



## Paris Europlace response to the European Commission targeted consultation on the functioning of the EU securitisation framework (3 December 2024)

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#### NOTE TO THE READER:

THE TEXT THAT IS EMBEDDED IN A FRAME IS FROM THE CONSULTATION; IT CONTAINS CONTEXT AND QUESTIONS.

THE TEXT THAT IS NOT EMBEDDED IN A FRAME IS THE PARIS EUROPLACE ANSWER TO THE QUESTION. THE LENGTH HAS BEEN LIMITED TO A MAXIMUM OF 5,000 CHARACTERS WITH SPACES, AS PER THE RULES OF THE CONSULTATION.

## CONSULTATION QUESTIONS

### 1. Effectiveness of the securitisation framework

The EU securitisation framework has been in application since January 2019. The framework consists of the [Securitisation Regulation \(SECR\)](#), which sets out a general framework for all securitisations in the EU, including increased transparency, due diligence, risk retention and other requirements, and a specific framework for simple, transparent, and standardised (STS) securitisations, as well as prudential requirements for securitisation positions in the [Capital Requirements Regulation](#) and in [Solvency II Delegated Act](#), and liquidity requirements for credit institutions in the Liquidity Coverage Ratio Delegated Act.

The framework was complemented on 6 April 2021 in the context of post-COVID-19 economic recovery efforts by extending the scope of the STS label to on-balance-sheet synthetic securitisations and by addressing regulatory obstacles to securitising non-performing exposures.

The general objective of the securitisation framework was the revival of a safe securitisation market that would improve the financing of the EU economy<sup>10</sup>. In the short run, it envisaged a weakening of the link between banks' deleveraging needs and credit tightening. In the long run, the aim was the creation of a more balanced and stable funding structure of the EU economy, for the overall benefit of households, SMEs, and larger corporations. Specific policy objectives included the destigmatisation of European securitisation in the wake of the global financial crisis, an appropriate risk-sensitive regulatory capital treatment, and the reduction/elimination of unduly high operational costs for issuers and investors. To achieve these specific policy objectives, two operational objectives were identified: differentiating STS securitisation products from more opaque and complex ones and supporting the standardisation of processes and practices in securitisation markets and tackling regulatory inconsistencies.

The 2022 review of the functioning of the SECR, which resulted in the publication of the Commission report on the Functioning of the Securitisation Regulation in December 2022 (later referred to as '[the Commission 2022 report](#)'),<sup>11</sup> looked at the impact of the SECR on the functioning of the EU securitisation market. A majority agreed that the SECR provided a high level of investor protection, and it was generally acknowledged that the SECR had facilitated further integration of the EU securitisation market. At the same time, respondents underlined the need to improve certain parts of the framework, such as due diligence and transparency requirements, to increase proportionality and reduce compliance costs for market participants. Considering that the securitisation framework was amended in April 2021 in response to the unprecedented exogenous factors related to COVID-19, and that the complete application of the framework was yet to be fully realised at the time of writing of the Commission 2022 report, the Commission decided that more time was needed to fully assess the impact and effectiveness of the framework.

Looking to the post-2019 evolution of the EU securitisation market, it is appropriate to consider whether the original policy objectives have been achieved, in full or in part, before proceeding to examine the necessity of any future adjustments to the regulatory framework.

<sup>10</sup> See [IMPACT ASSESSMENT Accompanying the document Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL laying down common rules on securitisation and creating a European framework for simple and transparent securitisation and amending Directives 2009/65/EC, 2009/138/EC, 2011/61/EU and Regulations \(EC\) No 1060/2009 and \(EU\) No 648/2012 and Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation \(EU\) No 575/2013 on prudential requirements for credit institutions and investment firms](#)

<sup>11</sup> [Capital Markets Union: The Commission publishes its report on the review of the Securitisation Regulation - European Commission \(europa.eu\)](#)

This section of the questionnaire looks into the impact of the securitisation framework on the market and the policy goals of the capital markets union, including improving access to finance and supporting the EU's competitiveness.

**1.1.** Do you agree that the securitisation framework (including the Securitisation Regulation and relevant applicable provisions of the CRR, Solvency II and LCR) has been successful in, or has contributed to, achieving the following objectives:

	Fully agree	Somewhat agree	Neutral	Somewhat disagree	Fully disagree	No opinion
1. Revival of a safer securitisation market					X	
2. Improving financing of the EU economy by creating a more balanced and stable funding structure of the EU economy					X	
3. Weakening the link between banks' deleveraging needs and credit tightening					X	
4. Reducing investor stigma towards EU securitisations	X					
5. Removing regulatory disadvantages for simple and transparent securitisation products					X	
6. Reducing/eliminating unduly high operational costs for issuers and investors					X	
7. Differentiating simple, transparent and standardised (STS) securitisation products from more opaque and complex ones			X			
7.1 Increasing the price difference between STS vs non-STs products				X		
7.2 Increasing the growth in issuance of STS vs non-STs products			X			

8. Supporting the standardisation of processes and practices in securitisation markets		X				
8.1 Increasing the degree of standardisation of marketing and reporting material		X				
8.2 Reducing operational costs linked to standardised securitisation products					X	
9. Tackling regulatory inconsistencies					X	

## 2. Impact on SMEs

Exposures to SMEs, in the form of direct lending, trade receivables, auto loans /leasing, mortgage lending, or other commercial credit, are categories of assets that can readily lend themselves to be securitised. Access to securitisation and its economic efficiency for originators can therefore have an impact on the availability of credit for SMEs and its cost. This section aims to gather insights into the impact of the securitisation framework on SME financing.

Questions to stakeholders:

### Question 2.1:

Have you come across any impediments to securitise SME loans or to invest in SME loan securitisations?

- Yes
- No
- No opinion

Please explain.

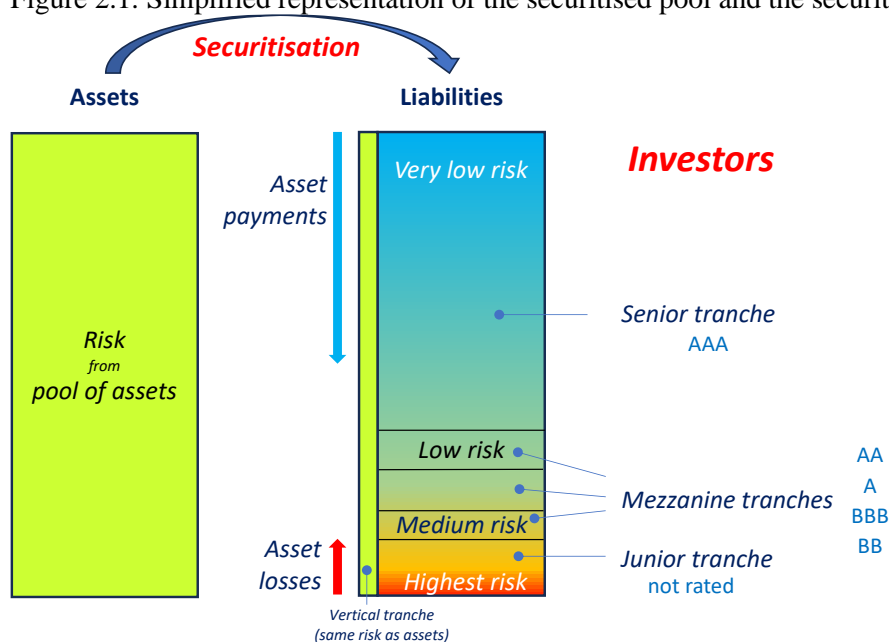
Answer to multiple choice:

- Yes

Explanation / justification / answer:

Generally, SMEs do not have direct access to the corporate bond markets, given the necessary size of issuance to absorb the costs, the need for repeat issuance to attract an investor base (every 1 to 2 years) and the lack of research by sell side analysts or rating agencies. Hence the need for pooling different SME exposures to reach critical size. The process of securitisation slices the risk of the pool in tranches (the least risky is the senior tranche, the most risky is the junior tranche, and the mezzanine tranches are in between) as in Figure 2.1.

