



19.5.2016

WORKING DOCUMENT

on Common rules on securitisation and creating a European framework for simple, transparent and standardised securitisation

Committee on Economic and Monetary Affairs

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“What are the odds that people will make smart decisions about money if they don't need to make smart decisions--if they can get rich making dumb decisions? The incentives on Wall Street were all wrong; they're still all wrong.”

Michael Lewis, The Big Short: Inside the Doomsday Machine

After the financial crisis that originated in the US securitisation market, your rapporteur has critically assessed the Commission proposals which aim to revive the securitisation market. They face the dual challenge of making the financial markets safer while reviving the market in the EU by better channeling private capital to the real economy. If well designed, these proposals can create an incentive for more and better investment in the EU, including a transition towards a low carbon economy and more long term investment.

Securitisation played a central role in the 2008 crisis

During the crisis securitisations in the United States which according to their AAA rating should have had a 0.1% probability of defaulting, in fact defaulted in 16% of cases. Securitisation allowed credit to be lent to those who could not afford it, and was constructed by originators that did not bear the risks but distributed bad credit quality loans to unknowing investors. Rather than keeping a check on these practices credit rating agencies would give out triple-A ratings. A toxic cocktail led to a financial crash of historic scale with trillions worth of investments being lost within several months. And even though governments and central banks intervened and many banks were bailed out with tax payer money an economic crisis could not be avoided. Although credit ratings in Europe did not turn out to be quite as wrong as in the United States, we cannot discard the lessons of the crisis when considering proposals to revive the European securitisation market.

Analytical framework

This working document tries to create an analytical framework within which we are able to assess the proposals for Simple Transparent Standardised (STS) securitisation, based on the following questions:

- What are the pros and cons of securitisation?
- What went wrong in the past and which lessons can be drawn?
- What happened in the securitisation market and why didn't it recover?
- How were these lessons implemented in the proposals for securitisation?
- What can be done further to mitigate the risks of securitisation while reinforcing the goals we want to achieve?

Broader context - CMU and CRR

The proposals to revive the securitisation market are an essential part of the initiative of the European Commission to create a Capital Markets Union in Europe. This initiative should reduce the reliance on banks for financing the real economy, although securitisation is still mainly a source of finance for banks. Within the work of the European Parliament there has been made a somewhat artificial split, between the legal framework that creates the STS securitisation and the CRR regulation dealing with the consequences on the capital requirements for STS eligible securitisations. This working document will be mainly focused on the STS requirements but will inevitably touch upon the CRR regulation as well.

1. What are the pros and cons of securitisation and what went wrong in the past?

Securitisation consists of taking an illiquid asset or pool of assets such as loans and transforming them into a security via a special purpose vehicle (SPV) and finally selling them to the wider securities market. This technique can present several advantages for issuers, for investors and also for the economy as a whole, but can also include some important flaws which have long been identified¹. Below we will discuss the pros and cons of securitisation, as we start to look for ways the trade-off has been improved and can be improved further.

Risk transfer, maturity transformation and investment opportunities

As a technique, securitisation involves a **risk transfer** from the lender to an alternative source of funding, thanks to which traditional lenders – usually banks – take risks off their balance sheet. The risk is transferred to investors that have an appetite for this risk and in particular its accompanying rewards.

The process of securitisation helps with the **maturity transformation** that financial institutions need to achieve. For banks securitisation has the potential advantage to reduce the (liquidity) risks of transforming short-term funds like savings deposits into long-term assets like loans and mortgages. The long liabilities of the assets are matched with the long term funding of the investors in the SPV of the securitised asset portfolio. The maturity transformation risk and the reliance on short term funding are reduced when assets are securitised. This assumes the market for securitisations is liquid, in good and in bad times, and that the risks are transferred outside the banking sector. Under these assumptions securitization has the potential of making banks and the banking sector as a whole more safe and sound.

Securitisation allows investors to directly hold **investments in real economy assets**, without being responsible for the origination or servicing of these assets. Instead of directly owning loan portfolio's institutional investors can buy bonds of SPV's holding securitised assets like residential mortgages. The structure and tranching of the securitised portfolio allows investors to tailor the risk-reward combination of their investments according to their risk appetite.

