European Parliament

Enabling sovereign bond-backed securities

Impact assessment (SWD(2018) 252final/2,[1] SWD(2018) 253 (summary)) accompanying a Commission proposal for a regulation of the European Parliament and of the Council on sovereign bond-backed securities (COM(2018) 339)

This briefing provides an initial analysis of the strengths and weaknesses of the European Commission's impact assessment (IA) accompanying the above-mentioned proposal, submitted on 24 May 2018 and referred to the European Parliament's Committee on Economic and Monetary Affairs (ECON).

Following the financial and sovereign debt crises, the EU banking union has aimed to create a safer financial sector for the single market and, in particular, to strengthen the diversification and stability of banks' portfolios.[2] In this context, the presence of a union-wide safe asset in the form of sovereign bond-backed securities (SBBS), is considered an important element.

Individual euro-area sovereign bonds issued by national governments are typically both tradable and liquid, albeit with divergent risks depending on the Member State. Securitisation is a financial practice of pooling similar income-generating assets that are not (or not easily) tradable individually. A specially created third party uses them as collateral to issue securities and sell them, thereby enhancing the redistribution of credit risks and the creation of liquidity. SBBS would, as a securitised financial instrument, consist of a diversified pool of euro-area sovereign bonds, structured in tranches, with the junior tranche being the first to take any potential losses. The junior tranche would protect the senior tranche, which is expected to become a new, 'low-risk' euro-denominated asset (IA, pp. 6, 14-15).

The proposal for an enabling regulatory framework for the development of SBBS is included in the Joint Declaration on the EU's legislative priorities for 2018-2019 to make the economic and monetary union (EMU) more resilient and uniform, adopted by the European Commission, the European Parliament and the Council of the EU in December 2017 (IA, p. 16). The IA and the proposal build mainly on the work of an inter-institutional high-level task force (HLTF),[3] whose final report, a 2018 feasibility study in two volumes, concluded that the development of SBBS 'may be feasible under certain conditions' and could improve the stability of the euro-area financial sector (IA, pp. 4-5).

Problem definition

The IA begins by highlighting the 'appealing' characteristics of the concept of SBBS, including its independence from other, more complex or controversial approaches to addressing the main vulnerabilities of the EU financial system, such as that of reforming the Sovereign Exposures Regulation or introducing Eurobonds (IA, pp. 4-6). That way, even before it has presented the problem, the IA introduces the concept of SBBS as a response to the two main factors that amplified the financial crisis of 2008: the bank-sovereign nexus[4] and the 'home bias', which induces banks to concentrate their sovereign bond portfolios in their own sovereign (IA, pp. 8-9).

Currently, individual sovereign bonds benefit from exemptions under the Capital Requirements Regulation (CRR). Conversely, SBBS would be considered securitised products and would therefore entail capital requirements and other consequences, because, due to their tranching and subordination of credit risk, they are considered riskier. This has prompted the IA to identify **the**

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impediments presented by the current regulatory framework that hinder the development of market-led SBBS (namely the 'extra' regulatory charges and discounts of SBBS compared to individual euro-area sovereign bonds), as the main **problem** to tackle (IA, pp. 9-10, 16). Consequently, instead of providing a problem analysis of the EU financial markets, the IA narrows the problem definition directly to the non-existence of SBBS. This 'shortcut' definition of the rationale underlying the legislative initiative seems problematic, lacks evidence and is explicitly not recommended by the better regulation toolbox.[5]

The IA describes in detail the **threefold unfavourable treatment** SBBS would receive: first, they would entail capital requirements; second, they would have their value discounted, as they would not be considered level-1 assets under the EU's liquidity coverage ratio (LCR);[6] and third, they would be subjected to restrictions under existing EU investment rules (IA, pp. 11-12). More specifically, holding a securitised product instead of the underlying portfolio triggers higher capital requirements, which also depend on the system used by the banks (the internal ratings-based approach or the standardised approach)[7] and on the interest-rate risk (IA, p. 10). Moreover, while all individual euro-area sovereign bonds qualify as level-1 assets, SBBS could at best be level-2b assets subject to a minimum 25 % haircut, because sovereign bonds do not feature among the eligible underlying exposures listed in the relevant Commission Delegated Regulation (EU)2015/61 (IA, p. 11). Consequently, rather than assembling, securitising and investing their sovereign bonds, banks and private investors currently use them for meeting liquidity coverage requirements or as collateral (IA, pp. 9, 16).

