REFORM OF SECURITISATION MARKETS

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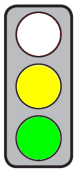
KEY ISSUES

Objective of the Regulation: The Commission wants to revive the securitisation markets.

Affected parties: Stakeholders involved in securitisation, institutional investors.



Pro: (1) The rules on securitisation and the label "simple, transparent and standardised securitisation" (STS securitisation) may, in principle, increase confidence in the securitisation markets.

(2) The risk retention applicable to stakeholders involved in securitisation helps to prevent conduct arising from moral hazard.

Contra: The system of self-certification for STS securitisations involves financial risks due to the unspecific criteria for financial stakeholders. It is therefore possible that financial stakeholders will decide not to use the "STS securitisation" label at all.

CONTENT

Title

Proposal COM(2015) 472 of 30 September 2015 for a **Regulation laying down common rules on securitisation** and creating a European framework for simple, transparent and standardised securitisation and amending Directives 2009/65/EC, 2009/138/EC, 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012**.**

Brief Summary

- **Definitions**
  - "Securitisation" refers to the situation where a number of exposures of one or (rarely) several creditors ("originator") - such as credit claims by banks or the trade receivables of a company - are pooled and then converted into tradeable securities which are then sold. (p. 2, Art. 2 Nos. 1 and 3)
  - An "originator" is the creditor of the receivables being securitised. He either established the original obligation himself or has acquired the exposures from a third party such as the original "lender". (Art. 2 No. 3)
  - A "Securitisation Special Purpose Entity" or 'SSPE' is a corporation that is independent of the originators and has been set up by third parties to carry out one or more securitisations. It acquires the receivables from the originator or originators ("true-sale securitisation") or just the risks associated with them ("synthetic securitisation") and issues the securities. (Art. 2 (2), (9) and (10))
  - In the case of a "programme of securitisations", both the receivables and the issued securities are replaced on an ongoing basis by new receivables and securities.
  - An "asset backed commercial paper programme" (ABCP) is a programme of securitisations where the issued securities predominantly take the form of asset-backed commercial papers with an original maturity of one year or less (Art. 2 No. 7 and Recital 14).
  - A "sponsor" is a bank that "establishes and manages" the programme of securitisations but is not itself the originator (Art. 2 No. 5). The sponsor acts as guarantor to the special purpose entity for any liquidity or credit risks (Recital 14).
  - "Institutional investors" – hereinafter "investors" – are banks, investment firms, (re-)insurance companies, institutions for occupational retirement provision (IORPs) and investment funds (Art. 2 No. 12).
- **Context and objectives**
  - Securitisations allow lenders to diversify their credit risks. Selling receivables to special purpose entities, unlocks scarce equity capital which banks can then use for further lending. (p. 2)
  - According to the Commission, the situation on the EU securitisation markets has been subdued since the beginning of the financial crisis. By contrast, the US markets have "recovered" despite higher losses. (p. 3)
  - With the Regulation, the Commission wants to revive the EU securitisation markets and increase confidence in securitisations (p. 3).
  - This will take place by way of (p. 9)
    - rules on risk retention for lenders, originators and sponsors,
    - rules on transparency for originators, sponsors and special purpose entities,
    - due diligence requirements for investors, and
    - the establishment of a label for "simple, transparent and standardised securitisations" (STS securitisations").
  - The Regulation is accompanied by an additional Regulation amending the capital requirements for banks in relation to investing in STS securitisations and non-STS securitisations [Proposal COM(2015) 473].

Authors: Philipp Eckhardt and Anne-Kathrin Baran | eckhardt@cep.eu
cep | Kaiser-Joseph-Strasse 266 | 79098 Freiburg | Germany | Telephone +49 (0)761 38693-105 | www.cep.eu

- **Risk retention for lenders, originators and sponsors**
  - In the case of securitisation, either the lender, the originator or the sponsor must retain "on an ongoing basis" not less than 5 % of the nominal value of the securitised receivables ("risk retention"). Sharing is not permitted. In the case of dispute, the originator must retain the 5% interest. (Art. 4 (1))
  - A risk retention is not necessary if the securitised receivables are owed or guaranteed by central banks, regional governments, public sector entities or multi-lateral development banks (Art. 4 (4)).
  - Within six months of entry into force of the Regulation, the European Banking Authority (EBA) will adopt technical standards to regulate risk retention (Art. 4 (6)).

- **Transparency requirements for originators, sponsors and special purpose entities**
  - The originator, sponsor or special purpose entity must make a range of information available to the investors and competent authorities "in a timely and clear manner and free of charge". This relates, in particular, to information on the securitised receivables. Prospectuses, investor reports, derivatives and guarantee agreements, collateralisation arrangements and information on priority of payments must be submitted. (Art. 5 (1) and (2))
  - The information must be made available on a "reliable and secure" website which has a well-functioning data quality control system. The data must be available for at least five years after the maturity date of the securitisation. (Art. 5 (2))
  - Within twelve months after entry into force of the Regulation, the European Supervisory Authorities will adopt technical standards on the provision of information and website requirements (Art. 5 (3)).