Figure 2.1: Simplified representation of the securitised pool and the securitisation tranches



For bank issuers, SME (and other asset classes) securitisation can enhance the velocity of the balance sheet, freeing up capital that can be reinvested into new lending, contributing to economic growth.

For investors, SME securitisation gives access to an asset class that they cannot access directly, providing

diversification in their portfolios. However, SME pools are complex to analyse as they are less granular than retail pools that allow a statistical approach (such as mortgages or consumer finance), but more granular than corporate loans securitisation, where corporates typically have public information available and external ratings to rely on. In the case of SME securitisations issued by banks, the investor relies on the bank's sound credit management practices, based on extensive due diligence (see EIF policies as an example).

The SME securitisation market is facing the same impediments faced by issuers and investors as for other asset classes. Investors require diversification. If the European Commission focusses on niches (SMEs, green securitisations, etc.) rather than on the market itself, it will be counterproductive as it would not offer the critical mass that issuers and investors need to invest in dedicated resources.

Thus, a packaged approach addressing the following four policy goals will foster the securitisation market as a whole, including the SME sub-segment:

- 1) On the supply side, reduce disincentives to securitise for banks as issuers, by reducing the excessive capital non-neutrality and recalibrating the RW floor for IRB and SA banks, on STS and non-STS exposures, senior and non-senior tranches (and consistently for ERBA/IAA frameworks).
- 2) On the demand side, remove obstacles for the insurance sector to engage by recalibrating Solvency II capital charges (on the asset side), and opening to credit insurance the synthetic STS securitisation market (on the liability side).
- 3) Improve market liquidity for all players, by redefining appropriate LCR bucketing and haircuts for highly rated tranches (AA- at least).
- 4) Facilitate access to market participants by making due diligence and disclosure requirements more proportionate and "principle-based".

As regards how these impediments materialise for SMEs:

1. The STS label is particularly difficult to achieve for SMEs, due to the homogeneity and granularity criteria, especially for smaller banks. The Non-STS SME securitisations have twice the capital surcharge as STS SME securitisations, and the fixed value floor of 15% risk weight (RW) for Non-STS and 10% RW for STS, makes these deals unattractive for bank issuers, compared to the SMEs 57% RW with the EU SME supporting factor (0.7619). Paradoxically, the latter works as a disincentive to securitise, given that the capital relief obtained is lower, in SRT transactions, due to the fixed value of the senior RW floor (see question 9.13). If the proportional RW floor was implemented, the capital relief obtained by banks would be more commensurate to the risk of all asset classes, including SMEs.
2. On investors, for (re)insurers investing in traditional securitisation (asset side of their balance sheet), the asset class is currently not attractive. With the standard formula, the non-STS SME sector requires up to a unjustifiable multiple (12.5 times) of the capital requirements of the STS SME segment. The potential loss of the 'STS label', and resulting shock in capital requirement, is a risk that some investors consider not worth taking (aka, "financial guillotine").
3. On liquidity, SME securitisation suffers the same disproportionate haircut, penalising banks as investors and market makers, as for other asset classes.
4. Paradoxically, the EU SME supporting factor works as a disincentive to securitise, given that the capital relief obtained is lower, in SRT transactions, due to the fixed value of the senior RW floor. If the proportional RW floor was implemented, the capital relief obtained by banks would be more commensurate to the risk of this asset class.

**Question 2.2:**

How can securitisation support access to finance for SMEs?

For banks, which are the main lenders to SMEs, traditional and synthetic securitisations are capital velocity instruments. Selling or protecting risky tranches (junior or mezzanine) ensures that credit risk is transferred outside of the bank. If the transaction meets the criteria for "Significant Risk Transfer" (SRT), as analysed systematically by the ECB or competent authorities, it allows the banks to recognise a reduction in the capital charge. In practice, banks replace the RW of the securitised pool by the RW of the retained tranches. The capital saving must be commensurate to the credit risk transferred, so that it justifies the price that the bank will pay to investors. Otherwise, the transaction does not happen. Unlike other businesses, securitisation is an option for

banks in their capital management toolkit, that bank senior management will use only if the financial and regulatory conditions make it value accretive.

When a securitisation is recognised as SRT, the capital saved, deemed to correspond to the proportion of risk transferred, can be redeployed in new lending. This additional capacity can be used by the banks as a function of its strategy. The capital saved will not necessarily be reinvested in the same asset class (although the EIF, for example, makes it a requirement with extensive ongoing monitoring). Conversely, capital saved through a large corporate securitisation can be redeployed in SME lending, depending on business opportunity.

Synthetic securitisation is the most appropriate route for SME securitisation, given that most SME loans are originated by banks, as it avoids selling the exposure to an SPV, the loans remain on the bank's balance sheet, and the bank continues to manage client relations, while sharing the risk with investors. The recent introduction of the Synthetic STS framework has boosted SRT issuances, benefiting SMEs among other asset classes. One of the main credit protection providers for STS SMEs is the EIF, which plays a major role to address this market gap.

According to the BCBS<sup>1</sup>, the total asset of European banks has remained flat since 2014 (not even inflation adjusted). Developing securitisation would increase their capacity to extend new funding to SMEs and to play their part in supporting the transition to a more sustainable economy. This benefit is not specific to SMEs and would apply to all asset classes.

Banks are also direct lenders to corporates through (private) ABCP trade receivables securitisations, funding their working capital needs hence financing indirectly their SME clients. By nature, ABCP securitisation is perfectly adapted to the funding of real economy assets such as trade receivables or equipment leases.

Securitisation can also support the development of other credit intermediaries such as private funds, digital platforms, etc., which now represent a sizeable part of the financing of the EU economy. These entities need securitisation especially for funding purposes, through traditional (cash) securitisation. If their origination role continues to expand, they will also need an expansion of the securitisation market to support their growth.

Securitisation offers opportunities for investors to invest in consumer and corporate credit exposures that would not be available to them otherwise. The development of a large securitisation market would offer a real investment alternative for investors that would be relevant in their portfolio allocation strategy: diversification, granularity, higher return and recurring volumes. SMEs will benefit from increasing the 'investment pie'. If the overall EU securitisation market grows, it will reach a critical size to attract investors, and the volume of securitisations in the SME asset class will increase.