The IA stresses that the **problem is driven** by the fact that the current legislation does not appropriately take into account the specific characteristics of the SBBS' 'sui generis' securitisation, i.e. the composition and (limited) risks of the underlying portfolio (i.e. euro-area government bonds) (IA, pp. 12-15). It argues that unlike other securitised products, this portfolio would not entail significant information asymmetries between the originator of the products and the investors, nor risks stemming from the non-linear pay-outs due to tranching (IA, pp. 13-14). Since these arguments are at the core of the IA's whole intervention logic, they would have deserved a more thorough analysis and, in particular, a more precise and transparent substantiation, which is missing.

Contrary to the better regulation guidelines, the IA does not assess the negative consequences of the lack of SBBS at national or EU level. Referring to SBBS in general terms, it does not specify the variation of risks between sovereign bonds across the EU. The question as to what extent, why and for whom the absence of SBBS is detrimental, is not elaborated. Only Annex 3 features clearly all of the key stakeholders that would be affected by the proposed legislation, namely banks and other financial institutions, other asset managers, the arrangers/issuers of the product, supervisors and debt management officers (IA, p. 69). Furthermore, the size and scale of the problem remain unclear – the IA states that the market potential of SBBS is 'difficult to predict', given that they are not yet in existence. (IA, p. 69). However, making such a prediction would in principle be difficult for any new instrument Later, in the context of the baseline scenario, it attempts to address this question, estimating that if all 105 EU banks considered in this context[8] were to switch their individual sovereign bonds' holdings into senior SBBS, the aggregated capital requirements under the current rules would amount to €70 billion (IA, pp. 19, 79-80). This illustrates hypothetically the cost of a shift to SBBS under current rules, but does not seem to take into account other factors, such as the riskier junior tranches, other criteria related to banks' decision-making, the general conditions on the financial markets, or the unpredictability of the exchange rate of sovereign bonds to SBBS. Calculations in Annex 4 including the junior tranche and lower exchange rates seem equally uncertain.[9] A 100 % replacement of individual sovereign bonds seems unlikely; this prospect limits the overall meaningfulness of the above estimate, as the Commission itself admits ('this is just a gauge', IA, p. 19).[10] The lack of information on this central issue affects all sections of the IA, making the ex-ante assessment of the impacts of the SBBS altogether challenging. The explanations the IA offers with regard to these uncertainties and caveats are not differentiated, substantiated and transparent enough to afford a thorough understanding of the situation.

Objectives of the initiative

According to the IA, the general objective is to remove the regulatory barriers preventing the development of a (privately produced) liquid, low-risk asset, such as the senior SBBS, with a view to strengthening the EU banking union (IA, p. 17). Formulated in such a way, this objective relates directly to the problem definition, but not to the EU Treaty, as required by the better regulation toolbox (tool 16, p. 100). In the same vein, the IA mentions the diversification of banks' portfolios in the euro area, the stabilisation of the euro area and the improvement of the creditworthiness of several EU and euro area Member States, as also being among the general objectives. These aspects all appear to be specific rather than general objectives, while the IA's presentation of (only) two **specific objectives** lacks specificity, where it is needed (IA, p. 18):

- eliminate regulatory impediments for SBBS securitisations;
- encourage the liquidity and 'benchmark' quality[11] of SBBS.

