afme/
Finance for Europe

13th May 2015

The European Commission, Brussels

Submitted online and by email to fisma-securitisation-consultation@ec.europa.eu

Dear Sirs,

Executive Summary of AFME response to the Consultation Document "An EU framework for simple, transparent and standardised securitisation"

The Association for Financial Markets in Europe ("**AFME**") welcomes the opportunity to respond to the EU Commission's Consultation Document entitled "An EU framework for simple, transparent and standardised securitisation" dated 18 February 2015 (the "**Consultation Document**").

AFME and its members would like to thank the Commission for producing a carefully thought-out and constructive consultation document. The announcement by the Commission in its Work Programme for 2015 that it would develop an EU framework for high-quality securitisation is a clear indication that policy-makers within the European Union now recognise the positive benefits of securitisation for the functioning of the financial markets. The seven years or so that have passed since the onset of the financial crisis now provide strong evidence of how well most European securitisations have performed. A robust EU framework will help to reinforce the confidence in securitisation.

We fully agree with the Commission's statements in the Introduction to the Consultation Document that "The development of a high-quality securitisation market constitutes a building block of the Capital Markets Union and contributes to the Commission's priority objective to support a return to sustainable growth and job creation" and "Securitisation is a crucial element of well-functioning financial markets. Soundly structured, securitisation can be an important channel for diversifying funding sources and allocating risk more efficiently within the EU financial system."

AFME and its members are very encouraged that the Commission is taking a significant step forward to developing a framework for simple, standard and transparent securitisations that are "qualifying" securitisations following the progress already made at the EU and international levels in (a) the discussion paper on "The case for a better functioning securitisation market in the European union" issued by the Bank of England and the European Central Bank in May 2014, (b) the EBA Discussion Paper on simple standard and transparent securitisations published by the European Banking Authority on 14 October 2014 and (c) the consultative document from the BCBS and IOSCO entitled "Criteria for identifying simple, transparent and comparable securitisations" dated 11 December 2014. AFME has commented in detail on these papers.

Our substantive response consists of our key messages and some over-arching comments which are set out in this short letter, followed by our answers to the 18 specific questions posed by the Consultation Document which are provided via direct response to the questionnaire on the website, as requested.

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A. Key messages

The Consultation Document is a key step in efforts to revive the European securitisation market, as the Commission has exclusive power to propose new regulations or directives in the EU.

Our key messages are as follows:

- Securitisation has performed well, in both credit and pricing terms. For many asset classes, credit losses through and since the crisis have been negligible and well within expectations. To the extent there have been shortcomings, these have been addressed both by regulation (the Capital Requirements Directive/Regulation rules for risk retention or "skin in the game") and by positive and voluntary action and engagement by the industry itself (for example, the establishment of the Prime Collateralised Securities initiative ("**PCS**")).

- Securitisation is a critical tool in helping to build Capital Markets Union: prudently deployed and sensibly regulated, it can act as a bridge between the balance sheets of banks (and non-banks such as corporates) and the capital markets, enabling banks to de-leverage and divest risk and non-banks to diversify funding sources while providing investors with high quality fixed income securities at attractive yields, broadening and deepening our capital markets.

- Securitisation has not been treated on a level playing field with other forms of fixed income or other investment in recent years. The differential treatment in regulations affecting capital, liquidity, transparency and disclosure and derivatives, when compared with both covered bonds and direct investment in "whole loan" pools, are well known. These have no logical or intellectual justification, and while it can be argued that the risks of these different forms of investment may not be completely equivalent, the differential as it exists today is wholly disproportionate to any difference in risk inherent to the different instruments.

- It is essential to encourage non-bank investors to return to the market. With hindsight it can be seen that the pre-crisis securitisation market was overly dependent on bank funding (of one form or another). A rebuilt and sustainable market in Europe requires non-bank investors to be encouraged to return. Solvency II and the AIFMD regimes have precisely the opposite effect for insurance companies and AIFMs and we call for their urgent review.