But the reforms of securitisation should not prioritise only SME securitisation. It is not reasonable to expect private investors to create dedicated teams for securitisation investments, to then narrow down their investment horizon to just one market segment, and within that to just a few SME issuances per year, in just a few countries. The reforms should address securitisation at large, being agnostic to the type of underlying portfolio, the type of banks, the type of country. If securitisation works, it will work also for SME exposures. Similarly, the focus should not be exclusively on green securitisation, which would also be a too narrow segment to justify the investment in dedicated capacities.

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<sup>1</sup> <https://www.bis.org/bcbs/publ/d581.pdf> - Graph 26

### 3. Scope of application of the Securitisation Regulation

#### Jurisdictional scope

In 2021, the Joint Committee (“JC”) of the ESAs published an Opinion to the European Commission on the Jurisdictional Scope of Application of the SECR<sup>12</sup>. The opinion was divided in two parts: (1) the application to third country-based entities of Article 5 to 7 and 9 of the SECR, and (2) the application of the SECR to investment fund managers. Both issues were subsequently clarified by the Commission in the [2022 report from the Commission to the European Parliament and the Council on the functioning of the Securitisation Regulation](#). Despite these clarifications, some market participants point out that the SECR does not clearly set out its jurisdictional scope, creating considerable legal uncertainty in cases where not all parties to the securitisation are located in the EU.

<sup>12</sup> See [ESAs’ Opinion to the European Commission on the Jurisdictional Scope of Application of the Securitisation Regulation](#)

Questions to stakeholders:

#### Question 3.1:

In your opinion, should the current jurisdictional scope of application of the SECR be set out more clearly in the legislation?

- Yes
- No
- No opinion

Please explain.

#### Answer to multiple choice:

- **No**

#### Explanation / justification / answer:

The September 2024 Paris Europlace Securitisation Report has eight recommendations to be implemented as a package. Recommendation 8 is “Make Europe a centre of international, not only regional, securitisation finance”.

Policy makers should acknowledge the importance of the position of EU institutional investors and banks in the global securitisation market and avoid penalising them by replacing the current requirement to apply ESMA templates to non-EU transactions by a framework of equivalence or a mutual recognition, or by making the disclosure and due diligence requirements principle-based.

Today, EU-based institutional investors face specific difficulties investing in non-EU securitisation transactions as non-EU reporting entities cannot or are not willing to provide EU investors with the full article 7 templated disclosure. EU institutional investors have been questioning whether it is appropriate to impose ESMA Templates to non-EU transactions, including transactions from MDBs who at the behest of the G20 have been encouraged to use securitisation techniques. In practice, there are many circumstances where EU institutional investors would manage to obtain appropriate disclosure, but in a format that does not comply with the ESMA Templates. Given that the securitisation market is global, it is critical that EU institutional investors can access the market as a whole, on a same level playing field with other global market players.

This issue is also essential for banks involved in securitisation on behalf of financial or corporate clients, for them to be able to compete in global markets, including accompanying their EU clients in their non-EU securitisation programs. Accessing the large US and Asian securitisation markets is also a pre-requisite for these EU banks to have the scale allowing them to maintain dedicated expert resources and develop a viable business model.



The adoption of a less prescriptive regime (principles-based approach) should therefore be privileged (with some safeguards). Paris Europlace, therefore, believes that so long as they can obtain appropriate disclosure, EU banks and institutional investors should not be expected to obtain it under the ESMA Template. They should rather make sure that they obtain all the information required to carry out proper due diligence, and it should be clarified that the ESMA Templates, to be simplified to the sole supervisory purposes, could be produced by the EU bank or institutional investor itself, instead of expecting non-EU entities to comply with an EU regulation that is not applicable to them.

This derogatory regime must be based on a clear scope of EU transactions subject to the ESMA Templates disclosure requirement, as discussed above, as opposed to non-EU transactions. We believe that the non-EU derogation should apply when an EU institutional investor invests in a transaction with no EU nexus, i.e., where neither the originator, nor the sponsor, nor the SSPE is located in the EU and no prospectus has been established in respect of the securities.

A number of these targeted adjustments can be implemented, either in Level 2 texts, or as a quick win, as was done for the Capital Markets Recovery Package. Such a quick win would provide a strong signal to market participants, broaden the offer and demand, and could generate a significant flow of funding and risk transfer. Some more fundamental review of the quantitative framework will require more work and can be part of a comprehensive review to come as a second step.

To achieve its critical role and be more efficient, the securitisation market also needs new EU issuers and new EU and non-EU investors: they are currently deterred by the entry costs caused by such ‘mille-feuille’ reporting and due diligence requirements but also face high costs in building the large-scale issuance and/or information infrastructures to operate and comply with a uniquely complex regulatory environment.

While this subject would help EU investors and structurers to access the deeper non-EU securitisation and improve their critical mass, it could also be solved by making the due diligence and disclosure requirements more principle based (see questions in Section 4 and 5). Hence it is not a priority, compared to the prudential reforms. Hence our “No” response.

**Question 3.2:**

**If you answered yes to question 3.1,** do you think it would be useful to include a specific article that states that SECR applies to any securitisation where at least one party (sell-side or buy-side) is based or authorised in the EU, and to clarify that the EU-based or EU-authorized entity(ies) shall be in charge of fulfilling the relevant provisions in the SECR?

- Yes
- No
- No opinion

Please explain.

Answer to multiple choice:

- **No**

Explanation / justification / answer:

This question is too detailed, and we cannot answer yes to the full statement.

Yes, in order to exempt some non-EU transactions from the prescriptive due diligence and reporting requirements stated in SEC-R, this derogatory regime must be based on a clear definition of EU transactions subject to the ESMA Templates disclosure and due diligence requirements, as discussed above, as opposed to non-EU transactions.

We believe that the non-EU derogation should apply when an EU institutional investor invests in a transaction with no EU nexus, i.e., where neither the originator, nor the sponsor, nor the SSPE is located in the EU and no prospectus has been established in the EU in respect of the securities.

It should also apply to non-EU transactions when an EU bank is the sponsor of the transaction, for example, when issuing a corporate securitisation in the US.

Also, it should be noted that when there is an EU leg in the transaction, the requirement to the EU party should be limited to its role in the transaction. Indeed, the ‘buy side’ (i.e. ‘investors’) cannot fulfil the reporting obligations of the ‘sell-side’ (i.e. ‘originators’ and ‘sponsors’), and vice versa.

The purpose of those changes should be to remove the obstacles for EU investors and structuring banks to access the international securitisation market, and for non-EU investors to invest into the EU securitisation market without excessive burden, to make the EU securitisation market more attractive, expand the investor base, and improve market liquidity.

The principle based due diligence and reporting requirements could be accompanied by a framework of equivalence or mutual recognition for jurisdiction having substantially similar frameworks.