The IA stresses that the achievement of the first specific objective would be a necessary but not a sufficient condition for the development of a SBBS market, as the viability of SBBS will depend on their attractiveness for investors. The idea that there are no guarantees for the development of the novel private financial instrument – even if the problem as defined here were solved – is reiterated consistently throughout the IA (IA, pp. 18, 24, 32,-33, 44). The IA concludes this section by defining yet another specific objective: the creation of a 'market test' for SBBS (IA, p. 24). Altogether, the definition of the objectives seems unnecessarily circuitous and imprecise, with the general and specific objectives intermingled with each other and rather broad. Moreover, it is worth noting that the IA does not present operational objectives to express the deliverables of policy actions, although this is required by the better regulation guidelines. Moreover, these guidelines require objectives to be 'S.M.A.R.T.' (specific, measurable, achievable, relevant and time-bound), so as to allow for effective monitoring and evaluation of progress in achieving the objectives. These criteria appear not to have been fulfilled in this case. For example, the specific objectives do not specify what the impediments are or how and when to eliminate them. Notwithstanding these shortcomings, the objectives are generally in line with the principles of the EU banking union and the goal of deepening the EMU.

Range of options considered

Keeping in mind that the development of the SBBS instrument was a prerequisite from the start and the definitions of the problem and the objectives were tailored to it, alternative policy actions to strengthen the stability and liquidity of the euro-area financial markets have not been explored; the IA justifies this by noting that 'other measures ... would require more analysis and more time' (IA, p. 5).

The IA's consideration of the **baseline scenario** concludes that without legislative action, SBBS would not be produced and made available to investors due to the mentioned regulatory barriers presented by the current legislation (IA, pp. 19-21). As a result, the IA states it 'has no option but to propose an 'enabling framework', (IA, pp. 9, 21). In addition, it makes the assumption – at this early stage, citing the HLTF's work but not providing own substantiation – that the 'unintended consequences' of a developed SBBS market, namely effects on the liquidity of national sovereign debt markets, would be 'limited' (IA, pp. 21, 82-87).

The IA presents the following policy options, classified in three parts (the options favoured by the IA are shaded in grey) (IA, pp. 6, 22):

1 Scope of applicability of the proposed legislation

Option 1.1: Only SBB proper. This option would allow only for securitisation of euro-area sovereign bonds complying with a fixed portfolio of bonds with known weights, based on the European Central Bank (ECB) capital key (or on each country's Gross Domestic Product (GDP)) and specified tranching points ensuring the senior tranche is 'low-risk'.[12]

Option 1.2: All securitisations of euro-area sovereign bonds. This option would allow for any securitisation, regardless of the composition of the portfolio and/or the number and level of tranches of SBBS. It offers the widest possible scope of applicability.

Option 1.3: A basket of euro-area sovereign bonds with respective weights in line with the ECB capital key like under option 1.1., but without tranching (this would only provide diversification of risk and not be considered a securitisation under current rules).

2 Extent of 'restored' regulatory neutrality

Option 2.1: Extend the regulatory treatment of euro-area sovereign bonds to all tranches of the SBBS, in particular: no capital requirements, eligibility for level-1 LCR, no concentration charges/limits and no investment restrictions.

Option 2.2: Extend the regulatory treatment of euro-area sovereign bonds only to senior tranches, entailing the same favourable treatment as mentioned under option 2.1. Sub-senior tranches would have additional charges, liquidity discounts and investment limits.

3 Compliance mechanism

Option 3.1: Introduce a self-attestation mechanism for the originator of the securitisation ensuring compliance with the SBBS-related criteria envisaged in the legislation.

Option 3.2: Option 3.1 complemented by an independent third-party assessment; such third parties would be specific 'control bodies' similar to those involved in the certification of organic products.

Option 3.3: Option 3.1 complemented by an ex-ante supervisory approval by prudential authorities.

The range of options complies with the minimum requirements of the better regulation guidelines (two options apart from the baseline). However, important details of certain options remain very vague. For example, it is not clear which entity would be responsible for determining the portfolio structure under option 1.1 (and 1.3), which implies flexibility for 'exceptional cases' - a public agency, such as the European Securities and Markets Authority (ESMA), the Commission, or a private entity.[13] The question of the weighting according to the ECB capital key or national GDP is not discussed, nor are the number and size of the tranches and the details of the certification and supervision procedures (IA, pp. 25-27). The baseline does not feature in the screening of options, but is used as a benchmark for the comparison of the options, as required by the better regulation guidelines. The IA notes two discarded options, one providing SBBS with preferential regulatory treatment over sovereign bonds, and one envisaging their issuance by a public arranger (IA, p. 23). Both were discarded because of the risk of destabilising national debt markets and the potential misperception (by investors) that incentives or public issuing would guarantee a bail-out or an implicit guarantee for SBBS flows in case of problems.

