
Global ABS 2015

Keynote speech delivered by Fernando González

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Introduction

Ladies and Gentlemen,

It is a pleasure to be here in Barcelona with you—the European ABS landscape has changed a lot in the last twelve months and there is much to discuss. My remarks this morning as Head of the ECB Risk Strategy Division involved in the implementation of the various asset purchase programmes launched by the Eurosystem will try to provide clarity to some key features of the ABS Purchase Programme, including the aims of the programme and its achievements to date. I will also set out what in my personal view could further support European ABS markets, including some additional transparency on the workings of the ABSPP. Let me remind you that my views may not necessarily represent those of the ECB.

Aims and achievements of the ABSPP

Let me start by explaining what the Eurosystem is trying to achieve with the ABS Purchase Programme. Put simply, the ECB's Governing Council seeks to use ABS markets to transmit the Eurosystem's monetary policy stance throughout the euro area economy. In this way, the ABS Purchase Programme is no different from our covered bond and public sector purchase programmes.

However, it is obvious that there are far fewer publicly-placed ABSs to be bought than covered bonds and government bonds. This doesn't mean the Eurosystem doesn't try to achieve volume when the opportunity arises, but rather that its general focus is more targeted. In other words, as part of our efforts to transmit an appropriate monetary policy stance, the revitalisation of the ABS marketplace is also deemed important as far as it helps transmitting monetary policy impulses. In my opinion, this means that one should think in terms of incentives for issuers to issue new simple and transparent ABS deals, in terms of removing stigma attached to the ABS brand, and in terms of not crowding out private investors. Let me also remind you that, as announced, the ECB intends to continue the ABS programme until at least September 2016.

So how is the market doing so far? Well, European ABS issuance, in particular within the Eurozone, is still low, but it appears to be picking up. But I think one should wait longer before ABS issuance can be used to gauge the success of the programme. Also, let's not forget that there are other reasons for low ABS issuance which the programme cannot address. For example, there are cheaper alternatives than ABSs for obtaining funding or raising capital, and there remains an uneven playing field in terms of regulatory treatment.

But let's consider the impact of the ABSPP from some other perspectives. For one, it seems that the Eurosystem's presence in the ABS market is helping to further de-stigmatise the asset class. Some investors that had left the market following the crisis have reportedly started returning.

Moreover, judging by the allocations the Eurosystem receives in primary issuances, in my opinion, it is clear that crowding out of investors is not taking place. While it is true that ABS spreads have fallen generally since the announcement of the programme, this to me does not automatically signal a crowding out of investors. The decline in spreads may also come from a more appropriate recognition of certain tranches' risk profiles, following the vote of confidence given by the Eurosystem. Indeed, some market participants have begun producing indices of ABS Purchase Programme eligible spreads. These spreads are consistently much lower than spreads for ABSPP ineligible tranches, for the same country and ABS type.

Another interesting fact is that we have seen quite substantial market volatility in the past few months, affecting sovereign bond markets as well as equities, corporate bonds, and other instruments. But ABS spreads appear to have shown less volatility and have generally held up relatively well.

Finally, since last November, the Eurosystem has screened and examined hundreds of transactions, which has built up significant ABS expertise across asset classes, jurisdictions, and vintages. This knowledge gained is leading to positive spillovers. For example, the Eurosystem is now able to better contribute to regulatory discussions on simple, standard, and transparent ABSs. Elsewhere, and the Eurosystem datasets contribute in helping regulators examine the desirability and impact of their proposals, such as for ABS transparency requirements.

What can the ECB do further to help the ABS market?

In my opinion, one also has to be realistic about the possible impact of the ABS Purchase Programme on the ABS market. Indeed, there are many hurdles to the market's functioning that are not within the Eurosystem's mandate. On this point it should be acknowledged that the ECB is not an "ABS regulator". This is the job of the Commission, the Basel Committee, the European Banking Authority, and other institutions who are directly concerned with setting rules to govern ABS markets and their participants.

Unlike regulators, the ECB has a (growing) balance sheet that needs to be managed in a prudent way and public funds to safeguard, which is why the Eurosystem must set its own rules to govern what ABSs it can accept as collateral or as policy portfolios. However, unlike the private sector, the Eurosystem does not have a profit-maximization objective.

