Paris, 22 September 2023

Evaluation on Effects of G20 Reforms on Securitisation
Paris Europlace Working Group's response to the FSB feedback invitation

Paris Europlace very much welcomes the FSB invitation to provide feedback on the effects of the G20 regulatory reforms on securitisation[1] implemented since the global financial crisis (GFC) in many jurisdictions.

Paris Europlace represents Paris international financial centre's market players, including banks, insurance companies, asset managers, financial intermediaries, international corporates and other financial services providers. It has a dedicated Working Group on Securitisation (participants in Annex), under its European Financial Regulation Committee[2] that adopts an international approach when analysing the ongoing financial and prudential regulation in the European Union and other jurisdictions (primarily the United States and the United Kingdom). Members of Paris-Europlace securitization Working Groups are securitisation specialists, often with decades of practice in this market, and working both on the issuing and investing sides, but also on transaction structuring, labelling, servicing, and thus Paris Europlace is uniquely qualified to provide fact-based feedback to the FSB taking into account the overall securitisation ecosystem.

1. Main messages

There is no doubt that US securitisation has represented a major systemic risk during the Global Financial Crisis, as a factor of contagion across various types of market participants and across geographies.

However it should be noted that :

- The European securitisation market performed much better during the GFC and did not contribute to the crisis in any significant way.
- At the time, the « originate and distribute » framework represented a significant moral hazard issue, which has since been solved in particular by the retention rules, which ensure « skin in the game » by the originator, as implemented in Dodd Frank and in the EU Securitisation

[1] https://www.fsb.org/2023/08/fsb-invites-feedback-on-the-effects-of-g20-financial-regulatory-reforms-on-securitisation/
[2] https://www.paris-europlace.com/en/paris-europlace/colleges-and-working-groups-1253

Regulation. Such measures have allowed to significantly reduce the systemic risk that had materialized during the GFC.

At the same time, prudential rules have become extremely conservative for banks and insurance, notably in Europe, which has driven a significant shrinkage of the EU securitization market, with low supply by issuers and low demand from investors. Looking at current issuance volumes in the EU, it is clear that securitisation does not have the scale that may generate a systemic risk, and would have considerable room for growth before reaching a potentially worrying level.

In the US, where retention rules have been implemented, but where the prudential treatment ahs remained basically local, as BCBS reforms (STC and prudential rules) have not been implemented, the market promptly restarted after the GFC, and is now much bigger compared to pre GFC levels, without having generated any systemic risk concern during the recent episodes of turmoil, linked to COVID, the US Treasury market issues, the Russian war in Ukraine, or the recent regional banks failures.

While comparing how the international standards have been implemented across jurisdictions, we would welcome that the FSB encourages Europe to remove some of the gold-plating (for example, in the extremely prescriptive and narrow definition of STS compared to STC, or in the very intrusive and burdensome interpretation of the principle-based notion of "Significant Risk Transfer".

On the other hand, some unjustified conservativeness is being removed in the CRR3, and other have been recommended by the European Supervisory Authorities in their 2022 joint report. It is now urgent to recalibrate the international rules, in order to favour international convergence and reduce the risk of deviations which are detrimental to the credibility of international standards setters. In this context, the FSB evaluation two-fold objective[3] is very welcome. On one hand, there is a need to look at the impact of specific reforms from a historical perspective. We view risk retention reforms aimed at addressing moral hazard risks as an example of successful reforms that largely reached their aim. On the other hand, there is a need to broaden the focus, such as whether some reforms have had material unintended consequences on the under-development of large regional markets like the EU securitisation market and the financing of the real economy through this tool. The reforms aimed at increasing capital requirements for a reduction in systemic risk are a perfect example to highlight in the context of this objective. We would like to emphasize that the BCBS framework for securitisation has not been consistently implemented in various jurisdictions. Consequently, the FSB analysis should tailor its approach of unintended consequences to the local implementations, at least for the main jurisdictions. Our comments below are mainly focused on the EU securitisation market.

