Response to the FSB invitation for feedback on the effects of the G20 reforms on securitisation

22 September 2023

The Association for Financial Markets in Europe (AFME) thanks the Financial Stability Board (FSB) for the opportunity to respond to its request for feedback on the following issues relating to regulatory reforms implemented by the G20 in order to address issues arising in the aftermath of the 2008 Global Financial Crisis (GFC), namely:

- The extent to which securitisation reforms are achieving their intended objectives, especially the reduction of systemic and moral hazard risks;
- Specific securitisation reforms (e.g. changes in bank prudential frameworks, risk retention requirements) which have had the greatest impact on originators, sponsors and investors; and
- The broader effects of these reforms on the functioning and structure of the securitisation markets as well as on financing the real economy.

AFME will respond in its capacity as representative of the leading European and global banks and other significant capital market players operating in Europe. For the purpose of this response AFME will limit its analysis to the effects of the implementation of the EU Securitisation Regulation (Regulation (EU) 2017/2402, "EU SECR") and UK Securitisation Regulation (The Securitisation (Amendment) (EU Exit) Regulations 2019, "UK SECR").

Executive Summary

Revisions to the securitisation framework by the Basel Committee on Banking Supervision (BCBS) were vital in prohibiting specific unacceptable activities originating in certain geographies and products in the run up to the GFC. Revisions were essential in not only limiting scope of activity but also restoring confidence in its utility to finance the real economy.

Whilst many of the underlying principles of these revisions make good sense, it has become increasingly clear in those regions that have embraced these standards, such as Europe, that there is merit in making targeted adjustments to some of these global securitisation standards with the objective of making them more risk sensitive and proportionate.

Such a review at global level should include within its scope (i) rules on disclosure, (ii) investor due diligence, (iii) criteria for the standardisation of transactions and (iv) review of their prudential treatment. Such review's primary objective should also be the implementation of a harmonised set of rules through its universal adoption across the G20. In that way, its utility to finance the real economy will be fully realised in each region equitably and it will therefore support global financial stability.

Turning to Europe, whilst many of the effects of the implementation of the EU SECR have doubtless been positive, not least in clearly encircling products for social good that fall within the revised regulatory definition of permissible securitisation, some regulatory measures have inhibited restoration of an effective and globally competitive European public securitisation market.

Through specific provisions the EU SECR now articulates a clear perimeter of activity within the regulatory definition which has the effect of prohibiting the kinds of poorly aligned transactions that proliferated

Association for Financial Markets in Europe
London Office: Level 10, 20 Churchill Place, London E14 5HJ, United Kingdom T: +44 (0)20 3828 2700
Brussels Office: Rue de la Loi 82, 1040 Brussels, Belgium T: +32 (0)2 883 5540
Frankfurt Office: Neue Mainzer Straße 75, 60311 Frankfurt am Main, Germany T:+ 49 (0)69 710 456 660
www.afme.eu

predominantly outside Europe in the run up to the GFC. However, the EU SECR had limited impact on EU issuers, as EU transaction structures and key terms issued since its implementation are almost identical to those issued in the run up to the GFC supporting the argument that the significant majority of transactions issued in Europe over this period were neither subject to moral hazard nor did they introduce systemic leverage.

An overlay of supplementary regulatory measures which address information asymmetry, investor due diligence and increased standardisation onto the above core activity has been influential in inhibiting growth of the securitisation market in Europe. Whilst no one would argue these measures have a role to play in standard setting, when overreaching, they have the effect of discouraging any activity from potential borrowers and investors.

Revisions to the banking and insurance prudential frameworks had the same effect of locking out capital by depleting an investor base that used to be an important constituent group prior to the respective frameworks' implementation. These investors remain an important buyer base outside Europe.

Revisions to the banking prudential framework also had the effect of discouraging potential issuers. We believe that further work at the Basel Committee should be promoted by the FSB as a matter of urgency and should be clearly included in its 2023-2024 road map and beyond. Europe, US and the UK are modifying their securitisation frameworks with divergent views. BCBS enhanced common rules would be very helpful to prevent fragmentation and exacerbate what has already become an uneven playing field.

There are lessons to be drawn from the European experience which should enable other G20 nations to short circuit what will be an iterative process in Europe to establish the right balance between, on the one hand, enhancing financial stability through proportionate and relevant regulation and, on the other hand, supporting the private sector in financing and investing in growth safely through use of this tool.

Lastly, increased focus on application of common standards across the G20 is important in supporting global financial stability. Harmonisation of many of the measures described in this paper will deepen capital market liquidity, improve cross-border capital flows and support suppression of accreting concentration risk in the global financial system.

Analysis

Whilst the reforms implemented through the EU SECR have been important in mitigating risks identified subsequent to the GFC, an array of complementary regulatory reforms have also been implemented simultaneously serving to address several of the same risks. Such measures are the Net Stable Funding Ratio (NSFR), the Leverage Ratio and the Liquidity Coverage Ratio (LCR).

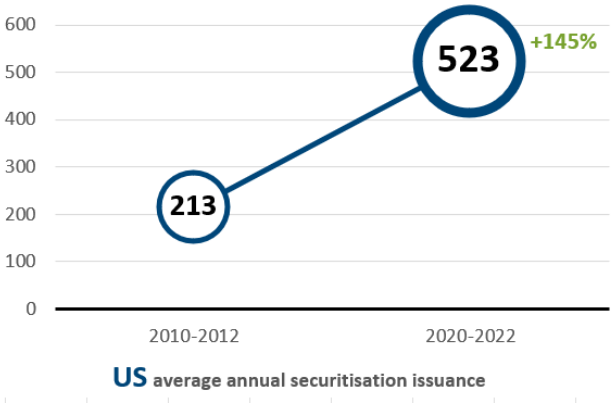
The EU SECR not only adopted the recommendations set out by BCBS in "Revisions to the Securitisation Framework",[1] but it further built on them. This had the effect of gold-plating these standards, thereby creating a regulation that goes further than any other securitisation regulation within the G20. Please see the Annex for a detailed comparison of the EU SECR against the Basel framework.