While this subject would help EU investors and structurers to access the deeper non-EU securitisation and improve their critical mass, it could also be solved by making the due diligence and disclosure requirements more principle based (see questions in Section 4 and 5). Hence it is not a priority, compared to the prudential reforms. Hence our “No” response.

#### **Legal definitions**

The SECR defines the key concepts in the securitisation market to appropriately delineate the legal scope of the Regulation. The definitions seek to align as far as possible with pre-existing legal concepts in EU legislation (i.e. existing definitions in the CRR), and with international standards.

Certain stakeholders have raised concerns that the legal definitions result in a potentially too broad or too narrow scope of application. For instance, a too broad scope might impose an undue regulatory burden in terms of higher standards for disclosure, due diligence, etc. Conversely, too narrow a scope may pose risks to financial stability, resulting from the non-application of the safeguards in the securitisation framework to certain transactions or vehicles that could be considered securitisations from an economic perspective. For example, the categorisation of a given transaction under the definition of a “securitisation transaction” might be contested on the basis of whether a transaction involves tranching of credit risk, considering the economic purpose of the transaction. In addition, the definition of a sponsor is limited to credit institutions, whether located in the Union or not, and to EU investment firms, which could limit the ability of the market to structure securitisation in an economically efficient way by limiting the pool of eligible sponsors.

Questions to stakeholders:

#### *Definition of a securitisation*

#### **Question 3.3:**

Do you think the definition of a securitisation transaction in Article 2 of SECR should be changed? You may select more than one option.

- Yes, the definition should be expanded to include transactions or vehicles that could be considered securitisations from an economic perspective;
- Yes, the definition should be narrowed to exclude certain transactions or introduce specific exceptions;
- No, it should not be changed;
- No opinion.

Please explain and specify, if necessary, how the definition should be expanded or narrowed in your view.

Answer to multiple choice:

- **No, it should not be changed**

Explanation / justification / answer:

The definition of a securitisation transaction in Article 2 of SECR should not be changed, as changing the substance would create regulatory uncertainty. Given this definition is also used in the prudential framework, changing the definition would lead to possible unwarranted changes in the prudential treatment of some transactions, or at least introduce unnecessary regulatory uncertainty for issuers and investors.

However, some concepts used to define securitisation and in particular originators could in our view be adjusted to reduce some legal uncertainties. The definition of originator could be slightly clarified to cover entities which not only originate or purchase assets but also entities that are fully responsible and act as risk retention holder of such assets. The case of single assets or single tranche could also be reviewed, notably as regards specialized financing.

Overall, the priority is to make the regulatory framework more commensurate to the risk of the transactions, and if this goal is achieved, there is no need to reduce the scope of securitisation transactions.

**Question 3.4:**

Should the definition of a securitisation exclude transactions or vehicles that are derisked (e.g. by providing junior equity tranche) by an EU-level or national institution (e.g. a promotional bank) with a view to crowding-in private investors towards public policy objectives?

- Yes
- No
- No opinion

Answer to multiple choice:

- **No**

**Question 3.5:**

**If you answered yes to question 3.4.,** what criteria should be used to define such transactions?

The answer to question 3.4 is 'No'.

Indeed, we should maintain level playing field whether the provider of protection is a public entity or a private financial institution. The securitisation treatment should be risk-sensitive irrespective of the type of protection provider.

Improving the framework only for transactions derisked by a promotional bank would actually further crowd out private investors/risk takers, and result in the opposite outcome of the Savings and Investment Union objective, which is to favour private risk taking, not only alongside public institutions.

An example of forced crowding out, which affects in particular the CEE countries and smaller banks across the European Union, was when the Capital Markets Recovery Package only allowed public entities to provide uncollateralised credit protection in synthetic STS, instead of enlarging access to the STS label to private protection providers (see our answer to question 7.4 to 7.8 on this issue).

*Definition of a sponsor*

**Question 3.6:**

Should the definition of a sponsor be expanded to include [alternative investment firm managers](#) established in the EU?

- Yes
- No
- No opinion

Please explain, including if the definition should be expanded to any other market participants.

Answer to multiple choice:

- No

Explanation / justification / answer:

Given the current provisions of SECR and its set of Level 2 regulations (e.g. Retention RTS), and the wide-ranging implications of the qualification as Sponsor under SECR, notably in terms of support and guarantees requirements (e.g. for ABCP securitisations), we believe there is no need for EU AIFMs to be included in the definition of Sponsor under SECR.

Also, we note that AIFMD II has further clarified that EU AIFs as originators can perform loan origination activities and as such, can act as retention holders under SECR and its Level 2 regulations.

However, from a commercial perspective, AIFMs' main business is management, not holding assets directly. Although sponsors do not own the assets before they are securitised, a sponsor under these circumstances would still need to hold risk retention, which is not something most AIFMs are set up to do themselves. If it were to be permitted for them to hold the risk retention in an AIF managed by the AIFM, then a question arises about how their duty to act in the best interests of their AIF investors would interact with their obligation to hold the risk retention for the life of the transaction. These are mentioned not as objections, but simply as collateral issues that would need to be dealt with in connection with allowing AIFMs to act as sponsors.

Therefore, we do not think this subject is a priority.

**Question 3.7:**

If you answered yes to question 3.6., are any specific adaptations or safeguards necessary in the [Alternative Investment Firms Directive](#) (AIFMD<sup>13</sup>), taking into account the originate-to-distribute prohibition in the AIFMD, to enable AIFMs to fulfil the functions of a sponsor in a securitisation transaction, as stipulated in the SECR? You may select more than one option.

<sup>13</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32011L0061>

- An AIFM should not sponsor loans originated by the AIFs it manages
- AIFs should not invest in securitisations sponsored by its AIFM
- Minimum capital requirements under the AIFMD should be adapted to enable AIFMs, in particular to fulfil the risk retention requirement under SECR
- Other safeguards
- No safeguards are needed

Please explain your answer.

#### 4. Due diligence requirements

A thorough due diligence process is key to ensure that investors are aware of what they are buying and appropriately assess the risks of their investments<sup>14</sup>. Article 5 of the Securitisation Regulation imposes due diligence requirements on EU investors both prior to investing and while holding the securitisation position.

<sup>14</sup> This principle is well recognised by the International Organisation of Securities Commission (IOSCO) in their [report on the subprime crisis](#), as well as their [report on good practices in relation to investment managers' due diligence when investing in structured finance instruments](#).

While due diligence is an integral part of the risk assessment process, feedback gathered by Commission services since the entry into force of the Securitisation Regulation in 2019 suggests that due diligence requirements under Article 5 might be disproportionate. Stakeholders highlight that the legal text is mostly interpreted in a way that (1) subjects all institutional investors to the same due diligence requirements regardless of the type of securitisation that they invest in, and (2) applies stricter and more prescriptive due diligence requirements than those that apply to other financial instruments with similar risk characteristics. As a result, smaller players might not be able to enter the securitisation market, because they lack the resources and/or necessary infrastructure to comply with the due diligence requirements. Due diligence requirements that do not properly take account of the mitigated agency and operational risk characteristics of STS transactions might also be hampering the growth of the STS market.

