



ICLG

The International Comparative Legal Guide to:

Securitisation 2014

7th Edition

A practical cross-border insight into securitisation work

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EDITORIAL

Welcome to the seventh edition of *The International Comparative Legal Guide to: Securitisation*.

This guide provides the international practitioner and in-house counsel with a comprehensive worldwide legal analysis of the laws and regulations of securitisation.

It is divided into two main sections:

Seven general chapters. These are designed to provide readers with a comprehensive overview of key securitisation issues, particularly from the perspective of a multi-jurisdictional transaction.

Country question and answer chapters. These provide a broad overview of common issues in securitisation laws and regulations in 32 jurisdictions.

All chapters are written by leading securitisation lawyers and industry specialists and we are extremely grateful for their excellent contributions.

Special thanks are reserved for the contributing editor, Mark Nicolaides of Latham & Watkins LLP, for his invaluable assistance.

Global Legal Group hopes that you find this guide practical and interesting.

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Time to Support High Quality Securitisation



Association for Financial Markets in Europe

Richard Hopkin

During the last twelve months, for the first time since the onset of the financial crisis, the tone of the regulatory response towards securitisation has become more encouraging as policymakers increasingly acknowledge the positive contribution that high quality securitisation can make in helping to restore growth in Europe.

Hope grew that these senior policymaker views would translate into positive regulatory signals that would bring ABS investors back to the marketplace.

Last year concluded with a flurry of updates of major regulatory initiatives: firstly, the Basel Committee recommendations on capital requirements for bank investors in ABS; secondly, a report from the European Banking Authority (EBA) on liquidity; and thirdly the much awaited report from the European Insurance and Occupational Pensions Authority (EIOPA) on calibration of capital requirements for ABS investment by insurance companies under Solvency 2.

The final form of these regulatory initiatives will have significant implications on whether Europe's securitisation market begins to recover or continues to languish at historically low issuance levels.

The Basel Committee re-proposal on ABS capital requirements is a significant improvement on the first proposal. A number of the industry's requests have been, at least, partly accommodated: the overall hierarchy of approaches is much simpler; some account is taken of excess spread; and the proposed floor on risk weights has been reduced from 20 to 15 per cent. However, the amounts of capital likely to be required even under the revised proposals remain significantly higher than at present, and than is justified by the historically strong credit performance of most securitisations.

The new Solvency 2 calibrations issued by EIOPA also represent a positive step forward by recognising, for the first time in a regulation, the concept of high quality securitisation. For insurers holding ABS, EIOPA has moved from a 7 per cent capital requirement per year of duration, to 4.3 per cent. However, even this reduced requirement remains very high – for a five-year AAA RMBS, 5 years x 4.3 per cent = 21.5 per cent of capital would need to be held by insurers. There is growing market concern that the reduction to 4.3 per cent is unlikely to be enough to encourage insurance investors back to the market, or even for those who remain to stay.

The EBA report on the liquidity coverage ratio takes a narrow approach, including only RMBS, subject to certain conditions, as a high quality liquid asset. AFME has consistently sought a broader approach, and we believe there is evidence to support the inclusion of other forms of high quality securitisation such as auto loans.

Whilst these initiatives show some positive steps forward, much remains in the balance. Securitisation issuance in Europe remains

depressed and significant threats remain to the revival of the securitisation market, both from existing and new regulatory proposals, and from overall monetary policy.

New Issuance and Outstandings

New issuance remains very low. AFME's most recent data report available at <http://www.afme.eu/Divisions/Securitisation.aspx> shows that total issuance in Europe for 2013 was €181 billion, a fall of 28 per cent from 2012. Of this headline figure, only €76.4 billion – just over one-third – was placed with investors. The rest was retained by issuers and used for repo purposes with the ECB or national central banks.

For comparative purposes, the 2007 market saw €454 billion of issuance, nearly all of which was placed, so the market has shrunk by over 80 per cent over five years.

Dealing with the Past

While a more balanced view of the benefits of securitisation is beginning to emerge, some outside the industry still perceive securitisation negatively. This is a mistake: the evidence continues to show that credit, liquidity and ratings performance of high quality European securitisations since the crisis has been very good.