Asymmetric information and moral hazard

Sharing risks should normally contribute to financial stability as long as the risk taker understands the risks and there is prudential supervision to avoid excessive concentration of risk. The transactions increase by definition interconnectedness between financial institutions and generate longer chains of intermediation. This will introduce risks, like counter-party risk, legal uncertainty, but also complexity of the financial system. Even more important, it leads to situations with **asymmetric information** between the issuer and its buyers. Not only knows the issuer much more about the security itself, but also the credit quality of the underlying loans, the profile of the credit receivers, and the relative quality of the different tranches. By contrast, the buyer may not employ the resources to perform a detailed analysis of the underlying loans and of the structure, in particular for complex securitisation deals.

The problems of the US securitisation market before the crisis extended to the nature and

¹ [*The impaired EU securitisation market: causes, roadblocks and how to deal with them*](#), European Central Bank & Bank of England, 27 March 2014

structure of the issuances and the transparency thereof. As issuers had limited disclosure obligations, they were free to create ever more complex structures for their securitisations. That complexity limited investors' understanding of such products and the risks attached to them. By contrast, overly complex structures were rare in the EU, because the issuers and the investors had less incentives and freedom to engage in such transactions. Nevertheless, with the crisis came to the fore that bankers did not understand their own products, let alone their clients.

The situation of asymmetric information gives rise to problems of **moral hazard**. Securitisation incentives are very different for each market participant, which raises potential problems of conflicts of interests between parties¹. It has widely been recognised that the misalignment of interests can lead to "*self-reinforcing dynamic between demand and supply*" (ECB-BoE, 2014) that are not sustainable. Indeed, ample examples of moral hazard and misalignment of interests materialised before the crisis. It seemed that what could go wrong went wrong. The originate-to-distribute model led to laxer credit standards. Issuers were misleading investors on the quality and creditworthiness of the underlying assets. Credit rating agencies were instrumental in legitimising the limited risk involved in investing in securitisation while being paid by issuers for their ratings. Also on the investor's side enough went wrong. Many Structured Investment Vehicles (SIV) were undercapitalised which led to fire sales of securitisations when the market got distressed. Supervision failed, and the assumption of some supervisors that the market would correct itself, has been admitted to be flawed.²

Indeed, before the crisis in the United States, structural flaws of securitisation were exploited by the excessive freedom given to credit (in particular mortgage) distributors. In contrast, EU issuers overall retained a bigger part of the portfolio of the loans that they securitised than their US counterparts, to the point where originate-to-distribute practices were almost non-existent in the European Union. Besides that, in the absence of sponsors for the Residential Mortgage Backed Securities (RMBS) market, EU investors were always fully responsible for their investments, while US investors may have felt that they could take more risks while benefitting from lower capital charges under the US regulatory regime. On top of that, between two thirds to almost 80% of securitisation instruments in the US benefitted from public guarantees from the US Government Sponsored Enterprises (e.g. Fannie Mae and Freddy Mac).

Unable to assess the structure of the product, in particular its credit worthiness, US investors relied on credit rating agencies (CRAs). Ratings by those agencies could have contributed to solving the asymmetry problem, but they did not. Overreliance led to failures on due diligences on the part of investors. Meanwhile issuers and rating agencies had aligned commercial incentives to ensure by all means that those products would be rated AAA.

Notwithstanding the different experiences on either side of the Atlantic, retention rules have been meant to align issuers' and investors' interest by giving **skin in the game** to the seller. The principle of introducing risk retention in the securitisation market was endorsed by the

¹ [Report on asset securitisation incentives](#), The Joint Forum BCBS-IOSCO-IAIS, July 2011

² The president of the US Federal Reserve between 1987 and 2006 Alan Greenspan has conceded that he trusted too much on the market forces in the run up to the financial crisis
<https://www.theguardian.com/business/2008/oct/24/economics-creditcrunch-federal-reserve-greenspan>

G20 in September 2009 and introduced in EU legislation via CRD II and further developed in CRR and its related technical standards.

Tranched instruments and cliff-edge effects

Securitised products are often designed as **tranched instruments**. Tranches of different risk profiles are created in order to satisfy different risk appetites by investors. However, there is a clear trade-off involved with tranching a securitised asset portfolio. Tranching encourages reliance on ratings, stresses the robustness of modelling and exposes investors to human errors of judgement. In particular, tranching creates greater risk of modelling error, potentially with high impact for the smallest of errors¹, which legislators have tried to mitigate by reforming rating agencies and better controlling internal models. Besides, risk-sensitive requirements for banks allow for a capital treatment differentiation per tranche that addresses this specificity of securitisation.

Credit ratings may generate "cliff edge" risks since downgrades can translate into substantial harshening of the regulatory treatment of a securitisation deal. This results into in-built fire-sales and similar instruments by financial market participants to pre-empt higher capital charges in the case of a downgrade. For those reasons, the use of external ratings by banks for the calculation of their capital treatment when holding positions in securitisation is banned in the US and remains controversial in the EU.