Scope of the impact assessment

Based on the HLTF report cited above, the IA establishes **two different scenarios** to frame the assessment of the options' potential impacts, the first based on a small (€100 billion) and the second on a large (€1 500 billion) volume of the SBBS market (IA, p. 24). This wide range illustrates the above-mentioned uncertainty of the assessment, which is mostly qualitative, with some selective quantitative elements. The IA focuses on **economic impacts in terms of effects on the euro-area sovereign bonds market** and stakeholders, excluding other micro-and macroeconomic effects, for instance, on employment or SMEs. The IA affirms that none of the options is expected to have any direct social or environmental impact, nor would it have a direct impact on fundamental rights (IA, p. 27).

For the options related to the applicability and the extent of regulatory neutrality, the IA states that it has specifically assessed the reduction in a) capital requirements; b) liquidity of national sovereign debt markets (cost); and c) holdings of domestic sovereign bonds. Furthermore, it refers to the impacts on the volume of sovereign bonds rated AAA and on their share in banks' balance sheets, and, finally, to the issues of facilitating cross-border integration and the reduction of asymmetric shocks (IA, p. 24). It has to be pointed out, however, that apart from the volume of AAA-rated sovereign bonds and their liquidity and share in banks' balance sheets, the other points have been addressed inconsistently, mostly without quantification or other substantiation. Furthermore, the effects on cross-border capital flows have not been explored.

For option 1.1, under the (important) assumption that the senior tranche of the SBBS would receive a AAA rating, the IA expects the volume of AAA sovereign bonds in the euro area to increase by 2 % in the smaller volume scenario, and up to 30 % in the larger volume scenario (IA, p. 26). Their share in banks' balance sheets would increase by about 40 % in the larger volume scenario. For option 1.2, no quantifications have been provided, because, according to the IA, the impact on AAA-rated assets and on sovereign bond market liquidity would greatly depend on the 'structure of the products', the regulatory treatment of the various tranches and the ultimate market size (IA, p. 28). Nonetheless, the IA anticipates a 'likely lack of liquidity' under this option. Option 1.3 is expected to create a sizeable SBBS market, but not to receive AAA ratings, *reducing* the AAA-rated sovereign bonds in the euro area by 3 % in the smaller volume scenario and by 25 % in the larger volume scenario, respectively. The IA describes the effects on the main stakeholders in general terms ('positive', 'unclear', 'neutral', 'small'), pointing to various unknown factors that have not been explored (IA, pp. 27-28, 30, 74-76). The qualitative assessment of the compliance mechanism (options 3.1 to 3.3) draws on another IA (conducted for the simple, transparent and standardised (STS) Securitisation Regulation), considering investors' confidence, as well as the risk of moral hazard and the potential administrative burden for stakeholders, without providing any transparent evidence here (IA, pp. 34-40, 43).[14] The IA does not provide a thorough costs and benefits assessment.