Questions to stakeholders:

##### Question 4.1:

Please provide an estimate of the total annual recurring costs and/or the average cost per transaction (in EUR) of complying with the due diligence requirements under Article 5.

Please differentiate between costs that are only due to Article 5 and the costs that you would incur during your regular due diligence process regardless of Article 5.

Please compare the total due diligence costs for securitisations with the total due diligence costs of other instruments with similar risk characteristics.

Paris Europlace is not in a position to provide costs estimates corresponding to the compliance with due diligence requirements. As noted by the Commission, what would matter is the additional cost linked to regulation, compared to the cost of due diligence that would be anyway carried out for risk management purposes.

Paris Europlace believes that estimating costs is not the appropriate approach to help solve the issue with securitisation. It is impossible to establish with certainty and depends on a lot of different factors. What is evidenced is the duplication of controls between all participants in regard to regulatory duties of originators or sponsors, which are supervised entities for most of them, and so implies a diffused and increased cost for the market globally. It is an obstacle to market increase, as the duplication of controls increase time to market (on primary and secondary markets) and put a limit on volumes that can be absorbed.

The excessive due diligence burden has following detrimental consequences:

- It acts as a high barrier to entry for medium and small size investors who would not be in a position to allocate expert resources in this process.
- It creates an issue of time to market that dissuades some investors to engage in the market: when an investor needs to sell, the buyer (in most cases the market maker) needs to go through the due diligence process, which means the transaction is delayed, and price may move during this period.
- **This requirement is unique to securitisation, and act as a strong disincentive to engage, compared to other asset classes.**
- This rule was defined in the aftermath of the financial crisis, as many EU financial firms had been investing in US subprime securitisation, with excessive reliance on rating agencies. Due diligence

requirements were implemented in the EU as a highly prescriptive response to the moral hazard and failure by rating agencies to properly capture the risks deriving from different US mortgage structures and originated by US mortgage brokers with no skin in the game. These issues are now largely resolved by retention rules, rating agencies supervision, and other post-GFC securitisation reforms. Therefore, there is now room to make these requirements less prescriptive, without jeopardizing financial stability.

Furthermore, for STS securitisations, investors must verify that the transactions meet the 100+ established criteria as part of their due diligence process and carry the responsibility for accepting any given transaction's compliance with STS criteria, regardless of whether the given transactions is or is not subject to third party verification (TPV). This makes investor due diligence of STS transactions effectively more burdensome than that for non-STS transactions. The rules should allow good faith reliance on TPVs' work.

Paris Europlace, representing a large scope of market players of different sizes, also warns the Commission that answers to the questions related to costs may suffer from an intrinsic selection bias, as respondents to the consultation are likely to be market players that are already active in the securitisation market, and therefore have already implemented the systems and procedures to comply with the current due diligence rules. Their answers may not reflect the views of potential medium size investors or issuers, where the rules represent a high barrier to entry.

**Question 4.2:**

If possible, please estimate the total one-off costs you incurred (in EUR) to set up the necessary procedures to comply with Article 5 of SECR.

The focus on costs should not be the primary priority to revive securitisation. Indeed, set-up costs and on-going costs discussions, while important, are secondary to the primary prudential concerns. Individually, by transaction and investor, the additional cost is manageable for large institutions but cumulated at market level on all parties and all transactions, it is quite significant and a source of distortion with non-European issuers and investors. It also acts as a high barrier to entry for medium size asset managers and investors.

The main issue currently and without a doubt is that the higher prudential and liquidity requirement have dried up this segment, being less interesting and relevant for investors to put their money in and for issuers to use the instrument for value creation. Less penalising prudential requirements for issuers and investors are of the essence to relaunch EU securitisation from a niche to a more significant market.

Reducing costs is a "nice to have", while a prudential reform is THE "must have".

The economic decision tree is fairly basic for an investor:

- 1) Does the risk-adjusted return on capital make sense? To simplify, this is return minus risk over capital. The denominator depends on the prudential treatment. When the denominator (i.e., capital charges) is too high, the numerator is not relevant. The trade does not proceed.
- 2) Can the investment be managed (i.e. sold to another party, as the need arises)? For senior tranches, when the LCR treatment blocks the efficient liquidity of European securitisation instrument, the answer is 'not when the need arises'.

There will be many other decision factors, including investment costs, taken into consideration if the first two answers are positive. But the first two are 'blockage' points.

From a bank perspective, the focus on costs should not be the primary focus of securitisation reforms either. The economic decision is fairly basic for an originator:

- 1) Does the risk-adjusted return on capital make sense? For SRT transactions, this is often based on the ratio of the senior tranche risk weight to the risk weight of the pool. The current fixed value risk weight floor creates havoc at this step, favouring certain asset classes instead of others, without any rationale.
- 2) Does the securitisation bring sufficient capital velocity (capital treatment of the non-senior part)
- 3) For traditional securitisation, does it bring the required liquidity? This is dependent on eligibility in the LCR in the first place (AAA Non-STs are not eligible, even when backed by granular pools) and on LCR haircut (which are currently too high).

The same selection bias applies also to this question, as described in question 4.1, and to all questions on costs.

**Question 4.3:**

Please select your preferred option to ensure that investors are aware of what they are buying and appropriately assess the risks of their investments.

- Option 1: The requirements should be made more principles-based, proportionate, and less complex;
- Option 2: The requirements should be made more detailed and prescriptive for legal certainty;
- Option 3: There is no need to change the text of the due diligence requirements;
- No opinion

Answer to multiple choice:

- **Option 1: The requirements should be made more principles-based, proportionate, and less complex;**

**Due diligence requirements prior to holding a securitisation position****Question 4.4:**

Should the text of Article 5(3) be simplified to mandate investors to assess at minimum the risk characteristics and the structural features of the securitisation?

- Yes
- No
- No opinion

Please explain.

Answer to multiple choice:

- **Yes**

Explanation / justification / answer:

Article 5 of SECR requires every type of investors to include in their due diligence exercises all the information that sell-side entities have made available in accordance with disclosure requirements under SECR article 7, with the prescribed frequency and modalities.

Article 5 parts (3)(a) and (b) are broadly in adequation with economic analyses required for all investment decisions (i.e. risk characteristics and structural features).

However, Article 5(3)(c) requires redundant controls on the compliance of STS operations with their specific regulatory constraints. Investors in STS securitisation should not be required to also perform such controls that have already been performed by the Originator, the Sponsor or SSPE that are regulated entities, and also subjects to specific legal obligations. Please refer to questions 4.10 and 7.15 related to this topic. Point (c) is already covered by existing duties relative to the Originator, the Sponsor or the SSPE (or its legal representant) and, for STS transactions, by the controls effectuated on the respect of all STS criteria by Third-Party Verifiers, themselves subject to national supervisor agreement and supervision.

The priority should therefore be to remove Article 5(3)c to reduce the redundancy of current requirements.

More generally, a more principle-based due diligence framework, especially for private transactions, would render the process more fluid. The information that will be requested from sell-side entities should differ from

operations to operations, because the needs of each party will differ, and products differ in terms of collateral and structure.