2. What happened in the securitisation market and why didn't it recover?

Prior to the financial crisis, the EU securitisation market was growing constantly for almost a decade. Issuance volumes had reached €594 Bn in 2007 and more than €800 Bn in 2008. After the financial crisis, European securitisation markets have plummeted and never fully recovered. The volume of securitisation in the EU in 2014 is 42% lower than the average in the period 2001-2008 and is 74% lower than in 2008. In contrast, the US market almost entirely collapsed in 2008-2009, but has rebounded more quickly.

Table 1: European issuance

Values (billion euros)	2006	2007	2008	2009	2010	2011	2012	2013	2014
Placed	478	418	106	25	90	89	87	76	78
Retained	0	175	713	399	289	287	166	105	138
Total EU	478	594	819	424	379	376	253	180	216
EU retention %	0%	30%	87%	94%	76%	76%	66%	58%	64%
Total US	2 456	1 254	916	1 352	1 170	1 031	1 555	1 496	1 070

Source: Association for Financial Markets in Europe.⁷²

Residential Mortgage Backed Securities (RMBS) securitisations still today make up the majority of the EU securitisation market because, as they involve residential mortgages, which are relatively more standardised products, with longer maturity and regular payment streams. However, the primary objective of reviving securitisation should be to channel fund to the real economy. SMEs loans securitisation is one of the most specific segments of the

¹ "[Securitisations: tranching concentrates uncertainty](#)", Adonis Antoniadis & Nikola Tarashev, BIS Quarterly Review, December 2014

securitisation market that has suffered a lot from the crisis - representing now less than half of the amount prior to the crisis (€36 Bn in 2014, compared with €77 Bn in 2007).

On the investor side, experts assess that half the European investor base is gone and only 30 to 40 institutional investors are regularly active. Banks slightly retreated and represent now only 30% to 40% of investments in securitisation but together with investment funds remain the largest part of the investment base (made of insurers and pension funds). Finally, most deals are now private transactions: in 2007, 70% of securitisation issuances were publicly placed to investors while today only 13% of issuances are. Since the start of the crisis the vast majority of the securitisations were retained by issuers and used as collateral in re-purchase agreement with the European Central Bank for funding. This makes the ECB a stakeholder that has an interest in reviving the securitisation market because it has become an important tool in executing its monetary policy.

Though prices are not the most prominent element to consider in an atypical market such as securitisation, it is clear that the secondary market's dried up liquidity has driven down prices for securitisation products and pushed even more primary investors into buy-and-hold strategies.

Why did the the European securitisation market not recover?

Why did investors decide on a massive scale to abandon a product that withstood the crisis reasonably well in Europe? And, even more intriguing, why did the EU market not recover (whereas the US market did)? The explanation of stigma on securitisation is far from satisfying, since we are talking about professional investors that tend to make rational investment decisions based on the underlying data of the performance of a product. In the search for an explanation we need to assess both demand and supply side to explain the lack of appetite in the European securitisation market. We must not see securitisation in isolation but as one of the many options issuers and investors have.

Supply side: other funding options and thirst for margin

On the supply side covered bonds (debt securities backed by cash flows from mortgages or public sector loans, but without risk transfer) seem to be more attractive, partly as the result of lower capital requirements. Also cheap funding from the ECB in the LTRO programmes reduces the need for issuers to use a more expensive source like securitisation. In a time when margins are under pressure in a low-interest environment financial institutions might consider to hold on to the assets they originate rather than selling them off in a securitised transaction. Especially if banks can use their retained securitisation in a repurchase agreement with the ECB and get funding while not sharing the margin with an investor.

Demand side: capital charges and regaining trust with a lot more transparency

That some institutional investors are directly buying asset pools, which in the past were used in securitisation, is a sign that something is preventing the market to revive even in the presence of appetite from the demand side. Within the international frameworks of Basel IOSCO the capital requirements were predominantly modeled on the American experiences with securitisation in the crisis and do not take into account the significant differences there are between the US and EU securitisation markets. Too high capital requirements will reduce appetite for investments in securitisation. Setting the capital requirements too low would discard the lessons of the crisis that financial institutions were overleveraged. Therefore, your

Rapporteur will also closely look at the links between the STS and CRR proposals in order to ensure that there is consistency between these two. For an effective STS, right capital calibration based on past experiences in Europe is key.