Against the backdrop of the ongoing debate on SBBS, the IA could have been expected to discuss certain issues raised in relevant research.[15] However, apart from the moral hazard issue, it does not assess other risks (or potential costs), such as the 'warehousing risk' for arrangers of SBBS,[16] nor does it assess the effects in varying economic and financial environments, especially in times of financial crises. Preventive measures, such as capping the SBBS issuance or the holding of junior tranches, are not mentioned.[17] Furthermore, the IA does not analyse the size and number of tranches, but refers alternately to two (senior, junior) and three tranches (IA, pp. 4, 6, 20, 81). It does not provide information or evidence on the existing or expected demand for the junior tranche, and on the potential effects this might have on the senior tranche. Moreover, it does not assess the concrete weight of sovereign bonds from different euro countries in the SBBS portfolio, or assess who would determine this weight and how. The same applies for the basis of the fixed SBBS portfolio (ECB capital key or national GDP), which could impact the diversification of bonds and their liquidity. The IA highlights repeatedly that SBBS do not include joint liability, but does not offer any reflection on this issue (IA, pp. 4, 6, 17-18, 63). Last but not least, the IA does not address the fact that the assumed AAA rating of the senior tranche of SBBS (European safe bonds, or ESBies) has been called strongly into question by rating agency Standard & Poor's: 'Given the lack of diversification of the sovereign bond portfolio underlying ESBies and the high correlation of Eurozone sovereign default risk, we would likely rate ESBies in the lower half of the investment-grade category'.[18]

To conclude, the IA presents a comparative table of the combination of options in five different models (IA, p. 41). Their set-up and the link to the objectives could have been clarified by additional explanations. The IA indicates a preference for option 1.1 and option 3.1 ('possibly' combined with option 3.2 on a voluntary basis), but none regarding the treatment of the SBBS tranches. It just points to the trade-off between the (riskier) most enabling option 2.2 (all tranches) and option 2.1, which involves greater risk reduction (IA, pp. 30, 39). In the end, it does not present a preferred model, suggesting that 'political considerations' be applied to 'prioritise the choices' (IA, p. 43).

Subsidiarity / proportionality

The IA argues that the impediments to the development of SBBS stem from the existing EU legislation and have to be corrected at the same level, whereas actions by the Member States would be 'suboptimal' and would lead to more fragmentation of the single market (IA, p. 17). The proportionality principle is only addressed briefly in the assessment of the compliance mechanism; the IA states that the latter should contain 'proportionate and dissuasive' sanctions, without specifying them (IA, p. 35).

No reasoned opinions from the national parliaments were received by the subsidiarity deadline of 24 September 2018.

Budgetary or public finance implications

The IA anticipates 'limited' financial implications for the public budgets only under the favoured option 3.1 on the compliance mechanism; supervisors would check ex-post whether there is compliance with the SBBS criteria (IA, p. 37). The IA does not provide quantifications of the costs in this or any other context (except for arrangers, mentioned in Annex 3).

SME test / competitiveness

The IA states that SMEs or retail investors are unlikely to be directly affected by the initiative, as they would not participate in SBBS markets (IA, p. 27). Nevertheless, it expects positive indirect impacts for them, provided financial stability and investor confidence increase as a consequence of successful SBBS. This issue is neither explored nor substantiated.

Simplification and other regulatory implications

The IA does not claim that the proposal would bring in any simplification, since it introduces additional rules for the development of a new financial product (IA, p. 43). The proposal entails amendments to other legal acts, namely the Undertakings for Collective Investment in Transferrable Securities Directive, the Capital Requirements Regulation, the Institutions for Occupational Retirement Provision Directive and the Insurance Directive (Solvency II). Moreover, changes to several delegated regulations, notably the Liquidity Coverage Ratio Delegated Regulation, are envisaged. The IA opts not to suggest incentives or a preferential treatment for the development of SBBS (discarded option, IA, pp. 18, 23) and not to link SBBS to a reform of the regulatory treatment of sovereign exposures. The HLTF study underpinning the IA highlights that the task force members remain split on whether these measures are conditional for a successful SBBS, but the IA does not contribute to this discussion.

Quality of data, research and analysis

As indicated, the IA builds mainly on the report of the HLTF, drawing only on a few other sources. While the presented elements are concise and logical, the analysis seems incomplete, as it excludes, without explanation, a number of relevant issues, while keeping others unspecified (see pp. 4-5). The IA acknowledges the uncertainties and the lack of evidence, especially with regard to the potential market size of SBBS, the future overall interest rates and investor behaviour, but remains silent on doubts about the AAA rating of the senior tranche (IA, pp. 20, 28, 30, 43-44, 69-70, 72, 76). It does not present a sensitivity analysis to check and visualise the reliability of the provided estimates. Generally, assumptions, methods and conclusions could have been explained in more detail. There are some inconsistencies, for instance, when it comes to the division in tranches, the standard and weighting for the fixed portfolio, and the references made to ESRB work that has evolved in recent years.