Therefore, it is essential that institutional investors be subject to proportionate due-diligence requirements ensuring that they properly assess the risks arising from all types of securitisations to the benefit of end investors, (including risks linked to the underlying and risks, or risk mitigation linked to the structure). Due diligence can thus also enhance confidence in the market and between individual originators, sponsors and investors.

In particular, the due diligence requirements in the existing framework on senior tranches are overly prescriptive, impacting directly the capacity of (re)insurance companies to act in the primary market, and also indirectly as in case (re)insurance companies want to sell those assets (for example to pay new insurance claims, the potential buyer or market maker (if it is itself subject to EU rules) also needs to go through this burdensome due diligence process.

A better approach would be to align due diligence principles for securitisation with the existing regulatory framework applying to all regulated activities (fiduciary duties, risk management processes, etc...) given that most market participants and activities are already duly regulated and supervised. Such an approach would avoid singling out securitisation, and encourage the inclusion of securitisation in investment portfolios, with a risk-commensurate investment decision process. Actually, these requirements cannot be examined solely in the silo of securitisation. They must be placed in the context of all other capital market instruments – many considerably riskier than securitisation – where no such due diligence framework is imposed. Investment decisions are made by comparing the cost/benefit balance of various available instruments. So, imposing an unnecessary cost on one instrument distorts the market and generates regulatory arbitrage. The issue of article 5 is not a securitisation cost issue but also a level playing field issue between securitisation and other financial instruments.

But this should not be considered as the top priority to revive securitisation. Currently the main drawback is the heavy prudential requirements for securitisations, which dried up this segment, rendering it less interesting for investors. Less penalising prudential requirements for issuers and investors are of the essence to relaunch the EU securitisation market.

**Question 4.5:**

**If you answered yes to question 4.4., please specify how this could be implemented.**

The individual assessment steps in Article 5(3) points a to c of the SECR should be deleted and replaced by principle-based wording. This might look as follows:

*Prior to holding a securitisation position, an investor, shall carry out a due diligence assessment which enables it to assess the risks involved. This assessment must take into account the underlying exposures and the structural features of the securitisation.*

*Notwithstanding the first subparagraph above, in the case of a fully supported ABCP programme, institutional investors in the commercial paper issued by that ABCP programme shall consider the features of the ABCP programme and the full liquidity support.*

In addition, regarding article 5(4), we suggest the following modifications aimed at removing burdensome and inexpedient requirements for investors:

*Article 5(4)a §2: the sentence shall be removed because not all the listed characteristics are relevant to every securitisation. It should be left to the professional judgement of investors to decide the scope of criteria to include and document in their written procedures for monitoring the risk, performance and regulatory compliance of their securitisation positions, depending on the nature of their investments and the types, features and underlying assets of the securitisations.*

*Article 5(4) points b and c: the provisions shall be removed. Detailed provisions on stress testing are not necessary in our sense, as the written procedures as per article 5(4)a will include these aspects as the case may be.*



**Question 4.6:**

**Taking into account your answer to 4.4**, what would you estimate to be the impact (in percent or EUR) of such a modification in Article 5(3) on your one-off and annual recurring costs for complying with the due diligence requirements under Article 5?

Please explain.

The purpose of this simplification would not be to reduce costs, but to provide flexibility to investors to achieve their due diligence process in a more proportionate way and timely manner, also depending on the complexity and risk of the transaction they engage in. This flexibility, combined with more risk-sensitive capital charges, would remove the disincentive for investors to engage, including small and medium size financial institutions across all EU member states.

Also, for existing players, reducing the due diligence burden would actually bring important benefits in terms of time to market, making sure that origination and investment decisions can be made in accordance with market practices, including in the case of market makers in the secondary market. In the current framework, EU investors and market makers are losing opportunities, to the benefit of non-EU players, due to the necessary time to perform due diligence which are often not proportionate to the risk of the contemplated transaction.

**Question 4.7:**

Should due diligence requirements differ based on the different characteristics of a securitisation transaction?

- Yes
- No
- No opinion

Answer to multiple choice:

- **Yes**

**Question 4.8:**

**If you answered yes to question 4.7.**, please select one or more of the following options to differentiate due diligence requirements:

- Due diligence requirements should differ based on the risk of the position (e.g. senior vs non-senior)
- Due diligence requirements should differ based on the risk of the underlying assets
- Due diligence requirements should differ based on the STS status of the securitisation (STS vs non-STS)
- Other

Please explain your answer.

Answer to multiple choice:

- **Due diligence requirements should differ based on the risk of the position (e.g. senior vs non-senior)**
- **Due diligence requirements should differ based on the risk of the underlying assets**
- **Due diligence requirements should differ based on the STS status of the securitisation (STS vs non-STS)**
- **Other**

Explanation / justification / answer:

The due diligence issue is about prescriptiveness and frequency of the due diligence, overlapping requirements for originators, investors, marker makers, TPVs, (cf. questions 4.10 and 7.15)

The core principle should be that the riskier the position and/or the underlying risk, the deeper and more frequent the due diligence are needed. The current situation is that due diligence requirements are imposed to all transactions in a “one size fits all” approach, calibrated on the riskier instrument, and mixing economic and non-economic criteria. Such extensive requirements can prove inadequate for less risky exposures, and crowd out European investors from transactions, as non-EU investors can seize market opportunities more easily.

A principle-based, proportional due diligence framework should differentiate according to:

- The risk of the position (senior/non-senior, external rating)
- The liquidity of the position (maturity, eligibility to Central Bank collateral policy)
- Whether the transaction has been reviewed by a TPV (in which case, more reliance on the TPV should be allowed to avoid redundant checks)
- The nature of the intention (in the secondary market, due diligence should be simplified, given the initial review performed in the primary market, and as a function of residual maturity, and current credit enhancement level)
- The quality of regulation and supervision applicable to the originator, as regards credit origination practices

Another important criterion to consider is the degree of sophistication of the investor. First, securitisation is an institutional investor market, with investors duly regulated as insurance, funds, or alternative funds. There is no room for retail investment in this market. Second, the greater the risk, the more sophisticated the investors should be. This also means that they should be able (and hence, allowed) to determine the exact level, scope and nature of due diligence they should be carrying out in order to appropriately assess the risk and make an informed decision, in line with their investment policies and processes, and proportionate to the amount and nature of the risk of the contemplated transaction.

Consequently, a higher risk should not necessarily trigger a more prescriptive due diligence scope or template. On the contrary, this tailoring of due diligence according to the type of investment should be included in the regulation as a principle-based approach, rather than the current prescriptive tick-the-box approach.

In practice, more informed/specialized investors, taking more risks, determine their appropriate due diligence level and analyse riskier or more complex transactions on a case-by-case basis, according to their internal investment policies, without using the ESMA templated disclosures.