A set of clear rules for securitisation and a label for STS securitisation could support the revival of market, but only if they are carefully calibrated. Your rapporteur does not share the assertion that the European market did not revive solely due to stigma, and thinks that more is needed. This means addressing the information asymmetry between investor and issuer, the difference in treatment of alternative investments and taking measures that will prevent the market from shutting down in bad times. Essential in regaining trust will be transparency within the securitisations market, not only on the assets and structure of the securitised asset portfolio, but also within the market. Supervisors and investors should know where the risk precipitates in order to keep trust in times of stress.

3. How were lessons of the crisis implemented in the proposals for securitisation?

Lessons from the crash of the securitisation market have been drawn by supervisors and legislators. Recommendations from international and European bodies, as well as G20 decisions, have been made into law in various stages since 2009. It is worth recalling that banking legislation (CRD II, CRD III, CRDIV), insurance legislation (Solvency II Directive), asset management legislation (AIFMD, UCITS Directive, Commission proposal on Money Market Funds Regulation) and the Credit Rating Agency Regulation all include provisions that are directly meant to make the securitisation market safer. They did not however result in a revival of the market and therefore more needs to be done.

Key is to tackle the twin problem of asymmetric information and moral hazard. This requires transparency for each market participant, including supervisors, combined with clear responsibilities to give and/or acquire information. Moreover, the different interests of the market participants need to be aligned, so as to avoid the possible problems of moral hazard. That is key to come to an asset category that contributes to financial stability as well as to investment in the real economy.

Bringing rules together in a single framework

- The Commission proposal at hand represents the first attempt to integrate those rules for the securitisation market into one **single framework**. It expands rules applicable to banks to other financial institutions, and updates requirements from existing legislation in line with the latest recommendations of the European Supervisory Authority and international bodies. The legislators should ensure that those rules are as consistent and thorough as possible and do not unduly conflict with the overarching objective of market efficiency and broadening.

More due diligences and transparency to tackle the asymmetry of information

- The asymmetry of information on the securitisation market will be better addressed through a **due diligence regime**, giving a clear responsibility to investors.
- The rapporteur welcomes the restriction whereby only professional investors can invest in securitisations, because the due diligence that is expected cannot be performed by retail investors. Yet, he notes that although most fundamental concerns identified during the crisis had to do with issuers' behaviours, the proposal does not impose any **restriction on the nature of the issuer, originator or of the**

securitisation vehicle, while most of the problems of moral hazard due to the asymmetry of information materialised on their side before the crisis.

- High expectations on due diligences also supposes that it is realistic for investors to build up a comprehensive analysis of securitisation products. Consequently due diligence requirements applicable to investors must go hand in hand with the **disclosure requirements** applicable to originators. It should also take into account the specificities of the type of securitisation and be tailored to the asset class.
- Nevertheless, and despite comprehensive due diligences, buyers may not be able to overcome the original asymmetry of information if the product is extremely complex. That is why confidence by investors requires simplicity, transparency and standardisation of products, which is the aim of the current proposal.

Risk retention and the skin in the game principle to overcome moral hazard

- Extending and harmonising risk retention requirement across issuers makes sense. Most details of the Commission proposal rely on the technical advice presented by the EBA in December 2014¹. The proposal maintains the **level of retention** of 5% of the securitised assets. It also does not introduce a different level of retention for STS compared to non-STs products.
- Your rapporteur notes that alternative mechanisms to align interests have been dismissed by the EBA and by the Commission, on the grounds that the other mechanisms would be too complex and difficult to establish and enforce. Your rapporteur is open to strengthening the risk retention rules if necessary and in this light has taken good note of the recent EBA report² which stresses that, though only a few credit institutions have been found non-compliant with the current risk retention rules, supervision practices could be improved and harmonised.

Credit quality standards, rules for CRA's and supervision on shadow banks

- In the aftermath of the crisis credit standards were sharpened in many member states and for a part harmonised under EU law. The Mortgage Credit Directive sets a framework to be for example when banks are assessing the creditworthiness of potential lenders. These developments have further secured a floor for the credit quality of assets originated within the EU. The STS framework does contain certain boundaries for the credit quality of the assets that can be used in a securitisation that want to qualify as STS. Loans that have been restructured less than three years before they were securitised cannot be part of a STS securitisation. Bad loans are therefore excluded.
- The important role Credit Rating Agencies played in the run up to the crisis, has led to the sector to be regulated. Within the European Union rules were adopted for the CRA's that reduced the conflict of interests and tried to reduce the reliance on credit ratings in the system. The STS proposals do not directly address the problems that might occur with credit rating agencies rating securitisations. The determination of STS eligibility was consciously left for the issuer and investor to make, not relying on a third party like a rating agency to take this responsibility of their shoulders.
- Before the crisis much of the originated securitisations were bought by alternative investment funds like Structured Investment Vehicles. These highly leveraged funds