This approach has, however, come at a cost and unintended consequences. In 2008, the size of the European securitisation market (including the UK) was 75% that of the US, whereas it diminished to only 6% in 2020,[2] a year after the implementation of the EU securitisation framework. In the meantime, and as Figures 1 depicts below, securitisation issuance within other finance blocs - US, Japan, Australia and China - has grown year on

[1] BCBS, Basel III Document, "Revisions to the Securitisation Framework" (here).
[2] As noted in this blog by the European Stability Mechanism (ESM).

year.[3] See also Figure 2 for a comparison of publicly placed securitisation in different jurisdictions as a percentage of GDP.

Figure 1: Growth of securitisation issuance in global jurisdictions



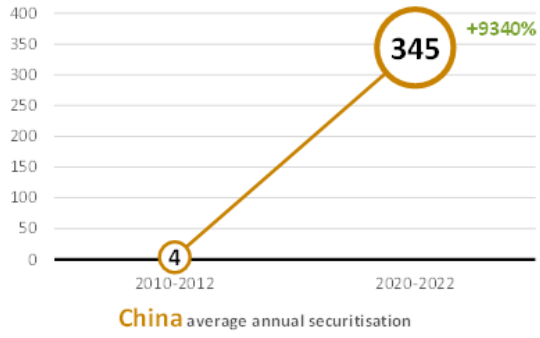
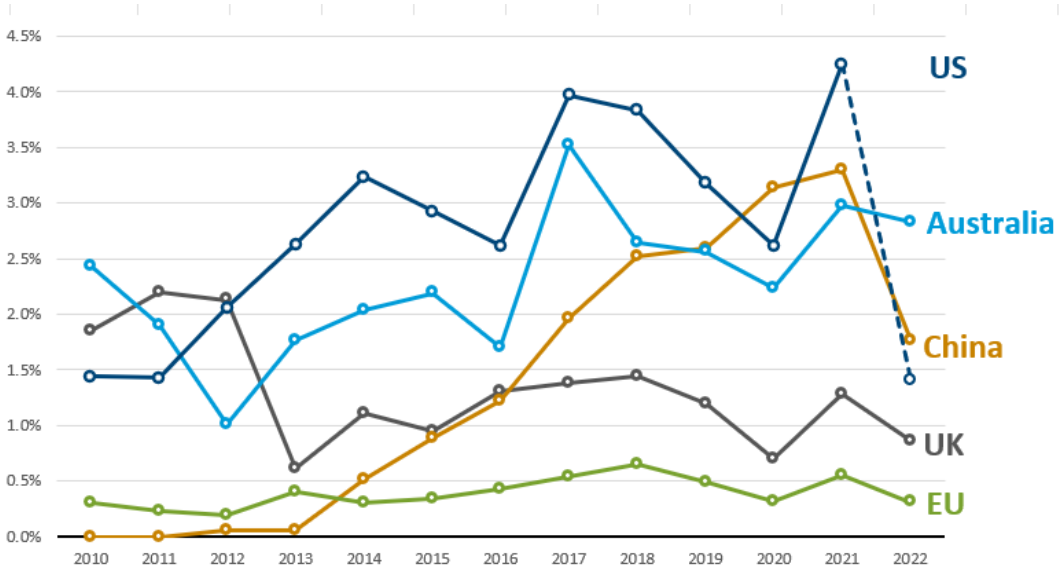


Figure 2: Publicly placed securitisation as % of GDP[4]

[3] All volumes are in EUR billion. AFME Securitisation Data Report Q4 2022 and 2022 Full Year (here). AFME, SIFMA, Bank of America, JP Morgan, NAB (National Australian Bank), Macquarie, S&P, World Bank. US and Australian volumes include ABS, RMBS, CMBS and CDO. US volumes exclude agency issuance. Australian volumes include ABS and RMBS. Charts show average annual securitisation issuance in 2011-2013 and 2020-2022 per jurisdiction. Exchange rate fixed as 2010-2022 average rate of EUR vs USD, JPY, AUD and CNY.

[4] Same source as above. US and Australian volumes include ABS, RMBS, CMBS and CDO. US volumes exclude agency issuance. Australian volumes include ABS and RMBS. European volumes include placed issuance only.

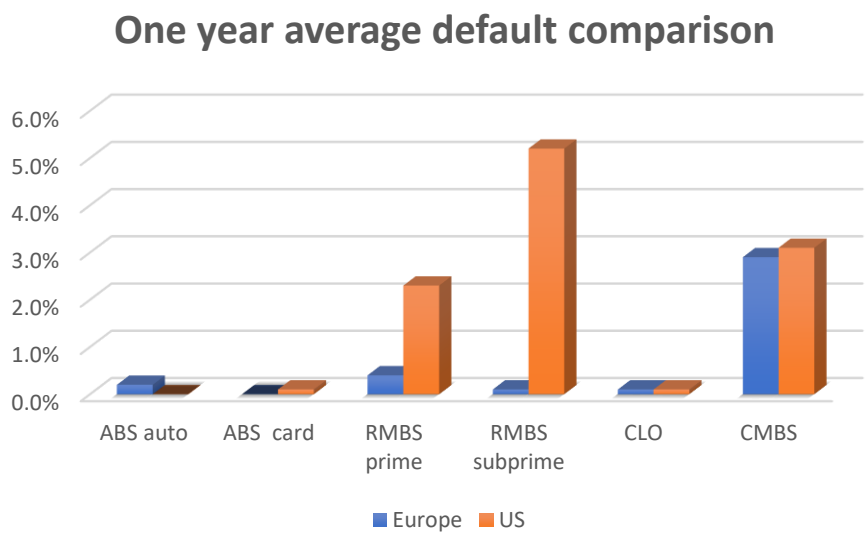


A recent study by the European Securities and Markets Authority (ESMA) shows that outstanding amounts in the EU securitisation market are also well below GFC levels. While in 2008-2009 the size of the European market exceeded 2tn. EUR, in 2013 it dropped significantly to 1.5tn. EUR. On the contrary, the total amount of securitisation reached in the US in 2021 was 13.7tn USD, well above its 2008 levels at 11.3tn USD.[5]

However, it is also true that, unlike in the US, European securitisation has proved overwhelmingly resilient before, during and since the GFC with credit performance that compares over the long term to corporate credit risk across the ratings spectrum.[6] Notably, we understand that the FSB is focusing primarily on CLOs and RMBS in this pre-consultation. Both asset classes have performed strongly in Europe over the study period. Please see Figure 3 below.