EU regulated investors such as insurance and funds are already subject to strict risk management rules and supervision, which should encompass securitisation as one of the asset classes in their portfolios. A simple rule would be that investors would be accountable to their respective supervisor (insurance, market, banking) to justify the appropriateness of their due diligence policy as a function of their business model and risk appetite, as per other asset classes. For institutional investors, this is an intrinsic part of their fiduciary duty. All participants should be able to demonstrate to their competent authorities, on request, that they have full and in-depth knowledge of each securitisation position and the exposures underlying it, based on dedicated written policies and procedures for investing and managing the risks they entail, to be approved by senior management.

It should be noted that, although a drastic simplification would alleviate some of the barriers to entry in the primary and secondary market, it would not be sufficient to revive the market, and targeted amendments of prudential requirements for issuers and investors are essential.

**Question 4.9:**

**Taking into account your answers to 4.7 and 4.8**, what would you estimate to be the impact (in percent or EUR) of differentiating due diligence requirements on your one-off and annual recurring costs for complying with the due diligence requirements under Article 5?

Please explain your answer.

See answer to question 4.6

**Question 4.10:**

For EU investors investing in securitisations where the originator, sponsor or original lender is established in the Union and is the responsible entity for complying with those requirements, should certain due diligence verification requirements be removed as the compliance with these requirements is already subject to supervision elsewhere? This could apply to the requirements for investors to check whether the originator, sponsor or original lender complied with:

- (i) risk retention requirements,
  - Yes
  - No
  - No opinion
- (ii) credit granting criteria requirements,
  - Yes
  - No
  - No opinion
- (iii) disclosure requirements,
  - Yes
  - No
  - No opinion
- (iv) STS requirements, where the transaction is notified as STS
  - Yes
  - No
  - No opinion

Please explain if you see any risks arising from the removal of these requirements, and if so, how they should be mitigated.

**Answer to multiple choice:**

- (i) risk retention requirements,
  - **Yes**
- (ii) credit granting criteria requirements,
  - **Yes**
- (iii) disclosure requirements,
  - **Yes**
- (iv) STS requirements, where the transaction is notified as STS
  - **Yes**

**Explanation / justification / answer:****(i) risk retention requirements:**

(removal from article 5(1)c). The originator, sponsor or original lender located in the EU is already subject to the risk retention requirement pursuant to Art. 6. It does not seem necessary to duplicate the burden towards investors with an obligation imposed to them to monitor compliance with risk retention.

In addition, in article 5(1)d, the reference to art. 6 should be deleted and replaced by "equivalent provisions", because an originator located outside the EU is not subject to SECR. This requirement can represent a significant impediment for European investors. The 5% retention threshold shall obviously be maintained as a safeguard.

**(ii) credit granting criteria requirements:**

When credit granting is already regulated and supervised in the EU at the original lender [or originator] level, the EU investor should be able to rely on the quality and intrusiveness of banking supervision. Other aspects should also be considered:

- **Verification Standards:** The expected standard of verification can indeed vary based on factors like investor type, investment tenor, and seniority. For instance, senior tranches might require more stringent verification compared to junior tranches due to their lower risk tolerance.

- **Historical Exposures:** For securitisations involving historical exposures, especially where the original lender no longer exists, investors should focus on the current originator of the securitised assets. Representations and warranties from this entity can provide the necessary assurance.

**(iii) disclosure requirements:**

Due diligence on disclosure should be limited to the verification of the availability of the information needed for due diligence purposes. In article 5(1)e, the reference to article 7 should be replaced by a more general provision.

In particular, if the current requirement is maintained, EU investors will continue to be excluded from the third country securitisation market which can be detrimental to the EU economy (this limits the opportunities to provide support to European companies operating outside the EU and to develop expertise in new asset classes from other regions). It also creates an unlevel playing field with non-EU investors and makes it practically impossible for EU investors to invest in third country securitisations.

Confirming compliance with Article 7 disclosure requirements pre-pricing does not tend to present challenges (and it makes sense) for existing investors in the primary markets, although it acts as a barrier to entry for new investors. However, the position of an investor or market maker in the secondary markets is different and there is uncertainty as to whether such secondary market investors should be required at all to verify any pre-pricing disclosures. Proportionate approach to investor due diligence would suggest that it should not be the case.

**(iv) STS requirements, where the transaction is notified as STS**

The verification of the STS criteria relies primarily on the originator and, if applicable, the Third Party Verifier, and it is currently disproportionate and fully duplicative to require the investors to double check compliance with STS criteria, adding to their administrative and compliance burden with no tangible added value, given the more than 100 criteria necessary to meet the STS rules. The requirement to review STS criteria where there is no economic benefit to the end investor (i.e. where they are not a bank, insurance company) is an unnecessary burden, given it is not investment relevant. An example would be a synthetic transaction designated as STS where only the originator would have the regulatory benefit arising from the STS designation (with none of the investors obtaining any regulatory benefit from the STS status). To the extent that investors do not rely on or benefit from the STS status, or if a TPV has verified compliance with STS criteria, the investors do not have to ensure due diligence on STS compliance.

Furthermore, simplifications envisaged in due diligence should be mirrored by simplifications in disclosure requirements, which should be defined as a subset of existing disclosures, in order to avoid additional development on existing transactions.

To conclude, overall, the STS label was created to give comfort to investors that they are investing in a Simple, Transparent and Standard transaction: requiring investors to verify that the STS label was appropriately granted deprives the label from its very purpose. The simplification would significantly increase the attractiveness of the label, provided that some of the current exclusions are also addressed (see answer to question 7.13 for details on targeted suggestions).

**Question 4.11:**

**Taking into account your answers to Q.4.10,** what would you estimate to be the impact (in percent or EUR) of removing those obligations on your one-off and recurring costs for complying with the due diligence requirements?

Please explain.

Removing such unwarranted due diligence requirements would significantly improve the efficiency of the EU securitisation markets, without any impact in terms of operational risks. See response to question 4.6.

**Question 4.12:**

Do the due diligence requirements under Article 5 disincentivise investing into securitisations on the secondary market?

- Yes
- No
- No opinion

Please explain

Answer to multiple choice:

- **Yes**

Explanation / justification / answer:

The current due diligence requirements makes it de facto impossible, for market makers and investors, to participate in the secondary market, unless they have already performed the due diligence on this securitisation transaction in the primary market. This is a severe limitation, which materialized for example in the LDI crisis, as UK MMFs were selling transactions, and EU market makers were not in a position to bid, losing significant revenue opportunity to the benefit of non-EU banks.

Indeed, compliance with current due diligence requirements is virtually impossible within the timeframe of a typical secondary trading transaction, and the needed resource allocation does not make sense for smaller investments. Redundant due diligence requirements are, by construction, even more unnecessary for secondary market trades than for primary. Examples of specific issues materializing in the secondary market include, for example:

- Where the seller wishes to effect a quick sale. This was seen during the UK LDI crisis when funds sought immediate liquidity and EU investors were not able to purchase due to their lengthy due diligence requirements.
- Where the buyer is purchasing to trade and so long-term credit considerations are not relevant compared to likely price movements.
- Where the buyer is purchasing a securitisation that is a senior STS close to maturity and where sequential amortisation has created a very substantial level of credit enhancement and a very short period of risk.

This reduces market liquidity and results in a less efficient market for all.