¹ [Opinion of the European Banking Authority on the securitisation retention, due diligence and disclosure requirements](#), 22 December 2014

² [EBA report on risk retention, due diligence and disclosure under Article 410 \(1\) of CRR](#), 12 April 2016

that would make profits on the margin between interests paid out of the securitisation and the funding costs on the short term wholesale funding market. There have been European initiatives trying to regulate the shadow banking industry, like the Money Market Fund regulation or the Long Term Investment Fund regulation. The STS proposals do not address the link there is between securitisation and the shadow banking sector that might use securitisations in their highly leveraged investment vehicles.

Creating a upper segment of securitisation

The Commission proposals does not ban non-STs securitisation, it merely defines the perimeter of an upper segment made out of STS products. Yet, creating a two-tier market presents **complex challenges** because it requires the introduction of clear, quickly-applicable and uniformly-enforced criteria for the STS concepts. Doing so without setting the bar neither so low that mistakes of the past will be allowed by loopholes, nor so high that the criteria will undermine the market take-up, or over-step into each investor's specific demand and appetite for various levels of investment risks.

By contrast, the lower tier of non-STs securitisations should not be unduly penalised and, with proper rules and supervision defined above, should remain attractive for certain very specialised and more risk-prone investors. The aim is not to eliminate risk, but to ensure that those who take the risk are aware of its nature and have sufficient assets to cover up for losses. The timing and the transitional provisions for introducing such a change in the market should also be carefully examined and considered.

Dividing the market does not solve structural issues. For example, as it does not benefit from public agency support like in the US, the EU market must be more stable on its own and that implies being open to every solution. As argued above, beyond the scope of this legislative proposal, mechanisms to ensure the stability and liquidity of securitisation in times of stress must also be considered.

4. What can be done further to mitigate the risks of securitisation while reinforcing the goals we want to achieve?

STS criteria should be clear

Though the content of the STS criteria has received broad support by public authorities and stakeholders, their number and their relatively vague wording in the Commission proposal could increase the risks of misinterpretation and market fragmentation, and casts important doubts as to the real-life market take-up. Your rapporteur has in particular paid attention to the calls for clarifying the definition of certain criteria. He is also of the view that concentrating the number of authorities involved could be very helpful to establish a single European interpretation of STS criteria. Further encouragement for quick level-3 measures (i.e. Q&A and Guidelines) could be considered. Whatever their final forms, your rapporteur is of the opinion that STS criteria should not be weakened and the door for "bad loan" securitisation under the STS category should not be opened.

The goal of the STS initiative should be to make the structure of the securitisation less of a black box for investors while fostering common norms and expectations for the market and leaving the financial risk assessment in the hands of investors and regulated in sector-specific legislation.

The securitisation market encompasses financial instruments of many different natures to be securitised. The proposal at hand is meant to cover the securitisation market as a whole (without any part of the market being excluded a priori from STS qualification). But certain criteria may make STS securitisations of certain assets more difficult than others. In that spirit, all criteria must be looked at to ensure that they fit the specificities of these different financial instruments, while making sure that the criteria are thorough in their design without creating loopholes, but also not being impossible to reach for one or several asset classes either.

Asset-backed commercial papers (ABCPs)

Precisely, the Commission proposal lays down criteria for ABCP securitisations to be considered as STS. In this area, the Commission relied on criteria developed by the EBA which do not derive from international work, because the STC criteria of the Basel Committee only apply to term securitisation and which were not submitted to public consultation beforehand.

These criteria must be adapted to particularities of ABCPs, which are by design untranching and revolving securitisations for which the receivables from auto loans, equipment leases, commercial receivables, stocks finance, etc. are accepted as assets. They may represent only a minority share of EU securitisations (€80Bn) but are key to the financing of a lot of projects by SMEs, non-rated companies and individuals. Finally, 70% of investments in ABCPs are made by MMFs and this market reality must not be overlooked when thinking of the MMF Regulation and of the treatment of those investors in the STS ABCPs.

