Myth busting – liquidity in ABS

Perception:

Securitisation does not and should not form a meaningful part of bank treasury liquid asset book.

Reality:

Securitisation bonds are a unique source of market liquidity which banks would take advantage of if it were not for the lack of risk sensitivity of the LCR framework and the limited supply of eligible assets.

For more information:

- AFME Survey: Bank Treasuries
- Comparing ABS and Covered Bond Liquidity: EUR
- Comparing CB, ABS and Corporate Bond liquidity: GBP

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Reality: Securitisation bonds are a unique source of market liquidity which banks would take advantage of if it were not for the lack of risk sensitivity of the LCR framework and the limited supply of eligible assets.

- Securitisation is an underutilised source of uniquely diversified liquidity for banks which would support prudential stability.
- AFME's bank treasury Survey highlights the 3 main reasons for low ABS investment linked to the LCR framework.
- The EBA's last LCR stress test was based on data between 2008 – 2012, ie. prior to implementation of the Basel Securitisation Framework in 2013 and implementation of EUSECR in 2019 and therefore referencing prohibited transactions under existing regulation.
- Empirical studies using data since implementation of the Basel Standards evidence market liquidity in securitisation is comparable to covered bonds. Nevertheless, LCR treatment is very different.
- Improved access to securitisation for banks would ambitiously raise investment levels from c.EUR25bln up to an estimated range between EUR150 - 250bln. Ie. less than 5% of HQLA. This would in turn support greater market liquidity in the product and financing of the green and digital transition.

Securitisation: important source of diversified liquidity for banks

HQLA eligible collateral is overweight fixed rate bonds

- Promotes instability in certain economic scenarios; recent egs - LDI Crisis in UK / Silicon Valley Bank / Signature Bank
- More than 85% of the EU bond market is made up of fixed coupon bonds (EUR23trln / EUR27trlln) e.g. Covered bonds (c.80% fixed rate)
- Conversely, over 75% of securitisation is floating rate
- Securitisation constitutes less than 3% of the EU bond market but over 20% of all floating rate bonds
- What is more, the majority of securitisation bonds are floating rate and rated AAA or AA (EUR535bln / 710bln)
- On this basis, at least EUR150bln of HQLA would be more representative of EU banking HQLA book (20%x15%=3%)

Key numbers

- Size of EU bond market: €27 trln
- Percentage floating rate: 15% (€4 trln)
- Size of EU ABS market: €990bln
- Percentage floating rate: >75% (€740bln)
- AAA/AA floating rate ABS: > €540bln

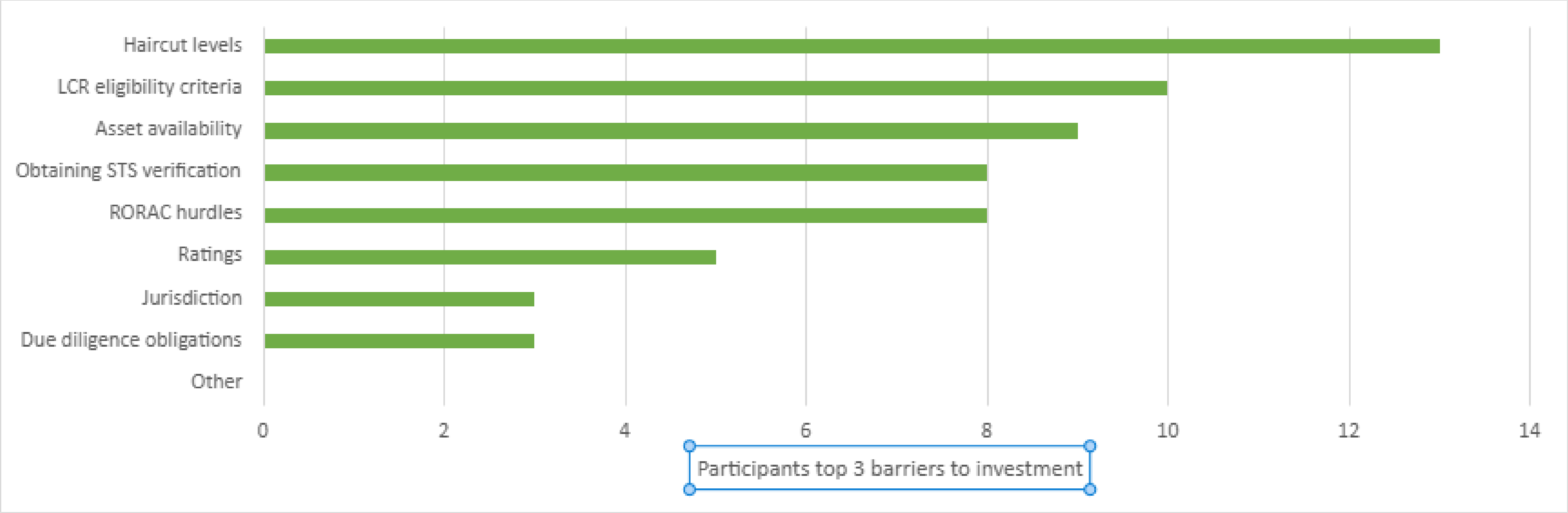
- Securitisation bonds rated AA and above should be an important source of uncorrelated liquidity for banks