- Securitisation must recover its function as a tool for risk transfer, not just providing funding. Because of its complexity, on a pure funding basis securitisation will normally be expensive compared with other forms of funding such as unsecured issuance and covered bonds. Securitisation can only compete meaningfully if its cost is compared with these competing products on a capital-adjusted basis, taking into account the saving in cost achieved by the freeing up of regulatory capital. While a single European framework for this exists in the form of the Significant Risk Transfer regime, many inconsistencies exist among different member states in its application despite guidelines already issued by the European authorities. These should be addressed urgently so that originators around Europe can assess the capital adjusted cost of securitisation on a uniform basis.

- Transparency and disclosure: securitisation as whole has been tarnished by stigma resulting from the shortcomings in disclosure that were prevalent in the run-up to the financial crisis in certain more complex structures which used securitisation techniques to create instruments that were opaque. It is important to distinguish these products, which (rightly) no longer exist due to both regulation and lack of investor demand, from the qualifying securitisation market where, as an asset-based form of borrowing, disclosure has always been extensive. This has always been what investors – rightly – have demanded. Disclosure in mainstream securitisation is more transparent than other forms of capital raising such as equity finance or unsecured borrowing, where investors have to rely on very high level financial statements rather than precise information on the assets supporting their investment. While the industry supports further improvements in the scope and accessibility of disclosure, there should be a single regime that is useful, easily accessible and carries minimal costs. To quote Yves Mersch, Member of the Executive Board of the ECB, "Some creative thinking on how to present the information in an accessible manner may help preserve legal precision while avoiding information overload."

- Risk retention: this has always been a feature of the European qualifying securitisation market, which has not used (in any material sense) the "originate-to-distribute" business model which helped lead to the problems in the US sub-prime mortgage market. As a result, AFME members consider that the rules for risk retention should be applied to all securitisations, and not just to qualifying securitisations, although we support the application of a direct approach to qualifying securitisations. We have also suggested in our answer to Question 3 certain adjustments to the risk retention regime to improve its functionality, following which we call for a period of stability in this area to help build certainty around the rules.

- It is important that regulations relating to qualifying securitisations be harmonised within Europe. Once criteria are agreed for identifying qualifying securitisations, existing regimes (notably those relating to Level 2B securitisations for purposes of the liquidity coverage requirement and Type 1 securitisations in the Solvency II Delegated Act) should be revised to conform with the criteria agreed as a result of the Commission's current consultation.

- While political challenges may exist, we ask for international co-operation and co-ordination of key securitisation regulations. Mutual recognition of risk retention rules would assist international capital flows between the US and Europe, as would recognition of and flexibility for the features of non-domestic assets in local disclosure regimes.

- While some benefit may be achievable in the medium to long term from a harmonised EU initiative regarding certain aspects of securitisation (e.g. asset transfer, legal form of securitisation vehicle) we do not believe these are appropriate areas of focus at this time. There are other, more urgent areas of focus and introducing today such an initiative would at the very least create a distraction while also risk potentially damaging and destabilising effects that would outweigh the longer term benefits of enhanced legal clarity and comparability for investors.

- While a single framework is one approach to remedy the issues listed above, and there may be advantages to consolidating regulatory requirements in one body of text, the issues that need to be addressed are well known and entirely capable of being remedied at a technical level, provided there is support from the Commission[1]. A new single framework, requiring a new regulation or directive, will take several years to come into effect, and carries significant risk both of delay and political opposition. We prefer a more practical, swifter and step by step technical approach to remedy each issue - capital, liquidity, transparency and disclosure, risk retention, money market funds and derivatives rules – separately and in parallel.

- Time is of the essence: each month brings more news of originators, structurers, underwriters or investors looking to exit the market as volumes have fallen to a level too low to justify the maintenance of staff, intellectual capital or technology. We urge the Commission urgently to take steps to address the regulatory factors holding back the recovery of the securitisation market by the end of 2015.

B. Over-arching Comments

1. *Identification criteria*

The criteria for "qualifying" securitisations should be uniform and principles-based, akin to the approach taken by the BCBS and IOSCO, with regulators given the ability to provide technical guidance in order to allow them to ensure that the purposes behind the regulations are met and to allow an appropriate level of flexibility as market practices evolve. Lengthy and complex criteria would be difficult to comply with and risk excluding a large number of transactions and structures in the market that are not intended to be excluded. This will also tend to stifle the natural development of markets – a process that should be encouraged in order to allow markets to adapt to meet the needs of new investors whose involvement in securitisation markets the Commission is seeking to encourage.