[5] ESMA TRV Risk Analysis "The EU securitisation market – an overview", 21 September 2023 (here).
[6] "European Structured Finance Weathers All the Storms", S&P Global Ratings, June 2023.

Figure 3: One year average default comparison[7]



A process is, therefore, underway to identify targeted adjustments to the regulation with the objective of creating a more proportionate and relevant framework which supports growth in issuance whilst preventing recurrence of those products that emerged prior to the GFC outside Europe. Achieving this balance will enable securitisation to play its part in risk diversification, financing the real economy and the green transition.

Notwithstanding, different approaches taken across the G20 to address these risks have had the effect of further limiting global liquidity and sustaining an environment in which pockets of risk may otherwise build.

We will now turn to each question of the pre-consultation separately.

1. **The extent to which securitisation reforms are achieving their intended objectives, especially the reduction of systemic and moral hazard risks**

In July 2011, the FSB, through the FSB's standing committee on Supervisory and Regulatory Cooperation (FSB SRC), requested that IOSCO in coordination with the BCBS:

- Conduct a stock-taking exercise reviewing current national and regulatory initiatives on:
  - Risk retention; and
  - Measures enhancing transparency and standardisation of securitisation products; and
- Develop policy recommendations as necessary.

The request highlighted the following weaknesses in securitisation market practices and the way in which these markets were regulated:

- An overreliance on ratings;
- Lack of due diligence by investors;
- Inadequate pricing of risk; and

[7] Source: S&P Global Ratings. Averages are calculated over a study period since 1973.

- Reduced incentives for originators and sponsors to conduct sufficiently rigorous due diligence of asset pools which contributed to the creation of conditions for excessive leverage in the financial system.[8]

In Europe, these risks were mitigated through reforms implemented via the EU SECR, the bank and insurance capital frameworks.[9] The regulatory measures that specifically address systemic leverage and moral hazard risks are the following:

- *Risk retention: Article 6 of the EU SECR*[10]

In short, the originator, sponsor or original lender of a securitisation retains on an ongoing basis a material net economic interest in the securitisation equal or superior to 5%. This obligation can be satisfied via one of three modalities, horizontal, vertical or through random selection of representative exposures.

As a general point, none of the US, EU or UK regimes currently provide for mutual recognition which results in cross-border securitisations having to comply with multiple risk retention regimes, which leads to costs and complexities without adding much to financial stability. A recommendation at the global level to address this fragmentation in future reforms would be helpful.

- *Ban on resecuritisation: Article 8 of the EU SECR*[11]

Underlying exposures used in a securitisation shall not include securitisation positions.

- *Criteria for credit-granting: Article 9 of the EU SECR*[12]

In brief, originators, sponsors and original lenders shall apply to exposures to be securitised the same sound and well-defined criteria for credit-granting which they apply to non-securitised exposures. To that end, the same clearly established processes for approving and, where relevant, amending, renewing and refinancing credits shall be applied. Originators, sponsors and original lenders shall have effective systems in place to apply those criteria and processes in order to ensure that credit-granting is based on a thorough assessment of the obligor's creditworthiness taking appropriate account of factors relevant to verifying the prospect of the obligor meeting his obligations under the credit agreement.

The three EU SECR articles above embody measures that, when combined, have the appropriate effect of reducing the scope of securitisation activity in Europe to one that finances the real economy, limits lenders' use of this tool substantively to refinancing or recapitalising their core lending businesses. Articles 6 and 9 align the originators interests to those of the investors by retaining important skin in the game and limiting use of the product to its core business. Article 8, prohibiting use of re-securitisation, not only caps excess leverage in the European financial system but also supports greater simplicity and transparency regarding the ultimate assumption of credit and market risk.

Figure 4: Defaults by vintage by product/bloc[13]

[8] Global Developments in Securitisation Regulation, Final report, IOCV-IOSCO, 16 November 2012 (here).
[9] Capital Requirements Regulation (CRR) and Solvency II.
[10] Article 6, Risk retention (here).
[11] Article 8, Ban on resecuritisation (here).
[12] Article 9, Criteria for credit-granting (here).
[13] Source: S&P Global Ratings (as per footnote 4).

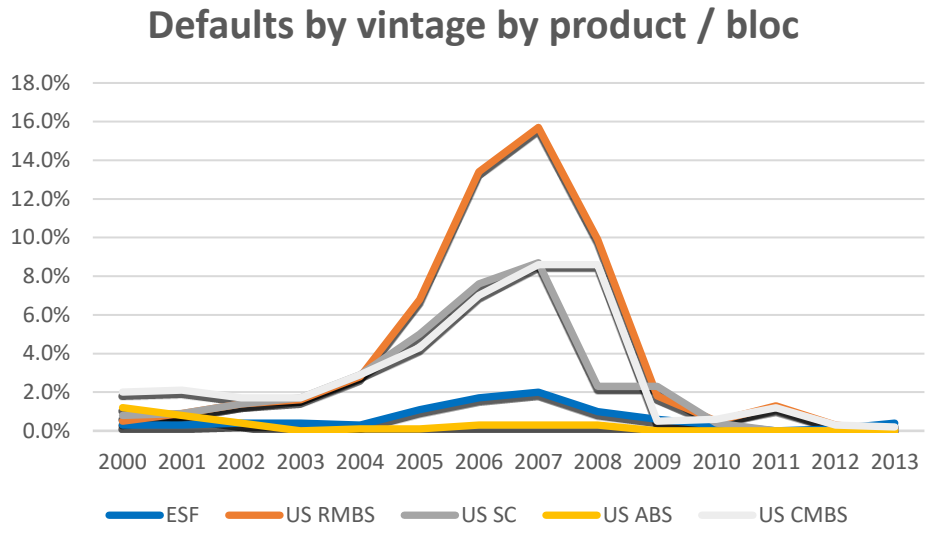


Figure 4 above shows performance by origination vintage for securitisations rated by S&P before, during and after the GFC. Evidently the spike in underperformance in the run up to the crisis reflects the rapid expansion of these risks embedded in banks' business models in four vintages of transactions originated from 2004 to 2008 in the run up to the crisis, predominantly in transactions falling within the buckets US RMBS and US Structured Credit (SC). US Asset Backed Securities (ABS) and the significant majority of European Structured Finance (ESF)[14] were resilient throughout the crisis and beyond.