- Source: Refinitiv, ECB

Securitisation: why is securitisation underweight in EU banks LCR buffers

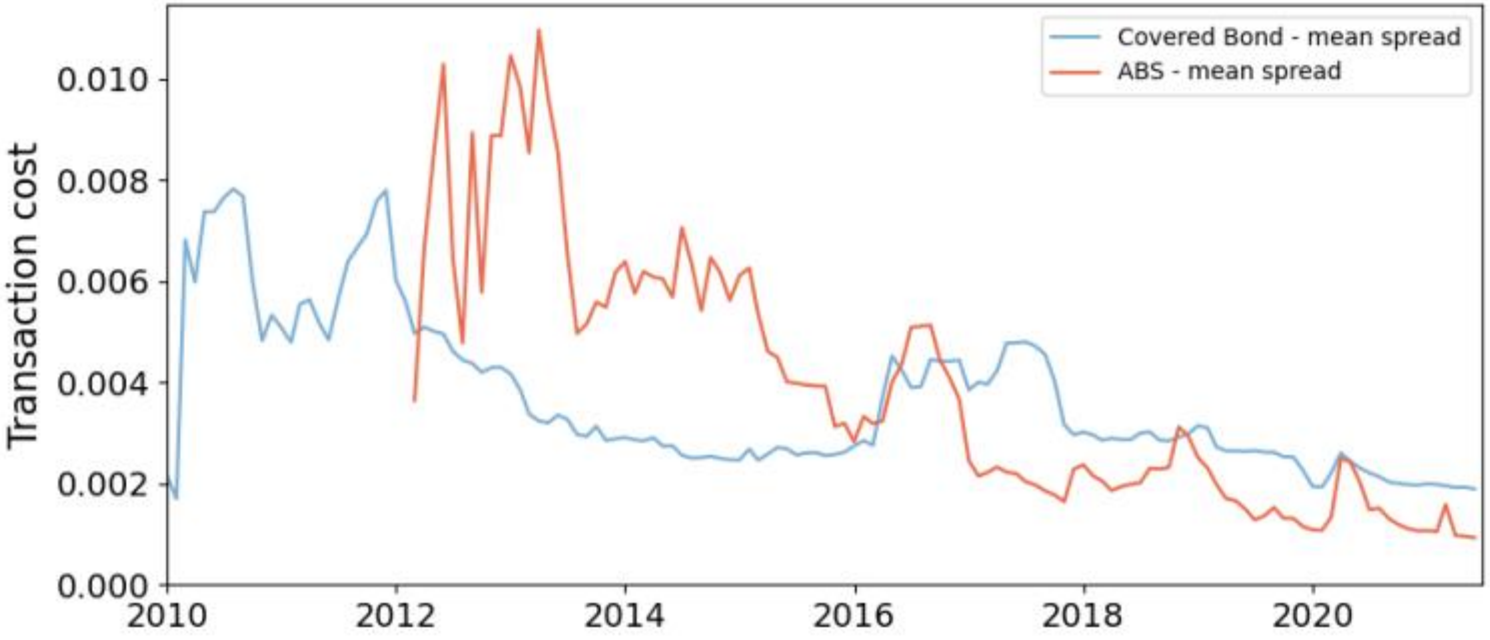
AFME conducted a survey of 25 bank treasuries in Europe to determine why securitisation is so poorly represented

Link to AFME's Survey here



Securitisation: a source of market liquidity over the long term

Plot of Average transaction cost: AAA ABS vs. AAA CBs



Source: RCL / AFME Research note – Comparing ABS and Covered Bond liquidity

- Study examines relative liquidity of senior Asset Backed Securities (ABS) and Covered Bonds (CBs).
- The analysis is based on bid-ask spread data on all securities in the two asset classes for which information is available on Bloomberg for the period 2010 to 2021.
- Key findings: 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.

For more information:

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EU CRR vs. Basel (1/2) – Gold plating the International Standard

	Basel Framework	EU
Eligibility: HQLA Type	Level 2B	Level 2B
Eligibility: Product Type	RMBS with a rating of AA or higher	The most senior tranche of AAA rated STS[1] securitisations The STS requirement imports a large number of additional and onerous eligibility criteria[2]
Eligibility: Underlying Assets	Residential mortgages, provided they are full recourse loans and the max. LTV of pool at issuance <=80%	Residential loans to individuals for their main residence satisfying either: avg. LTV of pool <=80% or LTI requirement in national law of MS where the loan was originated[3] Fully guaranteed residential loans meeting collateralisation requirements in Article 129(1)(e) CRR[4] and avg. LTV of pool <=80% Commercial loans, leases, and credit facilities (except to finance CRE), provided that >=80% of pool is SME exposures Auto loans and leases to EEA lessors Loans and credit facilities to EEA individuals for personal or household consumption

EU CRR vs. Basel (2/2) – Gold plating the International Standard

	Basel Framework	EU
Other Eligibility Criteria	Traded in large, deep and active repo or cash markets with a low concentration level Max. decline in price <= 20% or increase in haircut over 30-day period <=20 percentage points during period of liquidity stress Subject to risk retention requirements Underlying assets are not originated by, and securitisation not issued by, bank seeking to include securitisation in liquidity buffer or its affiliates	• Tranche size >= EUR 100 million (or equivalent) • Remaining WAL <=5yrs • General liquidity buffer requirements require assets to be "listed on a recognised exchange or tradable via active outright sale or via simple repurchase transaction on generally accepted repurchase markets", trading venues that are not recognised exchanges must provide for "an active and sizable market for outright sales of assets" with specified indicators • Underlying assets are not originated by bank seeking to include securitisation in liquidity buffer or specified affiliates, and originator of underlying assets is a CRR institution or specified financial institution • Issuer is not bank seeking to include securitisation in liquidity buffer or specified affiliates[5]. Issuer is not an institution or specified financial institution • Subject to risk retention requirements (as are all EEA securitisations)
Haircuts	25%	• 25% for RMBS and auto ABS • 35% for SME and consumer ABS
Max proportion of liquidity buffer represented	15%	15%