To address this misperception, much work has already been done to restore the reputation of securitisation, both through market-led initiatives and new regulations – many of which are now in place. The Prime Collateralised Securities (PCS) label is fully established and has already built an impressive market share. The European DataWarehouse has been implemented and will, for the first time, make available loan-level data for all ECB-eligible securitisations in a single central database. The industry has adjusted well to the risk retention requirements of Article 405 of the Capital Requirements Regulation¹, something made easier by the fact that nearly all European securitisations already retained “skin in the game” even before the financial crisis.

A Change in Tone

Many high-level policymakers have recently made positive remarks about securitisation, and the need to restore the market, most recently President Draghi and Yves Mersch of the ECB and Andy Haldane of the Bank of England. In its March 2013 Green Paper “Long-Term Financing of the European Economy”, the European Commission acknowledged that “reshaping securitisation markets could also help unlock additional sources of long-term finance ...

and help financial institutions free capital, which can then be mobilized for additional lending”.

Regulation Continues to Solve for the Last Crisis, Not the Next One

Unfortunately, despite these high-level statements of support and the cautious optimism brought about by recent regulatory developments, the reality of regulation on the ground remains one of heavy calibration, overly broad scope and a continuing focus on the past.

Many issues in existing regulations remain unresolved, such as the Basel, Solvency II and liquidity issues mentioned above.

In addition, important new regulations have emerged in recent months which, if not adjusted, will strongly discourage any revival of the securitisation market.

The most significant of these include the regulation for money market funds proposed in September 2013 by the European Commission, which bans money market funds from investing in securitisations other than those which fall within a narrow definition of “eligible securitisation”. Some in the European Parliament are proposing restrictions on tranching, so that no eligible securitisation can have more than three tranches – an idea that ignores the fact that tranching is a response to investor demand, not complexity for its own sake. Such restrictions would prohibit money market funds from investing in asset-backed securities and asset-backed commercial papers, reducing funding for corporates and the “real economy”.

The recent publication by ESMA of its consultation paper on draft Regulatory Technical Standards for additional disclosure for structured finance instruments also gives rise to concern, by extending existing disclosure requirements to private transactions and imposing a legal requirement for loan level data for all asset classes, however granular.

Is the Cure Prolonging the Disease?

The deeply subdued volumes described above are partly caused by today’s highly unusual monetary conditions; it is difficult to make the argument that securitisation is cost-effective when much cheaper funding is plentifully available under various ECB and national central bank schemes. While from a macro-economic perspective the reasons for current monetary policy are understood, an unfortunate side-effect is that reduced deal flow is making it more and more difficult for investors to justify the infrastructure they need – experienced analysts, data and technology – to maintain a presence in the market.

A Call for Action

Securitisation has a critical role to play in providing funding for growth. In an environment where banks are deleveraging, European businesses that traditionally relied on banks must now instead access the capital markets. It is time to stop punishing securitisation, and instead nurture and expand it to help ensure economic growth.

Securitisation has changed. New regulations mandate better alignment of risk, greater transparency, and less reliance on credit ratings. Market initiatives promote a focus on high quality.

2014 is shaping up to be a pivotal year. Much work remains to be done to ensure more co-ordinated, more sensibly-calibrated and evidence-based regulation that better reflects the performance of high quality European securitisation. Only then will securitisation be able to play its full role in funding Europe’s recovery from recession.

Endnote

- 1 Formerly Article 122a of the Capital Requirements Directive.



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He has originated, structured and distributed financings backed by a wide variety of asset classes including mortgages, credit cards, auto, consumer and SME loans, from across Europe, Australia and the US.

Born and brought up in Wales, Richard read law at Cambridge University and before embarking on his banking career he qualified as a solicitor with leading international law firm Clifford Chance.



The Association for Financial Markets in Europe advocates stable, competitive and sustainable European financial markets, which support economic growth and benefit society. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks, as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association through the GFMA (Global Financial Markets Association). For more information, please visit the AFME website, www.afme.eu.

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