We appreciate that it is a stated objective of the FSB evaluation to address, without compromising on financial stability, such material unintended consequences. This fits with Paris Europlace's own priorities, as we consider that quality of regulation of the financial sector is central to the competitiveness of players and their ability to finance the economy[4]. In that respect, we would like to raise the FSB's attention on the following points.

[3] https://www.fsb.org/2023/08/evaluation-on-effects-of-g20-reforms-on-securitisation-summary-terms-of-reference/

[4] https://www.paris-europlace.com/en/our-priorities/european-regulation-1263

2. **Urgent need for relaunching the EU securitisation market as a margin of manoeuvre is vital to face the unprecedented needs of financing for transformation of the economy, while preserving financial stability**

For the European economy, financing needs are now considerable due to the combination of several concurrent factors: recent economic and financial shocks following the pandemic, policy rates hikes and central banks tapering after the war in Ukraine, uncertainty regarding the magnitude of investments needed to finance the energy transition, not to mention digital transformation and other aspects of Europe's strategic autonomy. Therefore, securitisation is crucial to the financing of the real economy and it should be boosted as it does not present systemic risk.

Financing needs have a funding and a risk component. Thus, when making an evaluation of the functioning and structure of the securitisation markets since the GFC, the FSB needs to take into account the fact that the European markets have evolved in a way that the funding and the risk components of securitisations are increasingly managed as separate issues and are addressed by different markets.

- Post-GFC, European central banks in wanting to support the real economy have been innovative in developing tools to facilitate the funding component, such as by funding 'traditional' securitisations that are retained by banks or accepting covered bonds that are using the same underlying assets as securitisations; both instruments are consolidated on the banks' balance sheets with the risk remaining with the banks and therefore only addressing the funding aspect. Retained transactions have represented up to around 50% of total volumes, and in this case, given the absence of Significant Risk Transfer (SRT), the issuing/retaining banks continue to capitalise the portfolio as if it was not securitised, but have it in a form that can be sold or refinanced more easily in case of liquidity stress (as such it contributes to the banks' liquidity buffer).
- In parallel, on the risk management side, an 'on-balance sheet' (OBS) unrated private securitisation market has been developed in Europe[5] in a synthetic format so that banks' credit portfolio managers are able to actively manage the return of the underlying assets relative to the risk. When such securitisations meet the regulatory criteria for SRT, this frees up capital and new lending capacity, because banks can then release part of the capital they had to hold for the risks of the underlying assets. In this market, funding and risk are managed separately.
- In Europe, the pre-GFC public and private securitisation markets, made mainly from traditional securitisations, where the assets are sold to a special purpose entity and then tranched with the publicly rated tranches placed to a diverse investor base, have not recovered. In this market, funding and risk can be managed together. This market has become mostly used by non-banks, which have no access to central banks liquidity, nor to the covered bonds market, and by corporates, in particular in the form of Asset-Backed Commercial Papers (ABCPs).

In our view, given the record levels of debt reached by both public and private agents, the continuing regulatory and supervisory pressure on bank capital requirements, securitisation is probably currently the best available tool to recycle capital, allowing banks to provide more loans to households and companies, most importantly SMEs, as they often have no access, or a very limited one, to financial markets. Paris Europlace believes that there is a role for the FSB to evaluate how rules set by key

[5] https://www.bankingsupervision.europa.eu/press/publications/newsletter/2023/html/ssm.nl230816_1.en.html

Standard Setting Bodies (BCBS, IOSCO, IAIS) and their European counterparts (EBA, ESMA, EIOPA) for securitisation are creating regulatory frictions that impede the appropriate financing of the economy. Such frictions can be within a regulatory silo (such as BCBS-EBA) or inter-silos (such as BCBS-EIOPA, BCBS-ESMA). In this context, post-GFC reforms aimed at improving disclosures and facilitating standardisation have been a mixed blessing. While they have partially achieved their initial objectives, due to material regulatory frictions, they are now seen as market-distorting factors, impeding entire sectors of the economy from being financed; the lack of financial flexibility that they create can morph into future financial stability issues.