In fact, European transaction structures and key terms issued since the implementation of the EU SECR are almost identical to those issued in the run up to the crisis supporting the argument that the significant majority of transactions issued in Europe over this period were neither subject to moral hazard nor did they introduce systemic leverage.

2. Specific securitisation reforms (e.g. changes in bank prudential frameworks, risk retention requirements) which have had the greatest impact on originators, sponsors and investors

In addition to the three helpful (non-prudential) reforms outlined above, which have effectively reduced the scope of issuance to balance sheet led activity, supplementary measures have also been adopted which have had mixed outcomes for originators and investors. These are non-prudential measures and prudential measures, as further analysed below.

(a) Non-prudential measures

The remaining non-prudential measures are captured by Articles 5 and 7 of the EU SECR, namely due-diligence requirements for institutional investors and transparency requirements for originators, sponsors and SSPEs respectively. These measures address information asymmetry challenges identified post crisis requiring originators to provide highly granular reporting over the life of a transaction in relation to the securitised portfolio and transaction structure and requiring investors to conduct appropriate due diligence on securitised holdings.

With the scope of products under the regulatory definition of securitisation now limited by Articles 6, 8 and 9 of the EU SECR, the challenge to growth arises from an overlay of a "one size fits all" rules-based approach

[14] European RMBS, ABS, CLOs and CMBS.

applied on a still highly heterogeneous set of transaction types with very different risk return profiles. For example, contrast an originator selling an unrated, junior, mezzanine, unfunded tranche referencing a portfolio of solar project loans with an execution timeline of circa 9 months with a AAA rated credit card ABS which launches and closes in only 10 days. Whilst ESMA templates vary to reflect asset characteristics, they do not reflect the very different risk profiles of transactions. The same can be said of investor due-diligence obligations which are not proportionate to the transactions' risk level.

This "one size fits all" risk-insensitive approach has a counter effect to the one intended. Rather than reducing systemic risk, the implementation of regulation that is disproportionate to the product risk causes systemic risk to build elsewhere. Excessively high barriers[15] for using securitisation may be making less regulated and less transparent instruments appear more attractive.

- *Due-diligence requirements for institutional investors : Article 5 of the EU SECR[16]*

Post-GFC, the European investor due diligence requirements have become more harmonised, which supports financial stability. However, there is room for improvement, and the move to a more principles-based approach should be encouraged (as opposed to a more prescriptive and burdensome rule-making approach that does not reflect investor needs or allocation of investment risks). In this regard, we welcome the UK recast of the investor due diligence requirements in the ongoing UK reforms in relation to such matters as due diligence, disclosure and reporting when investing in UK and non-UK securitisations.[17] We would caution against following the EU approach which resulted in the extraterritorial application of the EU reporting templates, even though they were not designed for third country (non-EU) securitisations. We note, however, that the above mentioned ongoing work in the EU on the simplification of the "private" securitisation reporting regime is intended to address this, although we are yet to see the public consultation on this.

Further guidance is also urgently needed in relation to EU investors' holdings of 3rd country issuance. The European Commission (EC) recently clarified[18] long standing uncertainty around Article 5(1)(e) of the EU SECR, however it now means that EU institutional investors are required to obtain full Article 7 information from third country reporting entities. However, third country sellers may be reluctant to make changes to their reporting systems now especially whilst the Article 7 disclosure framework is subject to change (see section right below). The effect, therefore, of such interpretation is forcing EU investors to sell off non-EU ABS.[19]

- *Transparency and reporting: Article 7 of the EU SECR[20]*

Post-GFC, big improvements were made in Europe (the EU and the UK) to the transparency and reporting regime for securitisations. However, the highly prescriptive template-based regulatory reporting requirements (including loan-by-loan reporting for all asset classes) that have been adopted as a result of the European reforms is not an appropriate approach in practice given the diverse universe of securitisation products. This ill-fitting framework has the effect of hindering development of the securitisation markets and unnecessarily increases transaction costs, in particular in the private securitisation sector, rather than supporting financial stability.

[15] AFME Article 5 Issues Report: Due-diligence requirements for institutional investors under Article 5 SECR (here).
[16] Article 5, Due-diligence requirements for institutional investors (here).
[17] We refer to the FCA consultation (CP 23/17) and the PRA consultation (CP 15/23) both published in the summer of 2023 with a deadline for the 30th of October 2023.
[18] Report from the Commission to the European Parliament and the Council on the functioning of the Securitisation Regulation (here).
[19] Joint industry letter, "Request for guidance – Article 5(1)(e)" (here).
[20] Article 7, Transparency requirements for originators, sponsors and SSPEs (here).

In this regard, we welcome two initiatives, namely (i) the ongoing work in the EU on the simplification of the "private" securitisation reporting regime (again the public consultation on this is currently pending) and (ii) the UK discussion on redefining what constitutes "public" and "private" UK securitisation with a view to also simplifying private securitisation reporting requirements at a subsequent stage.[21]

Any ESG-related reforms relating to securitisation, such as the EU Green Bond Standard (EuGBS) and the additional, voluntary - for now - reporting requirements under the EU SECR on sustainability indicators in the case of EU STS securitisations backed by residential mortgages and auto loans/leases,[22] need to be better calibrated and adopt a more holistic approach when it comes to imposing any additional reporting and transparency requirements. Financial stability will be better served by avoiding duplicative and overly burdensome requirements for securitisations that essentially result (for no good reason) in the more restricted use of this financial product for financing the global transition to net zero at a time when more (rather than less) capital needs to be deployed to fund such transition.

- *Increased standardisation via the STS framework*

The Simple, Transparent and Standardised (STS) framework has been implemented with a very high percentage rate of adoption for those transactions eligible. However, the size and trajectory of STS issuance in EU since implementation has been disappointing.[23] The EU and Basel provisions in relation to STS and STC (Simple, Transparent and Comparable) respectively are broadly similar, but the EU requirements go further and are more constraining. On the one hand, this has had the effect of limiting supply of the STS eligible market in the EU. On the other hand, the European revised prudential frameworks have driven banks and insurers to disinvest of the product even though it has performed in Europe as well or better than other secured and unsecured asset classes.[24][25] Both bank treasuries and insurance companies used to be two important investing groups prior to the implementation of these reforms.[26]

(b) Prudential measures

Solvency II must be revised to become risk sensitive, while the bank capital framework also needs targeted adjustment to be more reflective of the actual risks, thereby aligning investment to the much needed growth of the real economy.

