Myth busting – Banks and Securitisation

Perception:

Banks should not hold securitisation exposure because it is too risky

Reality:

Securitisation plays an important and necessary role for EU banks in financing the economy

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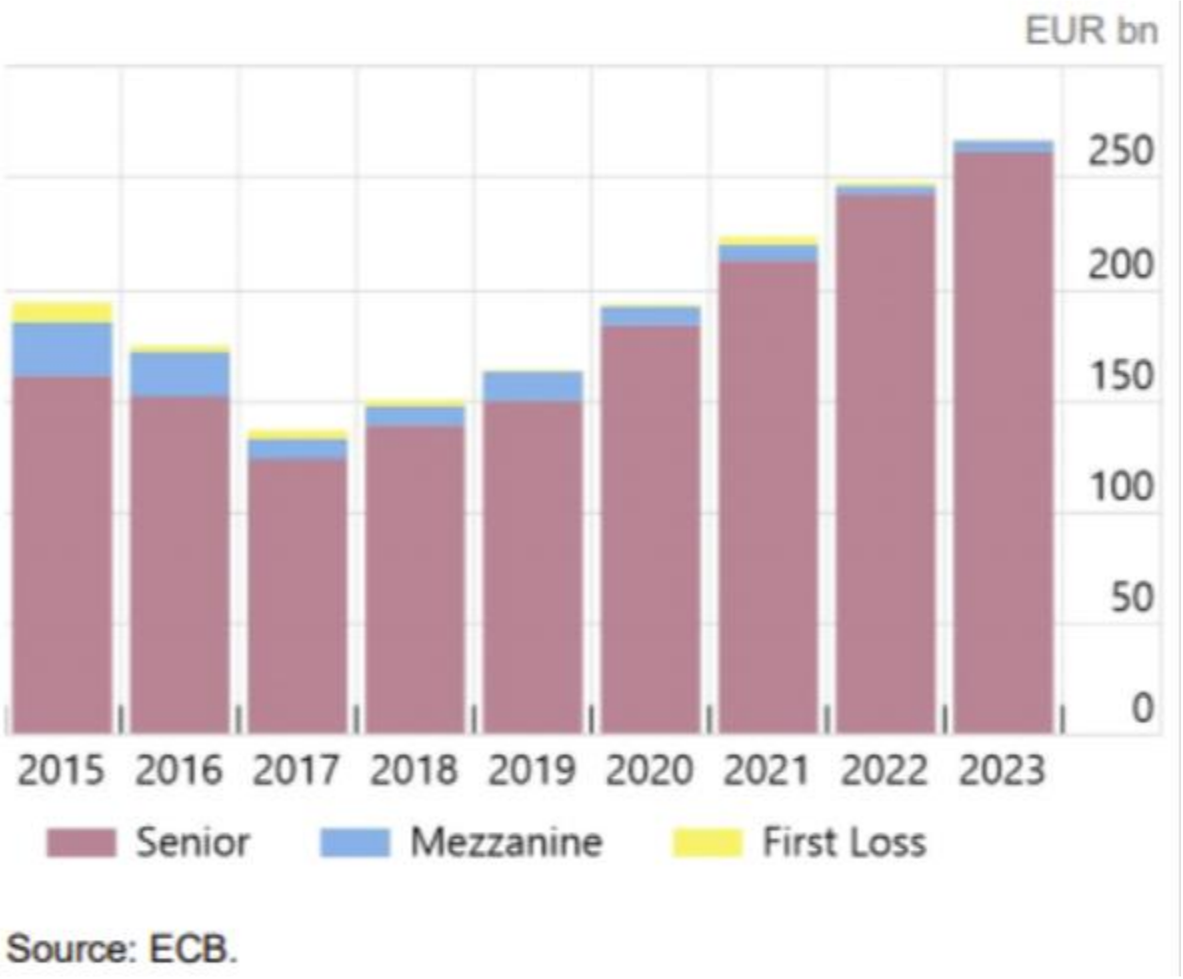
Reality: Securitisation plays an important and necessary role for EU banks in financing the economy

- Securitisation is an important tool for banks to finance investment banking and commercial banking clients (either via ABCP conduits or directly via the banking book). Securitisation enables banks to provide secured financing to clients without taking credit exposure to them. Banks have, instead, first claim to the securitised collateral pool, with the exposure typically rated AAA to Single A.
- Banks use securitisation (SRT) to transfer credit risk ("UL" (unexpected losses) and "EL" (expected losses)) from their prudential balance sheet. In doing so, they more often than not retain the most senior tranche which is of low residual credit risk.
- Senior tranches of securitisation are used as repo collateral to obtain liquidity from either the Central Bank or counterparties.
- Securitisation is also a unique source of uncorrelated liquidity for bank treasurers, which supports micro prudential stability.
- **It is crucial to recognise, therefore, the distinction between banks holding the <u>most senior / least risky tranches</u> of securitisation (see Myth busting series: <u>Episode 1</u>) and banks holding more junior / riskier tranches.**