Nevertheless, let me express my personal views on what is needed to further revitalise the ABS market. Some of these views follow on earlier suggestions done by the ECB together with the Bank of England about a year ago. First, it is clear that capital requirements for securitisations must accurately reflect their risks, where efforts have been made by market participants to provide relatively simple, straightforward, and transparent products. This risk sensitivity in capital requirements should be consistently applied across banks, insurers, and other market participants where relevant. Doing so will help avoid future loopholes and regulatory arbitrage, while also encouraging a diversified ABS investor base.

Following on from this desire for consistency, I believe it is important that the criteria for qualifying ABSs are applied across the regulatory framework, including Solvency II, Liquidity Coverage Ratio, Capital Requirements Regulation, and elsewhere. For example, at the moment, the criteria for Solvency II are different from the criteria for the LCR, which are in turn different from the criteria developed by the European Banking Authority. I understand that this issue will also be tackled by the European Commission in a comprehensive package for an EU framework including qualifying securitisations, and can only applaud this endeavour. I also hope that these measures can be fast-tracked by the European Parliament and in the Council.

I would also repeat the ECB earlier statement with the Bank of England that the most effective way of implementing these criteria is self-attestation by originators, combined with supervisory oversight by regulators and, of course, ABS due diligence imposed by responsible investors.

But investor vigilance should not translate into unnecessary burdens. That is why I believe that investors' lives need to be made easier going forward, in terms of their access to transparent and consistent information on the ABSs they consider purchasing. This is about investor reports, deal documentation, and broader ABS structures and arrangements. I know that there are many legal, cultural, and economic reasons for the divergences in ABS types that we see, yet I also believe that harmonised ABS transaction templates are not impossible to achieve. Even if this process happens within a country, this would already be an important step forward. Ultimately, if a deep and diversified ABS investor base should consolidate, in my view there is a need to make it easier and less costly for investors to satisfy their due diligence requirements. In saying this I also welcome the recommendations of the recent Joint Committee report on ABS transparency standards.

Further details on the ABSPP

But let's come back to the ABS Purchase Programme which from my perspective is an important lever at the Eurosystem's disposal to also further support the ABS market. I would like to provide some further clarity on how the programme works.

Let's start with the basics. The Eurosystem has currently four external and one internal asset managers who are tasked with proposing ABS purchases to us. The manager must prepare a memo for our consideration, which is expected to address all salient features of the transaction. Each proposal is assessed in terms of its price and in terms of its credit risk, after which a final sign-off is required by the Eurosystem. The Eurosystem aims to complete its screening and make a decision as quickly as possible, usually within a few days for first-time purchases and faster for repeat purchases.

Notwithstanding occasional criticism that the Eurosystem might be too slow to react, I am quite satisfied with this turnaround time, which is also driven by our desire to meet the same ABS due diligence requirements that apply to banks in the Capital Requirements Regulation. Although this process requires effort from our asset managers, this does not go beyond the normal due diligence for any conscientious investor. And it is natural that the effort necessary to prepare the memos is also driven by the complexity of the transaction.

It is important to emphasize that the Eurosystem strictly follows the ABSPP eligibility criteria decided upon by the Governing Council last October. One of these requirements is that only ABSs which fulfil the Eurosystem collateral criteria may be purchased. As an example, this implies that the Eurosystem requires the provision of loan-level data, even in the case of primary market issuances.

Once ABSPP eligibility is confirmed, the Eurosystem then embarks on its credit risk analysis, because purchasing an ABS is not the same as accepting it as collateral, on which I will now make some remarks. During the process of screening several hundreds of deals, the Eurosystem has found that certain types of bonds are more straightforward to understand than others.

The features we find easier to understand broadly accord with the EBA's draft simple, standard and transparent securitisation criteria. I look forward to seeing the final set of criteria from the EBA, which will reflect also the outcome of their public consultation.