- *Insurance prudential framework: Solvency II Delegated Act (Solvency II)*

On a global scale, insurance companies have been important investors in securitisation over decades. This remains the case across the world except in Europe. European insurance disinvested in size from European securitisations around the formulation and implementation of Solvency II. Capital charges associated with holding non-senior STS securitisations and non-STS securitisations are prohibitively high disincentivising insurance companies from participating in the asset class.[27]

[21] As above, FCA consultation (CP 23/17) and PRA consultation (CP 15/23).
[22] Articles 22(4) and 26d(4) of the EU SECR. Please also see here for the ESAs-ECB Joint Statement on climate related disclosures.
[23] AFME Securitisation Data Snapshot Q2 2023 (here).
[24] RCL research report commissioned by AFME, "Comparing ABS and Covered Bond Liquidity" (here).
[25] RCL research report commissioned by AFME, "ABS and Covered Bond Risk and Solvency II Capital Charges" (here).
[26] BofA, Global Research, European SF Weekly, EU insurers still with MIA status, 8 May 2023.
[27] BofA, Global Research, European SF Weekly, "End without beginning?", 4 July 2022.

- *Bank capital framework: Regulation (EU) 2017/2401 (The Securitisation Prudential Regulation)*

Incremental revisions to the EU bank prudential regulation have focused on creating a framework that is more prudent and risk sensitive, mitigates mechanistic reliance on external credit ratings, reduces cliff effects and has been adjusted to cover the STS framework as well.

However, the capital calibrations have resulted in overly prudent risk weights, and so, as cited in the EBA's advice, [28] further analysis is needed in relation to capital non-neutrality. In this way, bank capital requirements will be better calibrated to the risk embedded in these transactions.

Prior to the implementation of the LCR, European banks formed an important part of the public ABS investor base investing in senior, first pay AAA rated securitisations. Level 2B treatment with additional constraining criteria has inhibited investment in this product by bank treasury investors. Since the GFC we can point to several moments of substantive liquidity stress at which point securitisation has exhibited greater liquidity than comparable asset classes that have preferential treatment under LCR. Revisions to securitisation's treatment within LCR would be an important and welcomed adjustment.

We welcome the final position established in the EU's banking package negotiations with regards to IRB banks for which output floors are binding. P-factor adjustments mitigate the uniquely disproportionate effect of output floors on securitisation capital charges. This effect is caused by the application of floors as inputs and outputs as well as the non-neutrality formulation within the SEC-SA albeit for a temporary period ending 31 December 2032. Without these adjustments, there was consensus by IRB banks that this would stop the economic rationale for so called Significant Risk Transfer (SRT) transactions in Europe.[29] Making the p-factor reduction permanent change, reducing the p-factor calibration for SEC-IRBA and better calibrating the SEC-ERBA risk weights to these better risk-aligned SEC-SA and SEC-IRBA formulae is needed to further develop the securitisation market.

The broader review mandate by 2026 of the securitisation prudential framework beyond the output floor is also important to ensure that EU banks are competing on a level playing field to their global peers. From a market participant perspective, however, we are afraid that the time lag of several years could be detrimental to the revitalisation of securitisation in the EU.

In terms of proposals for the future review, we believe that the EC's proposal (unfortunately not embedded in the final CRR3 text) of lowering the p-factor parameter under SEC-IRBA and SEC-SA beyond the output floor and lowering the RW floor for STS transactions would be a good starting point.

We also strongly advocate for an extension of less stringent prudential measures to non-STS transactions. While we fully support the STS framework, we also observe there is a substantial universe of transactions that have exhibited strong credit performance over the long term yet cannot meet the label's 100+ STS criteria. We therefore encourage introduction of a mechanism that recognises this, for example, a hierarchy of such criteria that provides scaled treatment for those transactions that partially meet a subset of criteria.

We believe that a decrease of banks' capital requirements is justified by the progress made in the last decade, as also explained in the sections above. The EU securitisation framework has significantly reduced agency and model risks for securitisations across different transaction types, however, in respect of both STS and non-STS, it is very rigorous and much more stringent than the Basel III standards,[30] such as with respect to investor

[28] Joint Committee Advice on the review of the securitisation prudential framework (banking) (here).
[29] RCL research report commissioned by AFME, "Impact of SA Output Floor on the European Securitisation Market" (here).
[30] See Annex.

due diligence requirements, prohibitions on re-securitisations and limitations of access for retail investors to name a few.

Lastly, AFME fully supports the EBA's opinion[31] regarding recognition of disproportionately high capital requirements on investor credit institutions holding NPE securitisation positions when compared to relevant benchmarks, which, as a result, tend to overstate the actual risk embedded in the portfolio.

3. The broader effects of these reforms on the functioning and structure of the securitisation markets as well as on financing the real economy

Securitisation is the only financial instrument which enables financial institutions both to recycle capital and refinance lending to households and small businesses through risk transfer transactions and traditional securitisations respectively. Securitisation can be used to finance not just direct loans to SMEs, but also SMEs' working capital and leases of essential assets, such as low emission vehicles, solar panels and energy efficient manufacturing equipment. These assets, in turn, drive Europe's digital and green transitions. Securitisation's contribution to financing the green transition in different regions of the world is evident in the data.[32]

In responses received by the EC as part of its consultation,[33] close to 80% of respondents disagree with the view that the EU SECR has been successful in improving access to credit for the real economy, in particular for SMEs,[34] because the market's volume has not increased since the introduction of the EU SECR.

The European economy needs securitisation more than ever given its continued reliance on bank loans as a source of funding. Securitisation is vital to achieving the objectives of the Capital Markets Union (CMU) and addressing the very significant financing needs today and in the coming years, including those arising from the green and digital transformations, as well as from the economic impacts of the Covid-19 pandemic and the war in Ukraine.