- **Due Diligence requirements for investors**
  - Before investing in a securitisation, an investor must (Art. 3 (1) and (2))
    - check whether the lender, originator or sponsor complies with the rule on risk retention and the transparency requirements,
    - check whether the lender or originator, where it is not a bank, has granted the credits on the basis of "sound and well-defined criteria" and
    - check, inter alia, the risk characteristics of the securitisation and the securitised receivables as well as the relevant factors influencing this, such as priority of payments.
  - Once an investor has invested in a securitisation, it must, inter alia, set up procedures to monitor the progress of the securitisation and the securitised receivables and carry out stress tests. Investors must be able to demonstrate to the competent authority that they have a "comprehensive and thorough understanding" of the securitisation and the securitised receivables. (Art. 3 (3))

- **Label for simple, transparent and standardised securitisation ("STS securitisation")**

  A label for "simple, transparent and standardised securitisation" (STS securitisation) will be created. The originator, sponsor and special purpose entity may use the label where the securitisation meets a range of requirements and they have notified the European Securities and Markets Authority (ESMA). (Art. 6)

  Requirements for STS securitisation
  - "Simplicity": The special purpose entity must acquire the securitised receivables by way of sale or assignment ("true-sale securitisation"). The acquisition must be enforceable even in the event of the seller's insolvency. The seller must guarantee that the securitised receivables are not otherwise encumbered. The securitised receivables must not themselves be securitisations and must be of the same asset type. At the time of transfer of the receivables to the special purpose entity, none of the receivables are permitted to be in default nor can the debtor be credit impaired. (Art. 8)
  - "Transparency": The originator, sponsor and special purpose entity must inform investors about the historical performance of similar securitised receivables, particularly default and loss. In this regard, for receivables from individuals or small companies this shall cover the last five years; for other receivables, the last seven years. Prior to the issuance of securities, an external auditor must carry out a random check on the accuracy of the information about the securitised receivables. (Art. 10)
  - "Standardisation": Interest rate and currency risks arising from the securitisation must be "mitigated". The securitised receivables must not include derivatives unless for the purpose of hedging interest rate and currency risks. Any referenced interest payments for securitised receivables must be based on "generally used" market interest rates and must not be based on "complex formulae". (Art. 9)

  Requirements for STS securitisation within an ABCP programme
  - The label "STS securitisation" may be used for ABCP securitisations provided they "to a large extent" fulfil the requirements applicable to STS securitisations (Explanatory Memorandum p. 15, Art. 11, Art. 12 (1)).
  - The securitised receivables in an ABCP programme must have a remaining weighted average life of no more than two years. Receivables with a residual maturity of more than three years are not permitted, nor are loans secured by mortgage. (Art. 12 (2))

  Notification of STS securitisation, liability and sanctions
  - The originator, sponsor and special purpose entity must jointly notify ESMA that a securitisation meets the requirements for STS securitisation or that it no longer does so. They must also notify the competent authority, such as the banking, insurance or securities supervisory authority. ESMA will publish the notification on its website. (Art. 14 (1) and (3))

– ESMA or other competent authorities do not certify compliance with STS requirements. The originator, sponsor and special purpose entity are responsible for compliance. (Recital 20)
– Member States must establish "effective, proportionate and dissuasive" sanctions for breaches of the Regulation by lenders, originators, sponsors, special purpose entities or investors (Art. 17).

Main Changes to the Status Quo

- New is the obligation for EU-based lenders, originators and sponsors to provide a risk retention ("direct approach").
- It is already the case that EU-based banks, insurance companies and alternative investment funds can only invest in a securitisation where the lender, originator or sponsor provides a risk retention of 5% ("indirect approach"). In future, this will also apply to UCITS investment funds aimed at small investors and institutions for occupational retirement provision (IORPs).
- It is already the case that originators, sponsors and special purpose entities are subject, under the Regulation on rating agencies [Regulation (EC) No. 1060/2009, see cep**PolicyBrief**] and the Prospectus Directive [Directive 2003/71/EC, see cep**PolicyBrief**], to transparency requirements for securitisations. These will remain in place. Banks that are lenders, originators or sponsors are also subject to additional specific transparency requirements under the EU Capital Requirements Regulation [Regulation (EU) No. 575/2013, see cep**PolicyBrief**]. These requirements are replaced by those contained in this Regulation. The transparency rules under the Regulation are new for lenders, originators and sponsors that are not banks.
- It is already the case that banks, insurance companies and alternative investment funds have to comply with due diligence obligations when investing in securitisations. Until now, these did not apply to UCITS and IORPs. In future, the due diligence obligations in this Regulation will apply to all institutional investors.
- There are already criteria for STS securitisations. These are contained in the Delegated Regulation on the liquidity coverage requirement for credit Institutions [Delegated Regulation (EU) 2015/61, see cep**Input**] and in the Delegated Regulation on the Solvency-II Directive on insurance business [Delegated Regulation (EU) 2015/35]. In future, they will be replaced by the STS criteria in this Regulation.

Policy Context

In the Green Paper on Capital Markets Union of February 2015, the Commission announced, measures to revive the securitisation markets [COM(2015) 63, see cep**PolicyBrief**]. In June 2015, the European Council called on the Commission to submit a legal framework for STS securitisation. The European Parliament welcomed this in July 2015 in a resolution on Capital Markets Union.