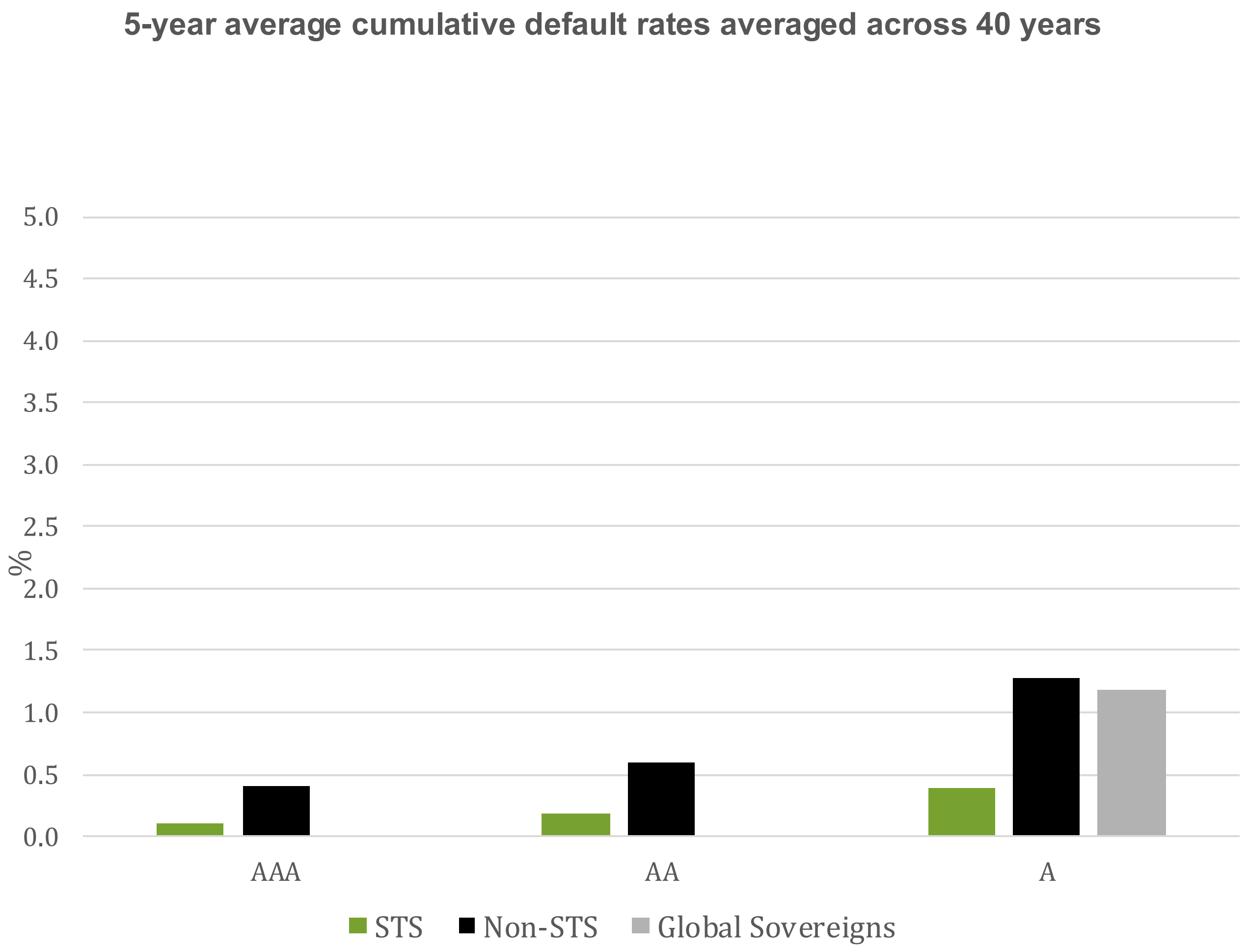
FSB recorded bank exposure to securitisation

Bank exposure to securitisation is nearly entirely senior tranche risk



Source: ECB / FSB Final Report "Evaluation of the Effects of the G20 Financial Regulatory Reforms on Securitisation"

Historical default rates on securitisation permissible under EUSECR held by banks have been consistently low

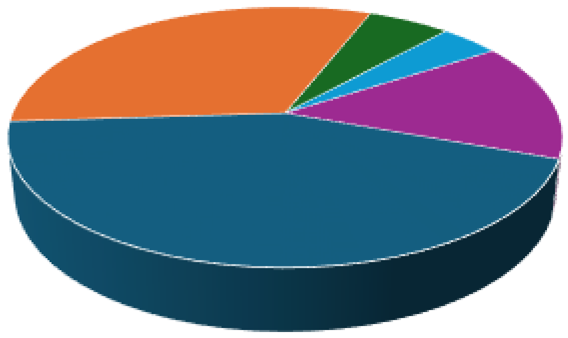


Senior tranches held by banks are typically rated single A or better and have performed in line with government bonds (generally considered one of the safest asset classes) over a 40-year study period.