Your rapporteur takes note of the **technical issues** identified by stakeholders and picked up by the Council. Questions have been raised around the requirements applying to the programme level and to the transaction level and how to take into account the key role of credit institutions acting as sponsors in partially or fully-sponsored ABCPs. Where a bank acts as sponsor at programme level, end-investors do not take the same risk because the bank acting as sponsor takes the risks by offering credit/liquidity assistance and has to comply with fitting capital requirements as the guarantees remain on its balance sheet. The guarantees brought by those institutions should alleviate concerns over some aspects, such as the maturity mismatch between the overall instruments and the individual transactions. Since the **car lease and loans** represent a majority of the ABCP market and one of the most dynamic parts of the market, it should be accommodated within the STS scheme.

Certification of the STS label

Without a **proper certification system**, the STS framework will not manage to restore confidence on the market. In the Commission proposal, the STS label would be self-awarded by the market participants and then, upon information by the issuer and automatically without any check, published on the ESMA website. It must be said that, to balance this option, Commission introduced the strong disclosure requirements applicable to the issuer and a strict sanction regime on the issuer side (see below).

Self-attestation has been identified as a point of discussion.

In its General Approach¹, Council strengthened the self-attestation with an optional third-party certification and an obligation for the originator (or sponsor or SSPE) to explain how

¹ [General Approach](#), 7 December 2015

STS criteria are met. It also laid down the whole authorisation process, rights and duties of the third party.

Your rapporteur supports the reasoning of the Commission, also followed by ESMA, that the responsibility for adhering to the STS criteria should lay with the issuers and investors of STS securitisations. Self-certification of the STS label properly reflects this conception. Parties are allowed to hire a third-party to help certify their securitisations, but this will not alter their ultimate responsibility to do due diligence and liability for not following the rules of the STS framework.

Penalties

As part of any enforcement system, there must be a deterring penalty regime. Because the Commission has followed the approach of relying on self-certification, it has developed a stricter penalty regime than in most other financial services legislation, for example by raising the minimum penalties for originators, sponsors and SSPEs breaching the regulation. It also seems by its drafting to treat every infringement case as a fraud case. Your rapporteur believes that a strict penalty regime cannot be a substitute for unclear criteria and could act as deterrent for investors.

Any sanction regime can only be implemented in a fair way if responsibilities are clearly identified in the law. The text should clarify systematically which entity bears legal responsibility for fulfilling each legal obligation. The sanction regime should also be fine-tuned to take into account the risk of diverging interpretations. Competent authorities should have a mandate to act and enforce rules with higher fines only when criteria are uniformly interpreted and applied.

Competent authorities

Furthermore, the Commission proposal empowers a long list of competent authorities. This approach generates risks of regulatory fragmentation and arbitrage. There can be diverging interpretations from different authorities and responsibility across authorities may be diluted. The matter is made worse in cases of cross-border investment, where the national supervisor on investor side will also have to look at the investors' compliance with regulations and may disagree with the issuer's national authority regarding the STS compliance of the securitisation.

On the latter, your rapporteur is of the view that this Regulation aims at restoring dynamics of confidence in a market in securities and that therefore ESMA should be the lead authority and have the power together with national market authorities to look into shortcomings of the securitisation market. In that sense, the rapporteur would support the ECB's view that STS compliance should be a matter for the securities markets authorities only. By doing this the number of different National Competent Authorities will be reduced and the interpretation of the STS rules placed exclusively in the hands of the market authorities.

Irrespective of the authority responsible for the different parts of the Regulation, current supervisory practices prevent pan-European securitisation. To achieve a proper common market, they should rather foster convergence. As far as assessment of securitisation is concerned, convergence should be sufficient to ensure that issuers can pool loans from different Member States. This practice is rare and is likely to remain so due to differences in national laws for the originated assets, like residential mortgages, which go beyond the remit

of this proposal. More importantly investors should be able to place their funds in securitisations issued in a different Member State and in securitisations with underlying loans from a different Member State. Your rapporteur supports channels for fostering cross-border investments in securitisations across the Union.

Transparency and rating issues

The Commission proposal does introduce originator-to-investor transparency requirements and ensure a high granularity of transparency on the underlying loans under the STS transparency criteria, but those data at the level of the issuer and transaction do not give **transparency to the whole market and to the supervisor**. Yet, data availability is widely recognized as one of the major market issue. In particular, due to the particularities of the SME securitisation business (see below), making SME loan-level data available to investors would be useful (see ECB-BoE, 2014), even more than information on term securitisation and on ABCPs.