From the dual perspective of financing the economy and financial stability, we note that in July 2022, the European Systemic Risk Board (ESRB)[6] published its *Monitoring systemic risks in the EU securitisation market* report. The focus of the analysis was solely on the RMBS segment, being historically the largest of the EU, the other segments being less significant in terms of size and far less relevant from a macroeconomic / systemic perspective. Nevertheless, asset classes such as auto loans and leases, consumer credit and trade receivables, financed publicly or privately (including through ABCP conduits) also play an important role in the financing of the real economy. On the largest segment, the ESRB did not identify any substantial systemic risks emanating from the RMBS portion of the EU market. There are four important reasons for this:

1. The EU RMBS market has shrunk in recent years and remains small within the EU financial system and from a global perspective.
2. The credit quality of EU RMBSs, as reflected by external credit ratings and historical performance, has remained high and stable even during the COVID-19 pandemic.
3. The leverage indicators for EU RMBSs in the form of DTI, LTV and debt service-to-income (DSTI) ratios do not appear excessive, which reflects the conservative approach on mortgage lending in most EU jurisdictions.
4. EU banks, which are the main originators and holders of EU securitisations, are better capitalised than before the GFC.

Practitioners and investors are fully convinced that traditional (also called 'cash') and OBS (also called 'synthetic') securitisations, including non-STS ones, add value in financing the European economy both by enhancing capital allocation efficiency and by diversifying funding sources for segments of retail and non-retail markets that otherwise are not able to access traditional bank lending.

3. **Although past securitisation regulations contributed to the reduction of systemic risk in Europe, they have gone far beyond their initial objectives. They have resulted in strong limitations to the development of the EU securitisation market, which dramatically shrank since the GFC and is currently much smaller than the US one.**

We are very concerned, at a time when the financial system should be a decisive contributor to finance the recovery from the pandemic and the green and digital transition, by the massive decrease in placed securitisation observed in many European jurisdictions. The securitisation reforms, at least in Europe, where they are applied, had ultimately the effect of sterilising the securitisation market. The figures,

[6] https://www.esrb.europa.eu/pub/pdf/reports/esrb.report_securisation.20220701~27958382b5.en.pdf

whenever public (ESRB, EBA, ESMA, EU Commission) or private (trade associations), are unanimous. The EU securitisation market is small and the introduction of the STS label has not changed anything with disappointing issuance amounts. Figures also show that the European securitisation shrank following the implementation of the regulatory reforms. The ESRB report underlines that "Over the past ten years the EU securitisation market has shrunk by around 40% (from €1.2 trillion in 2012). This is also reflected in the size of new issuances before and after the GFC, which were as high as €819 billion in 2008 compared with €181 billion in 2013. By the second quarter of 2021 new issuances amounted (on an annualised basis) to €171 billion (placed or retained). Compared with the total assets of the EU banking system, which is the main source of origination for EU securitisations, the size of the EU securitisation market is small at around 2% in the second quarter of 2021."

On the contrary, the dynamism of the US securitisation market fully benefits from both public guarantees (through the GSEs) and the non-application of the reforms such as those prescribed by the BCBS framework. The US securitisation market is around 10 times bigger than the EU one (with agencies included). However, it is not the only explanation as the US market remains 3 times bigger than the EU market when the RMBS (mortgages) and ABS (student loans) guaranteed by US government agencies are excluded. Contrary to Europe, US banks are not the main holders of securitisations and do not apply the BCBS securitisation framework, nor are they fully impacted by it as the securitisation market in more desintermediated than in Europe. Finally, as the US originate-to-distribute model embeds less constraints in terms of control and quality of the assets than the EU originate-to-hold model, the regulatory regime of the latter should therefore be appropriately relaxed in our view.