Options for Influencing the Political Process

Leading Directorate General:	DG Financial Stability, Financial Services and Capital Markets Union
Leading Committees of the EP:	Economic and Monetary Affairs, Rapporteur: Tang Paul (S&D, NL)
Leading Federal Ministry:	Federal Ministry of Finance
Leading Committee of the BT:	Finance Committee

ASSESSMENT

Economic Impact Assessment

Securitisations are, in principle, an economically useful mechanism. They make it easier to spread the risk on the financial markets and increase the potential for banks to grant credit. During the financial crisis, however, they were stigmatised. **The** proposed **securitisation provisions may** help to combat the stigma and **re-establish confidence in the securitisation markets.**

The risk retention for parties involved in securitisation – lenders, originators and sponsors – of 5% of the nominal value of the securitised receivables **helps to prevent conduct arising from moral hazard** because if these parties have to share liability for defaults, their incentive to lend to credit-impaired debtors, or borrow from third parties, will fall. The fact that, in addition to the indirect approach, the Commission is now introducing the direct approach, in this regard, reduces the possibilities for avoidance: lenders, originators and sponsors from the EU cannot avoid the risk retention obligation even in the case of securitisations which are to be sold to investors outside Europe. Due to the highly interconnected nature of the financial sector, this also contributes to financial market stability in the EU.

The benefit of the risk retention for financial market stability should not be overestimated, however. Even before the financial crisis, investors often required risk retentions but ultimately placed too much reliance on a positive price trend for the assets underlying the securitisations.

Originators, sponsors and special purpose entities generally have a head start on investors when it comes to information about the quality of the securitised receivables. The proposed transparency requirements may counteract this informational asymmetry. In addition, they are the basic requirement for the investors to make their own risk assessment and comply with their own due diligence obligations. They thereby also reduce the reliance on credit rating agencies whose assessments, prior to the crisis, were often too positive.

Due diligence obligations for investors are appropriate due to their importance for the stability of the financial system. Although investors should, out of self-interest, conduct a thorough examination of their

investments, there is a risk – as the past has shown – that they rely on third parties such as rating agencies and neglect to carry out their own risk analysis. Another point in favour of due diligence obligations is also the fact that, in future, independent third parties – such as bank resolution funds or tax payers – are likely to be involved in the resolution costs of large investors such as banks or insurance companies. Due diligence obligations are also appropriate in the case of STS securitisations: The risks of the receivables pooled together in STS securitisations are not lower per se than those of the receivables in securitisations which do not comply with the STS criteria.

A label for "simple, transparent and standardised securitisation" (STS securitisation) creates a type of securitisation whose risks can more easily be analysed by investors due to its transparency and lack of complexity. This **may, in principle, increase investor confidence in such securitisations. However, some of the criteria for STS securitisations are too unspecific** and could be interpreted differently from one Member State to another. This applies, for example, to the questions of when receivables belong to the same asset type and when a debtor's credit-rating is impaired. **This makes legal compliance with the criteria more difficult** for the originator, sponsor and special purpose entity. **The system of self-certification of STS conformity** thus **involves significant financial risks for the originator, sponsor and special purpose entity** due to liability for incorrect notifications and for complying with STS criteria. **It is therefore possible that financial stakeholders will decide not to use the "STS securitisation" label at all.**

This is supported by the fact that some of the criteria for STS securitisation are unnecessarily restrictive. This applies for example to the limit, placed on the residual maturity of securitised receivables in ABCP programmes, of an average of two years. One characteristic of ABCP programmes is that the securitised receivables generally have a significantly longer maturity than those of loans issued by special purpose entities. This incongruence in the time limit creates liquidity risks. Although a limit on the residual maturity may reduce these risks, the fact that investors are at least doubly secured – not only via the securitised assets but also by the sponsor's guarantee – means that residual maturities beyond the proposed two years are justifiable. Otherwise, ABCP programmes are generally unlikely to be able to meet the STS criteria.

Legal Assessment

Legislative Competency

The Regulation is rightly based on the internal market competence (Art. 114 TFEU) as it reduces distortions of competition in the internal market.

Subsidiarity

Unproblematic.

Proportionality with respect to Member States

Unproblematic.

Compatibility with EU Law in other respects

Unproblematic.

Impact on German Law

The Regulation applies directly in every Member State (Art. 288, para. 2, sentence 2 TFEU) so that no national transposition measures are necessary. Many aspects of the Regulation are also already regulated in other EU Regulations so no modifications to national law for reasons of legal clarity are required.

Conclusion

The rules on securitisation and the label for "simple, transparent and standardised securitisation" (STS securitisation) may, in principle, increase investor confidence in the securitisation markets. The risk retention applicable to stakeholders involved in securitisation helps to prevent conduct arising from moral hazard. Due diligence obligations for investors are appropriate. The system of self-certification for STS securitisations involves financial risks due to the unspecific criteria for financial stakeholders. It is therefore possible that financial stakeholders will decide not to use the "STS securitisation" label at all.