Public register for STS securitisations

Data comparison and analysis projects, based on continuous reporting on the relevant data of the underlying assets, are not within scope of the current proposal. Your rapporteur believes that transparency on the securitisations and their underlying assets should be improved, for the benefits of supervisors, potential market participants and other stakeholders like academics, through a public register. That approach would reduce compliance costs and monitoring costs. A data repository would capture and aggregate information for markets to extract and analyse. Based on the period loan-level reporting by the borrowers, the securitisation issuer can send the data to a trade repository to satisfy its supervisory obligation and its transparency obligation. Privacy issues of the lenders behind the securitised assets should be dealt with by anonymising the loan level data. The data collected would also allow market participants to calculate key risk factors on the underlying loans which will help them with their performance and loss probability measurement. Investors, especially those which have not built their own internal historical data, would benefit from further historical loan-level data being available via a central repository.

Given the confidentiality laws of Member States concerning the loan level data involved and the public objective pursued this initiative, the public register for STS securitisations could be designed as a non-for-profit utility to bridge the gap between originator, investor and supervisor. Indeed, such an infrastructure cannot be supported only by market participants or by individual countries. The European Datawarehouse of the ECB fulfils partly this task regarding loan-level data but it is questionable whether it could be expanded beyond. Moreover, the above-mentioned public register should be based on simplified and harmonised reporting requirements, which would not be duplicated across several initiatives, including the requirements of the Article 8b of the CRA Regulation and the ECB requirements.¹

Role of credit rating agencies

Furthermore, the Commission proposal does little to mitigate **over-reliance on credit rating agencies** as far as the securitisation market is concerned, which had been an objective under

¹ As part of its policy for accepting securitised products (e.g. SME asset-backed security) as collateral for Eurosystem refinancing operations, the ECB collect loan-level data, according to requirements for transparency and standardization as. The data collected is gathered under the European Datawarehouse and can then be used by current and potential investors to carry out their own credit analysis, and thereby help address information asymmetries.

the CRA Regulations. The CRAs will stay instrumental in determining the credit ratings of the tranches of a securitisation. Reinforcing the clarity of rating methodologies for securitisation and the disclosure of ex post performance of ratings should be the main goal in order to foster competition. Requirements to rotate for issuers should be strictly enforced and smaller CRAs should be systematically included in the multi-rating processes.

Balance sheet synthetics

By principle, some experts consider synthetics to be too complex to deserve an STS label. Yet the Special report by EBA of December 2015 determined that synthetic transactions that are genuinely used by institutions to transfer the credit risk, i.e. **balance sheet synthetics**, had a default rate historical performance comparable to traditional securitisations for higher rating grades and even superior for lower rating grades. From the standpoint of investors, that performance was aligned or superior to their expectations. Such balance sheet securitisations cannot be deemed more risky simply by their structure. By contrast, arbitrage synthetic transactions performed significantly worse than balances sheet synthetic transactions and should not benefit from any type of regulatory recognition. The investor base on the synthetic securitisation market mostly comprises non-bank entities, such as hedge funds, asset managers and pension funds.

Publicly supported SME securitisation

Relying on the conclusions drawn by that EBA report¹, the work on synthetic should be pursued to differentiate between balance sheet securitisation and arbitrage securitisation, to see how best to facilitate risk transfer and to boost balance sheet securitisation in favour of SMEs. **SME securitisation** represents less than 10% of the securitisation issuances in Europe. Only a few countries, namely Italy, Belgium and Spain, account for the majority of the market. The main lenders for EU SMEs are still big banks and therefore positive direct effects, via actual SME securitisation, and indirect effects, via increased SME loans thanks to capital relief obtained by securitising other loan portfolios, can result from the securitisation proposals.

But actually, direct effects are most likely to take place under a synthetic securitisation, which would not be part of the STS category, because a true sale of SMEs loans is quite difficult to achieve. In some countries, there are legal obstacles to such a true sale. But in most cases, it just boils down to operational, IT, legal or documentation costs on the issuer side. These problems are exacerbated by limited standardisation or outright lack of data on SME loans. Besides, in the absence of such data, investors find it also too costly to carry out their own due diligences. All these factors render true sale SME securitisation even more uneconomical². Issuers have therefore turned to developing dedicated instruments, such as ABCPs for the SME trade receivables, and other structuring techniques such as synthetic securitisations. But in the absence of a dedicated regulatory framework for synthetic, it is unlikely that such products would gather much support.