Yet securitisation volumes in Europe have continued to decline in sharp contrast to the growth seen in other markets in recent years.[35] Macroeconomic considerations and other factors, such as the pandemic and central bank monetary policy decisions, are no doubt contributing elements, but they are certainly not unique to the EU. On the contrary, they have affected nearly all G20 countries, yet have not affected issuance in the same way. The US, for example, recorded its highest ever issuance levels in 2020 and again in 2021.[36]

The absence of a well-functioning securitisation market represents a strategic loss to the European financial system. It is undermining the competitiveness of European financial institutions and limiting their ability to recycle capital to support new financing. It has encouraged institutional investors to shift towards other products that do not offer the same advantages in terms of protection, transparency and liquidity.

The decision not to review the EU SECR at this stage, nevertheless, strengthens the case for and urgency of pursuing targeted measures in other aspects of the framework, notably the prudential requirements for banks and insurance companies, where we identify some of the most pressing challenges.

---

[31] Opinion of the European Banking Authority to the European Commission on the Regulatory Treatment of Non-Performing Exposure Securitisations, 23 October 2019 (here).
[32] EBA, "Developing a framework for sustainable securitisation", 2 March 2022 (here).
[33] Report from the Commission to the European Parliament and the Council on the functioning of the Securitisation Regulation (here).
[34] As above. See Figure 1. We note that the remainder of respondents are mostly neutral on the question.
[35] As per Figures 1 and 2 above.
[36] HM Treasury, Review of the Securitisation Regulation: Call for Evidence (June 2021). Chart 2.B: Issuance volume of US and European securitisations, p.10 (here).

In relation to the bank capital regime under CRR3, we welcome the debate and final position in trilogues supporting temporary recalibration of the SEC-SA formula, which is particularly urgent to mitigate the substantial negative impact of the incoming output floor, especially for SRT transactions. However, CRR3 will only mitigate the unintended consequences of the output floor and will therefore only preserve the status quo of low securitisation activity. This measure will not help to relaunch the securitisation activity in Europe. That's why it is key that the comprehensive review, expected by 2026, should go beyond the output floor and improve the prudential treatment of both STS and non-STS transactions as proposed in detail under question 2 above.

A recalibration of the Solvency II capital charges on assets to levels that are proportionate and commensurate to the risks is a condition for the return of the insurance sector as investors in securitisation. Without these changes, there is no economic rationale for the sector to invest, despite the many advantages securitisation could offer.

The adoption of the above measures together with an appropriate treatment for synthetic securitisation in the EuGBS would be important steps towards the restoration of an active securitisation market in Europe. We emphasise that securitisation can provide a major contribution to the green transition by freeing up capital for banks to lend towards sustainable projects, such as mortgage loans financing energy-efficient houses, rooftop solar energy loans or other sustainable loans.[37]

As a conclusion, we strongly believe that further work at the Basel Committee should be promoted by the FSB as a matter of urgency and should be clearly included in its 2023-2024 road map and beyond. The EU, the US and the UK are modifying their securitisation frameworks with divergent views. BCBS enhanced common rules would be very helpful to prevent further fragmentation and an uneven playing field.

[37] AFME, European Green Securitisation Regulatory State of Play (here).

ANNEX

EU Securitisation Regulation: Key Areas of Super-Equivalence (Gold-Plating) to Basel Framework[38]

SECURITISATION REGULATION – GENERAL REQUIREMENTS (NON-STS/STC)

Risk retention

The EU risk retention requirement broadly requires eligible sell-side parties to retain a material net economic interest of 5% in line with prescriptive operational mechanics (which are adjusted for NPE securitisations), and requirements for originator-retainer substance. This requirement does not have a parallel at Basel level, other than in relation to STC transactions. Even for STC transactions, where retention by eligible sell-side parties of a "*material net economic exposure*" is required, no specific retention threshold applies at Basel level (i.e. the retention need not be 5%).

Prohibition on re-securitisation

EU provisions relating to the adverse prudential treatment of re-securitisations derive from Basel, however, the EU *prohibition* (subject to limited exceptions) on re-securitisation, does not have a Basel parallel, other than in relation to STC transactions.

Transparency and reporting

EU transparency and reporting requirements, impose highly detailed, and prescriptive, initial and ongoing, data and documentary disclosure obligations on sell–side parties, including disclosure of all transaction documents essential to understand the deal, template-based loan-by-loan reporting for all (non-ABCP) securitisations, template-based investor and ad hoc event-driven reporting, template-based EU STS notification reporting (if applicable) and (except in 'private' transactions) mandatory publication of all such information and reporting via EU-authorised securitisation repositories. In particular for private transactions (including third country transactions), this level of prescription is not fit for purpose, extremely burdensome and has little use by investors who generally negotiate bespoke reporting requirements. This has no parallel at Basel level, other than in relation to STC transactions. Even in relation to STC transactions, mandatory transparency/disclosure requirements are, by comparison, very limited, and non-prescriptive as to format. In particular, in Basel STC transactions, loan-level data disclosure is replaced with disclosure of "*summary stratification data*" for "*sufficiently granular pools*".

Due diligence

EU institutional investor due diligence requirements provide that, broadly, such investors, prior to investing, must verify certain matters, including compliance by sell-side parties[39] with risk retention, disclosure, credit-granting and, if applicable, STS notification. This has no parallel in Basel. The EU also requires institutional investors to, broadly, obtain, via due diligence, a "*comprehensive and thorough understanding of the securitisation position*", and imposes related ongoing requirements around monitoring, stress-testing, and internal reporting (including a requirement for written policies and procedures). These requirements have a parallel in Basel, however, the equivalent Basel due diligence requirements are a comparatively light touch: for example, only five indicative data points ("as appropriate") are identified at Basel level in relation to due

[38] **This analysis has been prepared by Allen & Overy.**
[39] Which is adjusted in certain cases for third country deals.

diligence on underlying asset pools, and six indicative data points are identified in relation to due diligence on the structural features of the securitisation.

Credit-granting standards

EU credit–granting requirements broadly require sell-side parties (with some relaxation for NPE securitisations) to apply the same sound and well-defined criteria to exposures to be securitised as to their non-securitised exposures. This requirement does not have a parallel at Basel level, other than in relation to STC transactions. In relation to performing purchased receivables, the EU credit–granting standards are more onerous even than the STC requirements at Basel level[40].

Prohibition on securitisation of self-certified residential loans

The EU prohibition (subject to limited exceptions) on securitisation on self-certified residential loans has no parallel at Basel level.