By saying that we find some ABSs easier to understand than others, I do not wish to imply that the Eurosystem limits itself to certain asset classes, jurisdictions, or issuance periods. The eligibility criteria and operational framework of the ABS Purchase Programme have been decided upon by the Governing Council and a new criteria is not being added here. Instead, this statement reflects the natural evolution of how the Eurosystem sees ABSs as its experience of assessing them deepens.

I would also like to take this opportunity to provide you with a few details on a separate ABS topic, namely residual value auto ABSs. Earlier this year, the Eurosystem announced that such ABSs will become ineligible as Eurosystem eligible collateral from 1 September onwards. Many of you have asked for further clarification regarding the motivation for this change.

The simple answer is that the Eurosystem, having thoroughly investigated the topic and consulted stakeholders, was concerned that, with residual value auto ABSs, it would be exposed to market risk, rather than credit risk. All other types of ABS currently accepted as collateral have as underlying assets loans, receivables or obligations on individuals or SMEs. These ABS types all expose the noteholders to the credit risk of the underlying obligors.

However, with residual value transactions, one is instead exposed to the market risk of selling a car, rather than the credit risk. Of course, it may be theoretically possible to model such market risk and size the senior tranche credit enhancement conservatively. Nevertheless, having exposure to securitized assets with market risk rather than credit risk goes against the spirit of the type of ABS we want as collateral.

Nevertheless, the Eurosystem also balances its risk management concerns with ensuring that issuers have as many viable options to fund themselves as possible. We continue both to monitor this asset class and to have discussions with key industry stakeholders. As with all topics associated to Eurosystem collateral, if market participants can provide a convincing business case relating to our rules, we will of course consider it.

What can be expected from you?

Before I conclude, I would like to turn the focus towards you. You now have more clarity on the workings of the ABSPP. We are all part of the ABS market and I believe there are actions that you could also take which could help.

One such action is to issue future ABSs that make our lives easier as investors, namely, simple, standard, and transparent ABSs. I believe the Eurosystem will of course still consider all types of eligible deals, particularly older transactions issued when times were different. But, remember that the Eurosystem requires other investors to buy in parallel with us. So, ABSs that are simple and transparent are most likely to please many investors, which over time will also help remove any remaining stigma issues and improve market liquidity.

Another step that I believe you could take would be further enhancements to ABS transparency. I am pleased to say that in my view, the ECB loan-level data initiative has been a resounding success overall, with excellent compliance by data providers. However, for those originators still not providing basic fields such as current loan to value, I can only say that this creates more doubt for everyone about your ability to create healthy ABSs.

The same could be said for originators who do not provide information of loan modifications and repurchases in their investor reports. Even if disclosing this does not reflect favourably on your deal's performance, the alternative is worse, because the resulting doubt over the true performance of these and other ABSs you issue is likely to stay around much longer than the one-off impact of this disclosure.

And, while we are on the topic of investor reports, any standardisation that could be achieved would be enormously helpful for attracting more investors from outside the local market. I know this process of investor report standardisation has already begun in jurisdictions like the Netherlands, and can only encourage other jurisdictions to coordinate in this direction. Additional standardisation of deal documentation would also be highly appreciated both by us and, I am sure, other investors.

Finally, I suggest you use all this additional transparency to reduce reliance on ratings and form your own opinion as well. There is more data and there are more tools available than ever before to assist you. And investor engagement is crucial for the success of the simple, standardized, and transparent ABS philosophy. In other words, self-attestation by originators and a disciplined investor base are the most cost-effective way of keeping everyone honest.

Conclusions

Let me conclude. I believe that the fate of Europe's securitisation market depends on four key groups. It is up to the first group—originators—to create ABSs that meet the preferences of investors such as ourselves. Investors, who are the second group, should take advantage of this unprecedented increased transparency to continue developing their own opinion of ABSs and, perhaps, not be shy in requesting additional transparency in other nearby products where they see a need.

Regulators are the third key group, and it is up to them to review capital requirements for simple standardised and transparent ABS, and improve the consistency of regulation across market participants and financial products.

The final group, in my opinion, is the Eurosystem which, in line with its monetary policy stance, also aims for a revitalisation of ABS markets via the ABS Purchase Programme.

A full revival of this market will not happen overnight. However, if we all pull our weight then I am confident that EU ABS markets have a successful future to look forward to.

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