Your rapporteur believes that SME securitisations should be encouraged through solutions that enhance transparency and develop an appropriate framework within the STS proposals. For this reason, we should look favourable at the example of the EIB/EIF which conditions its

¹ [The EBA Report on Synthetic Securitisation](#), 18 December 2015

² "[Revitalizing Securitization for Small and Medium-Sized Enterprises in Europe](#)", IMF Staff Discussion Note, Shekhar Aiyar, Ali Al-Eyd, Bergljot Barkbu, and Andreas A. Jobst1, 7 May 2015

guarantee on securitisation on banks re-using the freed up capital to finance the real economy, like giving out more SME loans. So far SME loans have been a very small part of the securitisation market. Even if the STS initiative helps the securitisation market to revive the impact on financing SME's are expected to be modest.

Take up STS framework depends on incentive and alternatives

Your rapporteur is concerned about the market take-up for the STS category and the necessity to look at the market failures which, besides investor confidence, have been the cause of the decline of the securitisation scheme. In this spirit, other improvements as follows could be considered.

The success of the STS depends obviously on devising an **effective incentives' framework for banks, insurers, funds**, etc. to adopt it, whether through the capital requirements for banks in the CRR amending act or through the upcoming requirements for insurers in the Commission Delegated Act under Solvency II or as part of the ongoing discussions on the Money Market Funds Regulation.

To expand the level of issuance and investment in securitisations, the attractiveness of the STS scheme depends of the **comparison between various instruments'** costs and rewards, for investors and issuers. While each instrument's framework should be differentiated with all due respect for its particular risk profile, a fair and stable global framework must be drawn up. The EBA recommendation of July 2015¹ stressed that the new framework for securitisation should operate in conjunction with a review of the framework applicable to other investment products such as covered bonds and whole loan portfolios. The legislators should pay attention to accurately reflect the risk and reward ratio for those asset classes. The Commission proposal, regrettably, misses the point that any upcoming development in the securitisation market may happen in substitution to or in combination with other instruments and does not hint at the possible evolutions for those markets. For example, the uncertainty surrounding the Commission's plans, under the Capital Markets Union initiative, for the covered bonds' market is also likely to favour the status quo for the securitisation market and discourage fundamental changes in its investor base.

Third country STS securitisations and equivalence

Reviving the EU securitisation market implies making it possible for **non-EU entities** to access that market. Through this proposal, the EU is the first jurisdiction to develop a differentiation between STS and non-STS securitisation. In the absence of any third country's plan to develop its own STS scheme immediately, the Commission proposal did not include any mechanism for determining whether a third-country STS scheme is "equivalent" to the EU's. It implicitly preserved the right for issuers from third countries to offer "STS securitisation" to EU investors or the possibility for EU issuers to securitise third-country debt while complying with the STS scheme.

The Commission proposal ignores that third country aspect, an approach which does not warrant sufficient safeguards. As for the Council, it shuts them completely out by imposing that the originator, sponsor and SSPE involved in a securitisation considered STS need to be established within the Union. Such a restriction may reduce the investment flows into Europe and could cause retaliation from other jurisdictions which would not recognise EU STS

¹ [EBA report on Qualifying Securitisation](#), 7 July 2015

securitisation as qualifying for favourable treatment under their own jurisdiction. Yet, in light of the experiences in the crisis, where the most problematic securitisations were originated in the US market, the rapporteur understands the cautious approach taken by the Council. Since the European Union is the first mover in regulating STS securitisations it is difficult to design a properly functioning equivalence regime at this point in time. A future review of the text in this regard, as proposed by the Council, seems therefore appropriate.

5 Conclusions - the success of Simple Transparent Standardised Securitisation will depend on reducing information asymmetry and moral hazard that are inherent to this market

Securitisation can potentially contribute to a more stable financial sector that is able to finance the real economy. It can be a tool for banks to share risk and rewards with investors who are often looking for way to invest directly in the assets used in securitisation. The securitisation process helps banks with the maturity transformation process and reduces their liquidity risk.

To achieve these benefits though, important lessons from the financial crisis have to be learnt, important lessons concerning asymmetry of information and moral hazard. These problems will not be solved by the market on itself and need to be dealt with in the STSframework.

Disclosure rules for issuers are essential, so will be the due diligence requirements for investors. The proposed self-certification process prevents market participants to rely on the judgement of a third party like a CRA and assures that issuers and investors both take responsibility for compliance with the STS rules. STS criteria therefore should be crystal clear and not allow for uncertainty on what is expected. Therefore the number of competent authorities should be limited, with a central role for ESMA in interpreting the STS rules.

Transparency is key to overcome the asymmetry of information and allow supervisors to keep track of developments in the securitisation market. Therefore your rapporteur proposes a public register that will contain the essential information of securitisations and which investor holds which position. This will be an important safeguard whenever the market would come under stress in the future.