Adverse selection

The EU adverse selection restriction broadly prohibits originators (in the absence of appropriate disclosure) from selecting assets for transfer to SSPEs with the aim of rendering losses on transferred assets higher than losses on comparable assets retained. This does not have a parallel at Basel level other than in relation to STC transactions, where 'cherry picking' by originators is prohibited.

SSPE requirements

The EU prohibits establishment of SSPEs in third countries blacklisted by the EU for tax or anti-money laundering and counter terrorism financing purposes (AML/CTF). The EU also imposes a tax authority notification requirement for investors when investing in securitisations involving third country SSPEs established in jurisdictions where the EU identified certain shortcomings in relation to the implementation of transparency and reporting for tax purposes. This restriction has no parallel at Basel level.

Sale to retail

The EU prohibits the sale of securitisation positions to EU MiFID retail clients unless specified conditions and, for portfolios ≤ EUR 500,000, specified investment limits, are complied with. This restriction has no parallel at Basel level.

CRR SECURITISATION PRUDENTIAL REGULATION – SIGNIFICANT RISK TRANSFER (SRT) REQUIREMENTS

Quantitative SRT Assessment

Basel imposes a high-level requirement for "*significant credit risk associated with the underlying exposures*" to be transferred "*to third parties*" (in which context, no threshold level for "*significance*" is specified). In the EU, this requirement is implemented via an extensive, prescriptive and conservative, stress-testing and lifetime modelling regime encompassing broader concepts of "*commensurateness*".

[40] The receivable seller's standards do not have to match the standards of the securitisation sell-side parties.

In addition to imposing tests relating to the quantum of risk transfer, as required by Basel (the CRR first loss test/mezzanine test, and proposed PBA test), the EU tests assess:

- the "*commensurateness*" of the risk transfer to the capital reduction achieved (an assessment currently made by NCAs, but proposed to be formalised and standardised in the CRT test),
- the sufficiency of tranche thickness (an assessment currently made by NCAs, but proposed to be formalised and standardised in a minimum thickness requirement in the CRR first loss test), and
- the sustainability of the risk transfer over the life of the transaction, with proposed mandatory modelling, in specified extreme stress scenarios, of transaction-specific features including time calls, amortisation structure and excess spread expectations.

In the context of the above tests, EU originators are also proposed to be required, with no explicit Basel parallel, to reflect excess spread as a retained first loss tranche, save that originators of traditional securitisations can avoid this treatment where a 'market test', relating to pricing, is passed.

Tests for High-Cost Credit Protection

General principles relating to the cost of protection in credit risk mitigation identified in 2011 Basel guidance (not forming part of the comprehensive Basel framework)[41], are proposed to be reflected, in the EU, in a series of binding (and conservative) quantitative tests, failure to pass *all* of which results in an on-balance sheet securitisation failing to qualify for SRT.

Mandatory Performance-Related Triggers to Revert to Sequential Amortisation

SRT transactions featuring non-sequential amortisation are subject to prescriptive mandatory performance-related triggers to switch to sequential amortisation (currently an NCA practice (save for STS transactions, where such triggers already exist), but proposed to be formalised and standardised), this has no explicit Basel parallel, other than in relation to STC transactions. Even in relation to STC transactions, specific performance-related triggers are prescribed only for transactions featuring replenishment.

CRR SECURITISATION PRUDENTIAL REGULATION – OTHER KEY AREAS[42]

Risk Weighting of Synthetic Excess Spread

EU originators of on-balance sheet securitisations are, in the EU, required, with no explicit Basel parallel, to risk weight excess spread as a retained first loss tranche (with conservative and complex calculation mechanics to establish the exposure value and adverse economic implications for transaction types, such as SME and consumer lending deals, that typically involve excess spread).

[41] https://www.bis.org/publ/bcbs_nl16.htmhttps://www.bis.org/publ/bcbs_nl16.htm

[42] **Please note that this analysis covers the securitisation framework, itself, only and not related areas of prudential regulation, including but not limited to the credit risk mitigation framework (which is relevant to on-balance sheet securitisations).**

Use of the Purchased Receivables Approach to K_{IRB}

The EU is more prescriptive than Basel about the circumstances in which the purchased receivables approach to the calculation of K_{IRB} can, and cannot, be used, it also imposes an internal model approval requirement in relation to the use of this approach, and more onerous fall-back LGD mechanics that does not allow for the recognition of collateral.

Weighted Average Maturity (WAM) calculation

The EU imposes prescriptive, complex and conservative calculation mechanics, involving asset and liability modelling, to calculate WAM for purposes of the maturity input to the SEC–IRBA and SEC–ERBA formulae. This has no Basel parallel (though Basel is more conservative in relation to the availability of WAM-based maturity (rather than final legal maturity)).

LCR

This analysis generally addresses the securitisation requirements of the credit risk framework, however, we make one observation, in passing, in relation to the treatment of securitisation as HQLA in the LCR. It is well-known that the EU LCR permits a somewhat wider range of securitisation collateral types to qualify as HQLA than does Basel. However, the EU HQLA requirements for ABS also gold-plate Basel in certain respects (including for RMBS, which Basel envisages as HQLA). Notably, the EU requires eligible ABS to:

- benefit from, broadly, a AAA rating rather than the AA rating permitted by Basel,
- be STS compliant (thus incorporating by reference a very large number of additional eligibility criteria, by contrast, Basel does not require STC eligibility)
- have a ≥5 year residual weighted average life).

EU SECURITISATION TRADITIONAL[43] STS REQUIREMENTS (NON-ABCP) AND BASEL STC REQUIREMENTS (NON-ABCP)

True sale, asset isolation, absence of severe "claw back" provisions, perfection events, no asset encumbrance affecting true sale

The EU and Basel provisions are broadly similar, but the EU requirements are more prescriptive and expressly require a true sale legal opinion.

Homogeneity of underlying exposures, periodic payment streams, no transferable securities.

Some starting points for these requirements are broadly similar. However, the EU is far more prescriptive, the EU expressly excludes transferable securities, confirms for periodic payment streams that underlying exposures may also generate proceeds from the sale of any financed or leased assets and provides for more granular rules on homogeneity factors via the corresponding technical standards.

[43] We note that the EU provides a separate STS framework for on-balance sheet (synthetic) securitisations.