Source: S&P Global Market Intelligence CreditPro. Average default rates based on 1983-2024 period. Historical proxy for STS sectors is ABS (excl. whole business), RMBS (excl. buy-to-let, nonconforming, nonperforming, and reperforming), and SME CLOs. Historical proxy for non-STS sectors includes whole business, buy-to-let, nonconforming, nonperforming, and reperforming RMBS, leveraged loan CLOs, and CMBS.

Securitisation: Key to financing commercial banking clients

EUR 230bln: Estimated bank commitments to clients by asset class



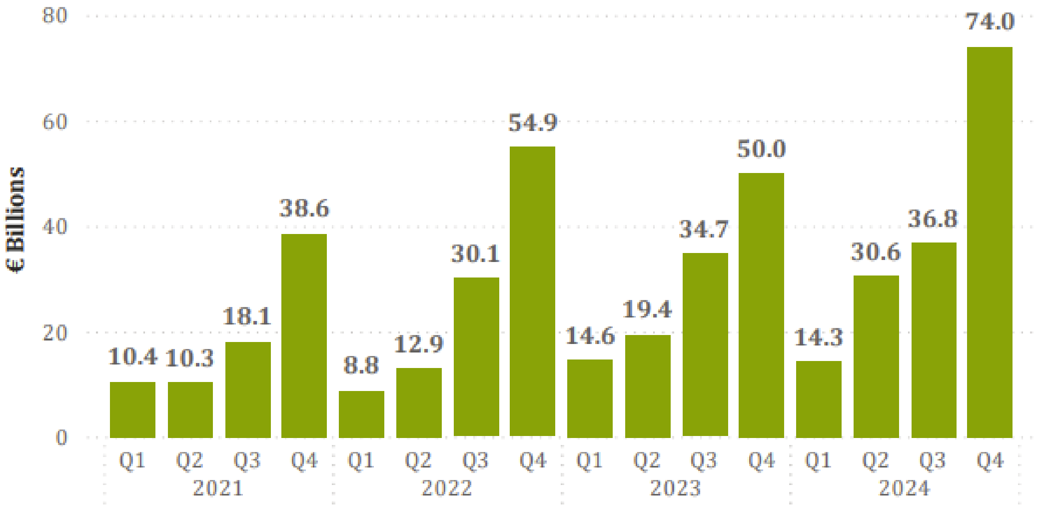
European Benchmarking Exercise (EBE) for Private Securitisations

- **EUR 230bln of funding:** The total estimated outstanding balance of private funding via securitisation by banks to the real economy in EMEA*.
- EUR 75bln of bank lending via ABCP conduits, financing the real economy in EMEA, rated by Moody's as at 30/06/2024.
- Banks provide additional financing to this client base directly via banking books.
- Securitisation enables banks to reduce credit risk exposure to the client base through securitisation (see the bar chart on the left hand side).
- ESG securitisation is a useful tool for banks to finance the green and digital transition.

*Source: European Benchmarking Exercise Report for Private Securitisations (H1 2024)

Credit risk transfer (CRT or SRT) is an important tool for banks to evacuate credit risk

4.1 Quarterly European SRT securitisation issuance



4.2 Top 10 asset classes for annual issuance (€ Billions)

	2021	2022	2023	2024
Corporate and SME loans	40.7	82.1	87.3	107.5
Consumer loans	3.0	2.3	9.7	14.8
Auto loans	5.8	4.5	2.6	7.7
Real estate / Mortgage loans	9.5	7.0	7.3	7.0
Leveraged loans	1.4		1.4	6.7
Leasing	2.0	6.9	3.8	4.0
Project finance loans	0.6	2.5	2.3	3.5
Transport, infrastructure and energy loans			1.7	0.2
Buy now pay later loans		1.4	0.7	
Undrawn corporate revolving facilities	5.3			
Other	9.0	0.1	1.9	4.4
Total	**77.3**	**106.8**	**118.7**	**155.7**

In 2024, over EUR150bln notional of credit risk across an array of banking products from bank originated lending was transferred outside the banking sector through SRT.

