europe. Here, various trade associations, including but not limited to the Association for Financial Markets in Europe (AFME), the International Capital Market Association (ICMA), CREFC Europe, and the Alternative Credit Council (ACC) in conjunction with the Alternative Investment Management Association (AIMA), have long been engaged in similar endeavours and persist in this influential work.

  While some parts of the EU existing framework could be maintained since important efforts have been made for developing appropriate IT systems for some categories of transactions, for instance public securitisations and ABCP securitisations, some new templates should be allowed.

  Specifically for the private operations an aggregated template based on the ABCP template should be implemented while a simplified notification might suffice for supervisory purposes with the investor report to be performed without any predetermined regulatory format.

  A dual approach, consisting of a simplified approach for private operations (i.e, removing LLD) as first option, but leaving the option for a more granular approach on a case-by-case basis (with LLD), should also be implemented.

  This dual approach would on the one hand leave some needed flexibility matching each and every operation specification while not incurring unnecessary developments for the existing operation on the other hand.

  Granularity by itself cannot be a single essential characteristic for proper risk assessment. It must make sense for the type of underlying assets and the risk analysis (loan by loan or statistical approach).

  For highly granular portfolios (e.g., granular pools selected according to defined eligibility criteria, assessed on a statistical basis - based on historical data- and monitored through aggregate indicators, factoring, trade receivables), aggregate information (under the form of stratification tables) is sufficient and largely accepted by the market (and used in the prospectus and marketing materials to describe the portfolio in public deals).

This is even more the case for private securitisations (e.g., synthetic), for which investors can negotiate and use an ad hoc template suited to each transaction. In that case, the LLD template is in most cases unnecessarily burdensome, as many fields are irrelevant and sometimes difficult to populate. This adds additional (internal and external) costs for the issuer.

A granular LLD template can be useful for investor due diligence on some specific asset categories (e.g., mortgages).

Also, if the decision is taken to remove the granular LLD, the originators / sponsors / issuers will still be required to produce a granular LLD as it is likely that some market stakeholders (including the ECB) could require a loan-by loan template.

A potential revision of the loan level may also result in sizeable implementation costs for the sponsors/sellers (IT developments…).

Thus, it should be preferable to give the possibility to originator / seller to provide aggregate data for granular portfolios and private securitisations while maintaining LLD granularity for specific cases, as above-mentioned asset categories or on a case-by-case basis.

As originating banks, arrangers and lead managers of securitisation in the public and private market, our understanding is that the current data disclosure is too detailed and certain mandatory information is not required / used by the investors, rating agencies. The transparency is key for the investors, but excessive disclosure reporting is in our view an obstacle to the development of the securitisation market.

We don't see the investors using a lot the ESMA Templates to make their due diligence or to monitor the portfolio. The investor uses the investor report as primary source of information.

This is the consequence of having a standardised and one-size-fits-all reporting for both risk and supervisory monitoring, which was entirely misconceived.

For private transactions, it is useless to require mandatory reporting templates when the investors negotiate ad hoc template suited to their own requirements directly with the issuer. Indeed, for most private securitisations, the reporting used by investors is not just for risk evaluation but also for the active determination of the borrowing base/ utilisation of the transaction. It therefore requires specific information, tests on eligible assets, concentration limits and dynamic calculations that are not part of the ESMA Templates and require tailor-made templates.

Most of these private transactions are not ECB eligible and not rated by the rating agencies. In this context, there is no reason to provide detailed line-by-line information in a securitization repository. The level of disclosure should only be negotiated on a bilateral basis between the seller and the involved investors, it being specified that the investors shall in all circumstances be able to conduct a proper evaluation.

- Investor due diligence regime

  The establishment of a distinct and investor due diligence framework within the Level 1 text would be appropriate. The objective is to institute a principles-based structure that is equally effective and applicable across both primary and secondary markets. Moreover, it is designed to be inclusive of securitisations within the European Union as well as those from external jurisdictions.

  [The same principle could be applied to ABCP where the level 1 text (and relevant secondary legislation) is very poorly designed for ABCP transactions/programmes. There was never any

meaningful consultation during the original level 1 work on how (and whether) the regime should apply to ABCPs. Therefore, the amended level 1 text could include a separate Chapter with high-level principles-based framework only for ABCPs empowering the ESMA and the EBA to provide further details via level 2 measures (RTS/ITS), if considered appropriate, and/or via guidelines setting out the best practice recommendations. More detailed consultation with the industry should then be undertaken to ensure that any prescriptive implementing measures work and make sense for ABCPs.]