Eligible underlying assets, including underwriting standards, assessment of retail borrower' creditworthiness

The EU has more prescriptive requirements, as well as certain additional requirements, for the purposes of these criteria. These include requirements specific to certain asset classes (eg residential mortgage loans); requirements for the application of post-closing eligibility criteria; a requirement for the originator to have expertise in originating exposures (which must be disclosed to investors in sufficient detail in accordance with applicable confidentiality requirements); requirements for disclosure of material changes from prior underwriting standards; and equivalence requirements for the assessment of the creditworthiness of borrowers in third countries.

No active portfolio management

The EU has more prescriptive parameters for what may constitute active portfolio management, which effectively exclude managed CLOs.

At least one payment made

The EU requires that at least one payment should have been made by each underlying borrower, at the time of the transfer, in order to reduce the likelihood of the loan being subject to fraud of operational issues. There are no similar requirements in Basel.

No re-securitisation

Broadly similar restrictions on no re-securitisation apply in the EU and under Basel. However, the EU anticipates, by way of derogation, to permit re-securitisation in certain cases. To date, no guidance or rules have been introduced in the EU to further specify the cases when this might be permitted.

Appropriate mitigation of interest rate and currency risks, only hedging is permitted and no other derivatives

Broadly similar requirements apply in the EU and under Basel, but the EU requirements are more prescriptive, they require appropriate disclosure, and include a requirement for sufficient creditworthiness of the counterparty and, failing which, a requirement for collateralisation, replacement or guarantee by another counterparty.

Absence of credit-impaired obligors and loans in default

Some Basel and EU provisions are similar, but the EU requirements are much more prescriptive, they extend to the guarantors of the debtors, prescribe "best knowledge" standards and set parameters for debtors or guarantors that have undergone a debt-restructuring process.

Remedies and actions related to delinquency and default of a debtor

The EU is more prescriptive and requires, in addition, disclosure to investors (without undue delay) of any change in priorities of payment that materially adversely affect the repayment of the securitisation.

Continuity/replacement of counterparties

The EU and Basel provisions are broadly similar.

Restriction on reliance, for repayment, on future sale of assets

Similar restrictions apply in the EU and under Basel, but the EU frames the requirement as an absence of "predominant reliance" on the sale of assets (which does not prevent roll-over or refinancing of the assets subject to prescribed parameters/conditions).

Pass-through requirement, priorities of payment, early amortisation provisions and triggers for termination of the revolving period, restriction on cash trapping in certain scenarios

The EU requirements are more prescriptive. The EU also include provisions and sets out parameters for SSPE cash trapping and provisions relating to non-sequential priority of payments, which are not provided for in Basel.

Interest rate formulation, referenced interest payments

Broadly similar requirements apply in the EU and under Basel.

Resolution of conflicts between different classes of investors, provision of an "identified person" acting in the best interests of investors, voting rights of investors

The EU is more prescriptive and includes specific requirements on there being clear (contractual or statutory) provisions facilitating the timely resolution of conflicts.

Servicer expertise and performance history

The EU is more prescriptive, sets out more granular criteria on the expertise of servicer, including prescribed parameters for deemed compliance (eg five years of servicing exposures of a similar nature to those securitised) and detailed requirements for well-documented and adequate policies, procedures and risk management controls.

Mandatory external asset verification

The EU is more prescriptive as to which independent parties are eligible to carry out such verification, sets out parameters for the scope and confirmation of verification.

Liability cashflow model

The EU provisions are more prescriptive.

Environmental performance of assets, sustainability factor disclosure

Only the EU regime (not Basel) includes requirements relating to environmental performance of the assets (currently limited to residential mortgages and auto loans and leases). This disclosure regime will, in due

course, be accompanied by new (yet to be finalised) technical standards on template-based reporting on the sustainability factor.

Transparency and reporting and disclosure of historical performance data

The EU prescribes, more specifically, reporting on historical performance covering at least five years. Basel simply refers to a "time period long enough".

In addition, the EU imposes prescriptive, initial and ongoing, transparency and reporting requirements in relation to data and documentary disclosure obligations on sell–side parties, including disclosure of all transaction documents essential to understand the deal, template-based (in xml format) loan-by-loan reporting for all (non-ABCP) securitisations, template-based investor and ad hoc event-driven reporting, as well as disclosure of template-based STS notification and (except in 'private' transactions) mandatory publication of all such information and reporting via EU-authorised securitisation repositories. By contrast, at Basel level, mandatory transparency/disclosure requirements are, in comparison, very limited, and non-prescriptive as to format. In particular, in Basel, loan-level data disclosure is replaced with disclosure of "*summary stratification data*" for "*sufficiently granular pools*".

Risk retention

The EU risk retention requirement broadly requires eligible sell-side parties to retain a material net economic interest of 5% in line with prescriptive operational mechanics, and requirements for originator-retainer substance. The Basel provisions are less prescriptive and do not provide for any specific retention threshold (i.e. the retention need not be 5%).

Maximum collateral risk weights for STS prudential treatment

Broadly similar requirements apply in the EU and under Basel though certain definitions used at Basel level have yet to be implemented in the EU (under CRR3)).

Collateral granularity requirements for STS prudential treatment

The EU granularity requirements make use of a concessionary 2% concentration limit envisaged in Basel (Basel generally requires a 1% concentration limit), but extends it to all transactions (Basel limits the concessionary concentration limit to transactions, with corporate exposure collateral, in jurisdictions with structurally concentrated corporate loan markets, and subject to ex ante supervisory approval, where the originator or sponsor retains subordinated tranche(s) (not themselves eligible for STC) that absorb the first ≥10% of losses).

RRE LTV requirements for STS prudential treatment

The EU imposes a 100% LTV cap for RRE exposures in STS securitisations. There is no Basel equivalent to this requirement.

Requirements relating to prior ranking security rights over RRE and CRE for STS prudential treatment

The EU imposes a requirement for loans with lower ranking security rights over RRE or CRE to be included in collateral pools only where all prior ranking security rights are also included in the pool. There is no Basel equivalent to this requirement.

AFME Contacts

Shaun Baddeley
Managing Director, Securitisation
shaun.baddeley@afme.eu
+44 (0)20 3828 2698
+44 (0)7584 582 759

Maria Pefkidou
Manager, Securitisation
maria.pefkidou@afme.eu
+44 (0)20 3828 2707
+44 (0)7789 870 120