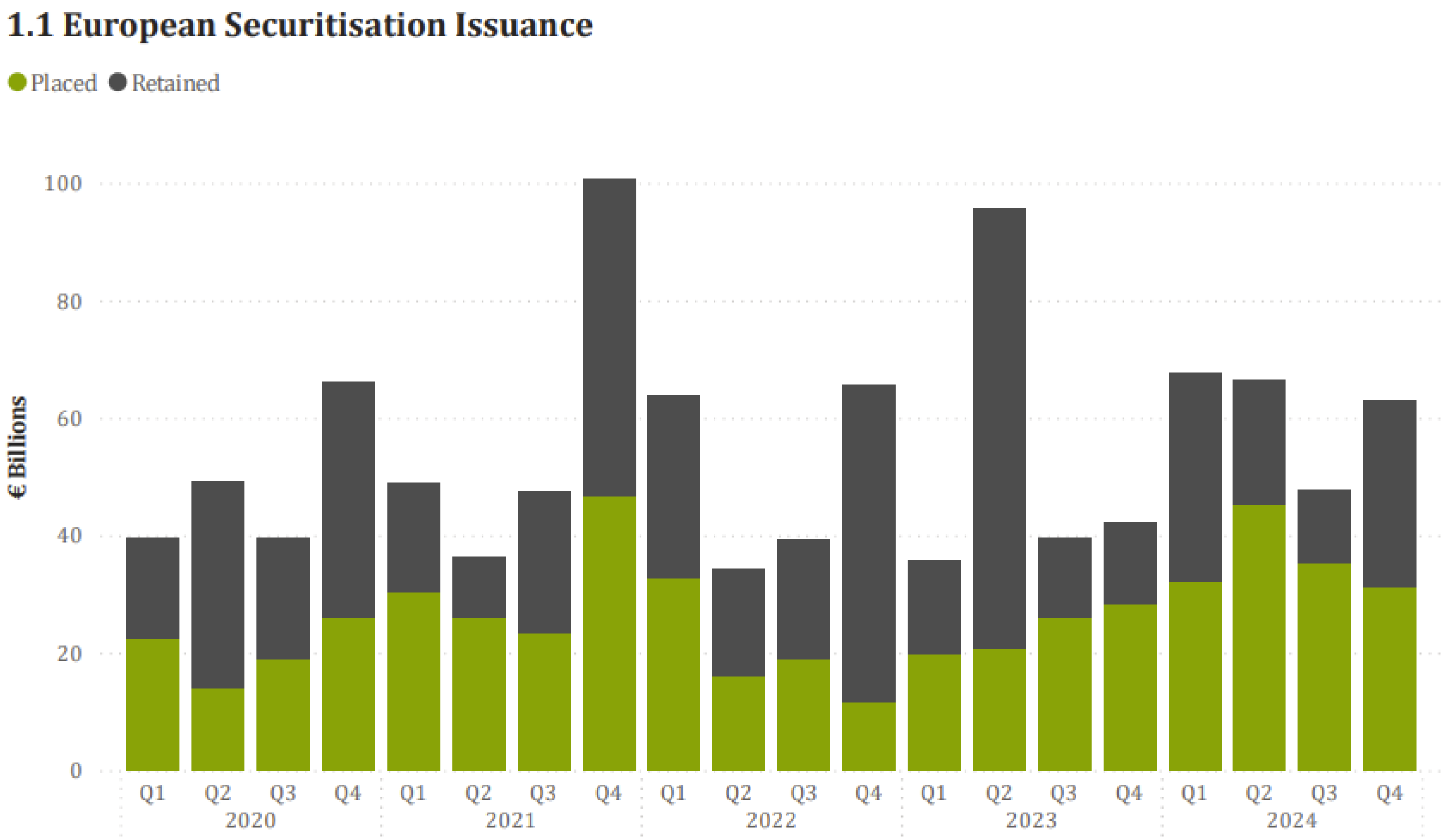
Banks typically retained the most senior credit risk as a securitisation tranche.

In other words, the exposure to the credit risk of this bank lending is transformed (through the sale of expected and unexpected losses to third parties) into a senior tranche of low residual credit risk.

This exercise enables banks to transfer credit risk away from the banking sector, liberate regulatory capital in the process, provide additive financing to their banking client base whilst maintaining relationships with their banking clients.

Source: Securitisation Data Report – Q4 2024 & 2024FY

Securitisation retained by the originator for repo operations



Banks hold exposure to senior securitisation for repo operations.

Investors in securitisation have no recourse to the originating bank. Recourse is limited to the assets owned by the SPV.

This unique characteristic enables reverse repo counterparties to finance repo counterparties through lending secured by the repo counterparty's own originated securitisation.

Unlike any other bond, the securitisation bond survives the insolvency of the repo counterparty.

This has enabled banks to generate contingent liquidity through using their own securitisations as collateral.