4. The securitisation prudential regulations should be urgently improved to relaunch the securitisation market in Europe

In the European Union, in particular, if the SECR was an important step forward in addressing the risks (notably through the ban of re-securitisations, risk retention), we have been arguing for many years that the prudential regulatory reforms implemented after the 2008-2009 crisis, namely CRR/CRD for banks and Solvency II for insurers have been very much excessive and too hastily assessed, given their substantial impacts on the real economy. Consequently, the decline in the size of securitised assets compared to what have been observed in other large markets has been both impressive and very worrying. This has been largely due to the following:

- The excessively punitive BCBS treatment, whose calibration generates an important 'non-neutrality' between capital charges before and after securitisation, making transactions often value destroying for bank issuers. It is only after the intervention of IOSCO, that BCBS developed jointly a less burdensome framework, capital-wise, for Simple, Transparent and Comparable (STC) securitisations. The existence in itself of the STC framework highlights what the FSB can achieve when coordinating Standard Setting Bodies.
- Regarding the Significant Risk Transfer requirements, in Europe, supervisors implemented so stringent rules, beyond the BCBS ones, that potential issuers are often discouraged by the lack of fluidity and the lack of predictability of the SRT tests. As such, a detailed assessment of the kind of measure that should define SRT (and for which purpose) is necessary. In this respect, the treatment of excess spread, which corresponds to future revenues that are not included

in own funds, should be considered carefully. Regarding the SRT tests as prescribed by the EBA, they can be viewed as complex and even uneconomical for some transactions. Regarding the SRT notification process to the supervisor, the proposals of the EBA may bring additional complexity and operational burden.

- Unfortunately, the gold-plated implementation in the EU of the BCBS STC and capital frameworks, with an extremely prescriptive and often unworkable Simple, Transparent and Standardised (STS) framework (with 103 prescriptive criteria to be met for 'true sale' transactions and between 145 and 160 for synthetic operations, depending on their nature), combined with an extremely restrictive and burdensome recognition of SRT leads to regulatory cherry-picking of economic sectors that are favoured for financing, without having produced any explicit rationale for doing so.
- A concrete example of inter-silo regulatory friction linked to gold-plating by the EBA are the rules impeding the participation of insurers and reinsurers in the European STS OBS securitisation market. While (re)insurers are allowed to participate (as per BCBS rules) in securitisation markets with unfunded insurance contracts, they are not allowed in the EU framework to do so in the STS markets, restricting de-facto their activities to the non-STS market. From a financial stability perspective, one would have thought that increasing the investor base outside the banking sector would be beneficial, especially with the multiline (re)insurance market that is highly diversified and those carriers under the Solvency II (and equivalent) regime are highly-regulated and well-capitalised.
- For banks, eligibility of senior STS and non-STS tranches in the Liquidity Coverage Ratio (LCR) is currently too restrictive and should be reviewed. An adjustment of the eligibility rules for the High-Quality Liquid Assets (HQLA) of the LCR for both Asset-Backed Securities (ABS) and Asset-Backed Commercial Paper (ABCP) should be envisaged to further support the EU securitisation market. Recent research shows that ABSs have liquidity features comparable to Covered Bonds but benefit from a less favourable LCR treatment.
- Disclosure templates should ensure proportionate transparency requirements mirroring investors' and supervisors' information needs, particularly in the case of private transactions for which investors generally define their own reporting needs. Loan-level data in the reporting templates can be very burdensome to produce and irrelevant, especially for private securitisations.
- Due diligence requirements should be less prescriptive and more proportionate. As an example, trading capabilities are significantly hampered in Europe, which prevents a healthy development of the investor base.

While the above comments highlight some important issues, we note that the regulatory landscape is not static, and sometimes the regulatory pendulum is adjusted by the lawmakers themselves. For example, volumes of OBS transactions have been recently on an upper trend, after EU legislators amended some prudential rules (in the so-called Covid-related Capital Markets Recovery Package). Further steps are expected as part of CRR3-CRD6 review by 2026 to reduce the non-neutrality of the framework, beyond the final transitional measures to mitigate the unintended effects of the output floor, hoping improvements will cover comprehensively all segments of the market securitisation, including non STS transactions.