Stakeholder consultation

The Commission did not conduct the obligatory 12-week-long open public consultation for this IA, contrary to the better regulation guidelines. Instead, it refers to a short, public online survey on sovereign bond-backed securities, carried out by the ESRB between 22 December 2016 and 27 January 2017 (in the framework of the above-mentioned HLTF study) (IA, p. 48). According to the IA, 15 'credible' responses to the targeted questions were received; these are presented with answer breakdowns in Annex 2 (IA, pp. 48-62).[19] The replies show mixed positions, for instance, on the classification and the liquidity of SBBS or on the probable exchange rate of individual government debt holdings for SBBS. Some questions received up to 10 non-answers. Apart from the survey, the IA draws on two workshops, organised in Paris and Dublin (also in the framework of the above study). The IA reports that they also revealed 'a broad diversity of views' (IA, p. 62). Generally, stakeholder views are irregularly mentioned in the text, the liquidity of sovereign debt markets being their key concern, according to the IA (IA, p. 26).

Monitoring and evaluation

Without designating a clear preferred combination of options, the IA remains very vague and general on the monitoring and evaluation of achieving the objectives. It implies the volume of assembled and traded SBBS would be monitored on the basis of the information contained in banks' balance sheets and 'traditional measures of liquidity' (IA, pp. 43-44). It also suggests that a Commission report be published five years after the entry into force of the regulation, anticipating at the same time difficulties related to distinguishing the effects of this regulation from those resulting from other legislation or from factors such as potential legal costs, SBBS market size and developments, or overall interest rates (IA, p. 44).

Commission Regulatory Scrutiny Board

The Regulatory Scrutiny Board issued a positive opinion with reservations[20] on the draft IA on 16 February 2018. Notably, it did not criticise the Commission for not having carried out a public consultation. However, it found 'significant shortcomings' in the insufficient assessment of risks and unintended consequences of SBBS, especially in the context of stressed financial markets. It also pointed to the lack of consideration of trade-offs between alternative models and to the fact that there is no appropriate guidance for the political choice of the preferred option. These issues are still present to a large extent in the final version of the IA. It does not inform if and how the Board's suggestions were handled, despite this being mandatory under the better regulation guidelines.

Coherence between the Commission's legislative proposal and IA

Even though the IA does not select one clear preferred combination of options, the proposal appears to follow its general indications of favoured options. At the same time, it goes beyond the IA regarding the technical specifics of the SBBS, for example, with regard to the composition of the underlying portfolio; the flexibility, under specific circumstances ('adverse market developments'), to decrease the senior tranche; the monitoring and supervisory tasks of the ESMA; and sanctions in case of non-compliance. It suggests assigning zero-risk weights to all tranches (option 2.1).

Conclusions

The IA's definition of the problem and its definition of the objectives do not entirely follow the better regulation guidelines, as the former refers, without making a thorough analysis of the wider context, directly to the current lack of SBBS, and the latter presents objectives that are not clear-cut, specified and measurable. Notwithstanding these weaknesses, the policy options, including the baseline scenario, seem logical and pertinent. They lack, however, the necessary specification and precision, leaving central aspects unclear. The assessment focusses on the direct effects that the introduction of SBBS would have on the euro-area sovereign bonds market, expecting no direct social or environmental impacts. It does not provide a comprehensive cost and benefit assessment of the initiative. The IA acknowledges that tangible evidence is not available as regards the central question of the potential SBBS market size and some other elements, which makes a reliable ex-ante assessment challenging. While admitting its limitations, the IA could have explained its underlying assumptions, methods and uncertainties to increase its transparency and accountability. It relies mainly on the work conducted by the relevant high-level task force, as a 12-week open public consultation, mandatory for each IA, was not carried out. In addition, it omits, without explanation, a number of relevant disputed issues, such as certain risks and the debate around the AAA rating of the SBBS senior tranche. Together with the absence of a preferred combination of options, this seems like a missed opportunity to provide comprehensive and transparent support to evidence-based policy-making.