2. *Short term securitisation instruments*

We would like to stress that the ABCP and balance sheet (asset based) lending markets are a very important part of the overall securitisation market in Europe as well as being critical tools in funding the real economy. ABCP and balance sheet financing are the principal ways certain asset classes (e.g. trade receivables) are securitised, predominantly for corporates (including SMEs), making them a significant contributor to working capital supporting trade and business in the European Union. We believe that ABCP and balance sheet financing should be subject to a similar regime to the one described in the Consultation Document, but with criteria adapted to suit the specific characteristics of this form of securitisation. In this way, such short term simple, standard and transparent securitisations can support trade and the real economy. For further details, please see our response to Question 2 of the Consultation Document.

3. *International alignment of regulations*

The lower risk profile of qualifying securitisations should be recognised on an internationally consistent basis, so that investors have a level playing field. A mechanism for mutual

[1] Table 1 to the EBA's Discussion Paper on simple standard and transparent securitisations dated 14th October 2014 sets out a reasonably comprehensive list of the regulations which need attention.

recognition of equivalent "qualifying securitisation" frameworks being put in place in jurisdictions other than in the EU, whether as part of a BCBS and IOSCO initiative or otherwise would appear to us to be crucial to the success of the qualifying securitisation initiative in Europe, particularly as attracting international investment in order to broaden and deepen European securitisation markets is one of the objectives of the Capital Markets Union as set out in the Green Paper. It would give both investors and issuers confidence in the framework on a global basis. It would also allow market participants to structure transactions according to the requirements of their home jurisdictions, safe in the knowledge that investors in other jurisdictions would nonetheless be able to benefit from the improved regulatory treatment associated with a qualifying securitisation.

The risk retention and investor due diligence requirements would benefit from mutual recognition arrangements so as to ensure that there is a logical and proportionate relationship maintained between the cost of compliance and the resulting benefit to investors.

4. *Alignment of regulations within the EU*

Many of the regulations in the EU affecting securitisation seek to achieve similar goals, often in very similar terms but, unfortunately, the different regimes are not aligned. The result is that the costs of compliance multiply, creating confusion for, and little or no additional benefit to, investors.

5. *The relative regulatory treatment of securitisation compared with other products*

The review should also cover the relative regulatory treatment of other products. The regulatory treatment of, e.g. investment in covered bonds or directly in whole loan portfolios is very different from that of investment in securitisations. These differences are often not justified by the different characteristics and risk profiles of the products themselves. Change is needed in order to align the regulatory treatment - disclosure and transparency requirements, direct constraints and regulatory capital and liquidity treatment of investment products - more closely with the risks they present and the actual evidence of their performance through and since the crisis.

6. *Disclosure, transparency and monitoring*

It is helpful that the Commission's approach is to focus on transparency and the ability to understand and model risk, rather than an attempt to reduce or eliminate risk. The function of any efficient market is to price and allocate risk, not to eliminate it. In the case of the securitisation markets, the risk that ought to be priced and allocated is the credit risk of the underlying assets, as modified by the structuring of the transaction (via tranching and credit-enhancements such as swaps and liquidity facilities). It follows that investors need the information necessary to properly assess those risks and their ability to bear them so they can price the risk accurately. That makes sensible requirements relating to simplicity, loan-level data (where meaningful) and general ability to model the risk sensible and appropriate. Qualifying securitisations are not intended to be risk-free, and should not give the impression of being risk-free. Rather, the badge of "qualifying securitisation" ought to represent a belief that the risks are capable of being modelled reliably by the targeted investor base using the information made available to them.

C. Detailed answers to questions

Our answers to the 18 specific questions posed by the Consultation Document are provided via direct response to the questionnaire on the website, as requested.

Once again AFME and its members would like to thank the Commission for the opportunity to respond to the consultation document. Should the Commission wish to discuss any aspect of our response in further detail, please contact the undersigned.

Yours faithfully,

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