5. **The securitisation regulations should be urgently improved at international level in order to avoid fragmentation and arbitrages within global markets**

Such improvements in the EU framework should be transported in the international standards, as ensuring financial stability at a worldwide level should also imply to properly look after level playing field considerations, especially when regulatory arbitrage or loopholes may undoubtedly lead to uncooperative behaviours with unpredictable effects on financial institutions. And as the FSB governance has materially changed since the GFC, with a greater representativity of emerging economies countries, Paris Europlace takes the view that there are (positive and negative) lessons to be learned from the European experience, that can be transposed to the new FSB members to ensure that securitisation can become for them an important tool of economic development and a key enabler to satisfy the financing needs linked to climate change.

The FSB evaluation should look holistically at the securitisations reforms, putting concerns on financial stability at its core. The very unequal regulatory framework across jurisdictions creates riskier conditions for internationally-active financial institutions. In the European Union most strikingly, we think that the relative lack of competitiveness for financial institutions arising from a burdensome and penalising securitisation regulation impedes financial markets to correctly allocate capital and assess risks, and makes the economy more reliant on bank funding, therefore threatening the efforts made by national supervisory authorities to tackle recently appeared challenges, notably the increase in NPLs in some countries, not to mention rising bank funding costs.

From the originator/sponsor perspective, transactions remain excessively burdensome and costly given the very conservative prudential charges. Bank capital requirements for securitisation in Europe should be aligned with their risk profile, in order to allow European banks to be active actors in the securitisation market as issuers and sponsors. The successive post-GFC reforms have led to such a disconnect in securitisation between risk weighted assets and the real risk that a profound revision is needed to revive the securitisation market. Recent reports[7] by European regulators have clearly acknowledged the improperness of the existing conceptual framework, underpinning bank capital charges. While some adjustments are likely to be introduced in CRR3/CRD6, we strongly believe that a more holistic review is needed at international level.

From the investor perspective, the lack of an active securitisation market deprives investors from investment opportunities which would bring adequate risk/returns, diversification into pools of assets not available in listed markets, and access to large pools of ESG/SDG investments (energy efficient mortgages, electric car loans, renewable energy project finance, to name a few), while providing a very extensive transparency and retention safeguards, largely beyond any other asset classes. The CRR3 and Solvency II regulations introduced at the same time were too conservative, and this led to a post-GFC attrition of the placed securitisation market in Europe.

[7] https://www.esma.europa.eu/press-news/esma-news/esas-publish-joint-advice-eu-commission-review-securitisation-prudential

6. Conclusion and recommendations

To conclude, considering the state of play, Paris Europlace strongly advocates for an urgent review of the BCBS securitisation framework and better calibration and application of regulatory disposals in all jurisdictions, towards harmonisation aimed at ensuring an incentivising landscape for investors and issuers to enable them to face the economic uncertainties and to support the climate transition. Securitisation should rank high on the BCBS priority agenda in 2024 and beyond.

Immediate action is all the more required that there is absolutely no material or analytical reasons to continue seeing securitisation in the current environment as if we were still in the eye of the storm of the GFC. Helping banks freeing up capital is an imperative to preserve financial stability.

Paris Europlace very much thanks the FSB for its invitation for feedback and remains at its disposal to share its expertise, and to detail the technical evidence and analysis on the points mentioned above, with all relevant parties working on, or with an interest in, the FSB evaluation. We also look forward to the public consultation which will be launched in 2024.

Annex

List of Institutions members of Paris Europlace's Securitisation Working Group

Paris Europlace's Working Group on Securitisation currently includes the following participants:

Accola
ACPR (Autorité de contrôle prudentiel et de résolution)*
AFG
AFME
Allen & Overy
AMF (Autorité des marchés financiers)*
Ashurst LLP
Axa IM
BNP Paribas
BPCE
Clifford Chance
CMS-Francis Lefebvre
Crédit Agricole CIB
Dentons
Direction générale du Trésor*
EthiFinance
Eurotitrisation
FBF
France Assureurs
Groupe GTI
Herbert Smith Freehills
Hogan Lovells
IACPM
Jeantet
Jones Day
Kramer Levin LLP
Linklaters
Mayer Brown
Natixis
Orrick
Prime Collateralised Securities (PCS)
Reed Smith
Sienna
Société Générale
White & Case

* as observer member.