ENDNOTES

[1] On 29 June 2018, the Commission presented a revised version of the IA of 24 May 2018, correcting mistakes regarding banks' exposure to domestic sovereign bonds (IA, p. 9, Figure 3).

[2] See A. Delivorias with J. Ulic, Sovereign bond-backed securities, EPRS, European Parliament 2018.

[3] Established in 2016 under the aegis of the European Systemic Risk Board (ESRB), the group is chaired by the governor of the Central Bank of Ireland and comprises representatives of 16 national central banks, the European Central Bank (ECB), the

European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), Member States' debt management offices and academics. See its 'Sovereign bond-backed securities: a feasibility study, 2018'.

[4] The link between the creditworthiness of a country's government and that of its banks. The deterioration of sovereign creditworthiness reduces the market value of domestic banks' holdings of their government's exposures, which in turn reduces the perceived solvency of domestic banks, then increasing sovereign stress in expectation of a possible bail-out by the government.

[5] 'A commonly made mistake is to conclude that a problem exists because a policy framework, regulatory measure, database etc. does not yet exist at EU level. These "missing elements" are not problems per se but may in fact be possible policy solutions to an appropriately defined problem.' (Tool 14, p. 82).

[6] Indicator for banks' capacity to absorb short-term liquidity shocks. There are three categories: level 1 assets have no discount of their value, whereas level 2a and level2b assets receive haircuts on their value.

[7] Under Basel II rules, banks meeting certain conditions can apply their own risk parameters to calculate regulatory capital.

[8] EU banks at the highest level of consolidation according to the EBA Transparency Exercise 2015.

[9] Annex 4 arrives at even higher amounts of capital requirements under these circumstances. The caveats of these estimates are the same as for the 100 % switch (IA, pp. 81-82).

[10] It is worth noting that the €70 billion estimate featured in the quantification tables as 'direct benefits' in the first draft of the IA, but was removed from the benefits overview in the final IA (IA, p. 70).

[11] Reflecting its quality as a standard benchmark for other financial products, based on its liquidity and critical mass.

[12] Following the HLTF, the IA considers that a 70 % senior tranche would have a low five-year expected loss rate, comparable to German sovereign bonds (IA, p. 6, footnote 9).

[13] The IA does not explore this aspect further and does not indicate the preferred option, noting instead: 'These avenues will be explored in the drafting of the legislative proposal...' (IA, p. 25).

[14] Some quantifications of costs for arrangers are provided for option 3.1 in Annex 3, citing, again, the HLTF report as their source. The IA estimates upfront costs of €1.15 billion and annual costs of €3.26 billion for an SBBS programme of €6 billion, without offering further explanation (IA, p. 77).

[15] See P. de Grauwe/Y. Ji, How safe is a safe asset? CEPS policy insight No 2018-08, 2018, and G. Claeys, Are SBBS really the save asset the euro area is looking for? Bruegel blog, 2018.

[16] Arrangers stock assets in a warehouse account during the pooling phase, until the target amount of a securitised asset is reached; during this time, they carry the capital risks of these assets.

[17] K. Ji, A review on ESBies. The senior tranche of sovereign bond-backed securities, CPB Netherlands Bureau for Economic Policy Analysis, 2018, pp. 9-11.

[18] S&P's global ratings, Ratings direct, How S&P Global Ratings would assess European "Safe" Bonds (ESBies), 2017, p. 2.

[19] Replies from four investment and three commercial banks, four asset managers, three funds and one clearing house.

[20] Not a 'positive' opinion as indicated in the explanatory memorandum of the proposal (p. 8).

This briefing, prepared for the ECON committee, analyses whether the principal criteria laid down in the Commission's own Better Regulation Guidelines, as well as additional factors identified by the Parliament in its Impact Assessment Handbook, appear to be met by the IA. It does not attempt to deal with the substance of the proposal.

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