Alleviating due diligence requirement in the secondary market would improve market liquidity, but the most important measure in this regard is to review the LCR treatment, to reduce the haircut applying to securitisation (see answer to question 9.40)

**Question 4.13:**

**If you answered yes to question 4.12.,** should investors be provided with a defined period of time after the investment to document compliance with the verification requirements as part of the due diligence requirements under Article 5?

- Yes
- No
- No opinion

Answer to multiple choice:

- **No**

**Question 4.14:**

**If you answered yes to question 4.13.**, how many days should be given to investors to demonstrate compliance with their verification requirements as part of the due diligence requirements under Article 5?

- 0 – 15 days
- 15 – 29 days
- 29 – 45 days
- No opinion

N/A

**Question 4.15:**

**If you answered yes to question 4.13.**, what type of transactions should this rule apply to?

Offering the possibility to perform due diligence after the investment is not the right answer to the problem, as proportionate due diligence should always be performed prior to investing.

Maintaining the current prescriptive and one size fits all due diligence framework, and allowing market participants to comply with it after investment would not reduce the workload, possibly even increase it.

Being authorised to carry out the due diligence ex post would in theory make possible swift transactions, but the consequences of a negative outcome of such ex post due diligence are unclear: would the investor have to sell? would such sale be suitable in case the ex-post due diligence would have revealed an issue?

Post investment due diligence would mean that risk analysis could be performed too late in the process, which we think is not sensible. In any case, investors would need to perform some checks prior to investing (in a proportionate manner) (which would not prevent them from doing post trade documentation and further analysis if they want to).

We believe that this would not really work realistically and that the benefit would be quite limited. In terms of governance and process, internal formal approvals are needed before investing and these approvals require that the due diligence work has been completed and sufficiently documented ahead of the investment.

A principle based, proportionate ex ante due diligence framework would be much more impactful, and consistent with prudent risk management. Cf. also our answers to questions 4.8 and 4.10.

**To conclude, either the due diligence framework is commensurate to the risk, and it has to be performed before trading, or it is not relevant for the decision, and therefore it is of no use after trading.**

**Question 4.16:**

Do the due diligence requirements under Article 5 disincentivise investing into repeat securitisation issuances?

- Yes
- No
- No opinion

Answer to multiple choice:

- No

**Question 4.17:**

**If you answered yes to question 4.16.**, how should repeat or similar transactions be identified in the legal text and how should the respective due diligence requirements be amended?

Our answer to question 4.16 is 'No', because due diligence requirements disincentivize investing into all securitisation transactions, repeat or not. Providing with improvements limited to "repeat deals" would not achieve the goal, all the more that defining a repeat deal is likely to be very difficult from a legal standpoint, as seen in the ECB discussion on SRT.

**Question 4.18:**

Should Article 32(1) be amended to require Member States to lay down rules establishing appropriate administrative sanctions, in the case of negligence or intentional infringement, and remedial measures in case institutional investors fail to meet the requirements provided for in Article 5?

- Yes
- No
- No opinion

Please explain your answer.

Answer to multiple choice:

- **No**

Explanation / justification / answer:

Adding new sanctions in SECR would only deter more investors to come into the market which would be detrimental to the development of the EU financial markets.

Administrative sanctions already exist in case of failure to respect the fiduciary duty, which is sufficient to provide Competent authorities with the necessary powers in case a market participant is not in compliance with regulation, whether on securitisation or not. Differentiating securitisation from other asset classes from the point of view of sanctions and having rules depending on individual member states would act as a powerful disincentive to engage from this asset class.

**Question 4.19:**

Taking into account the answers to the questions above on due diligence requirements, do you think any safeguards should be introduced in Article 5 to prevent the build-up of financial stability risks?

The monitoring of financial stability risks must be holistic, covering all asset classes, and there is no reason to single out securitisation in this process. The build-up of financial stability risks will also depend on the share that securitisation represents in an investor portfolio and should be addressed through monitoring by supervisors rather than due diligence. Any safeguards deemed necessary from a financial stability perspective, such as imposing strong governance and risk management, should apply across all asset classes, and not specific to securitisation.

Although badly originated, structured and opaque securitisation (almost entirely from the US) played a key role in the financial crisis, it should be recognized that European securitisations performed much better in the crisis. Since then, the SECR has profoundly increased the resilience of the market by removing moral hazard and agency risks. There have been no risk occurrences in the EU, all the more so since the 2017 regulations, which would justify the need for financial stability safeguards related to due diligence in securitisation.

Overall, financial stability risk does not appear to be a securitisation issue.

**Question 4.20:**

Taking into account your answers to the previous questions in this section, by how much would these changes impact the volume of securitisations that you invest in?

Addressing due diligence excessively prescriptive requirements would improve the time to market, make the market more liquid, and encourage more medium size investors to access this asset class. However, unless these changes are coupled with targeted reforms on the prudential side for banks and insurance companies, it is unlikely that overall volumes could increase significantly.

**Question 4.21:**

If you are a supervisor, how would the changes to the due diligence requirements suggested in the previous questions affect your supervisory costs?

N/A

**Delegation of due diligence****Question 4.22:**

Should the National Competent Authorities (NCAs) continue to have the possibility to apply administrative sanctions under Article 32 and 33 of SECR in case of infringements of the requirements of Article 5 SECR to either the institutional investor or the party to which the institutional investor has delegated the due diligence obligations?

- Yes
- No
- No opinion

Please explain your answer.

**Answer to multiple choice:**

- No

**Explanation / justification / answer:**

As per our answer to 4.18, NCAs already have the possibility to apply sanctions whenever a supervised entity does not comply with any of the requirements of the overall applicable regulation. These powers de facto cover securitisation.

As an example, here is an example of the French ACPR supervisory policy applying to the insurance sector, as a national implementation of the Solvency II Directive:<sup>2</sup>

*« L'Autorité analyse le respect du principe de la personne prudente par les organismes, en étudiant en quoi les actifs choisis répondent aux critères de sécurité, qualité, liquidité et rentabilité au regard des engagements de l'organisme. Elle s'appuie notamment sur des indicateurs de risque pour déterminer les zones d'attention et examiner les processus mis en place sur celles-ci. Les politiques et processus d'investissement sont également évalués. »*

*« L'Autorité est susceptible de prendre des mesures de supervision correctrices, et s'assure que celles-ci*

<sup>2</sup> <https://acpr.banque-france.fr/controler/contrôle-prudentiel-des-assurances/demarche-de-controler/politique-de-supervision>



*sont cohérentes, proportionnées, objectives et documentées. L'Autorité est notamment susceptible de prendre des décisions administratives visant à la mise en œuvre par l'organisme de mesures correctrices, et le cas échéant engager une procédure disciplinaire pouvant conduire à une sanction. La notification à l'organisme ou au groupe des mesures à mettre en œuvre est effectuée par écrit et, le cas échéant, selon un calendrier adéquat à suivre par l'organisme ou le groupe. Après notification, l'Autorité assure un suivi et une revue des mesures mises en œuvre. »*

Similar provisions exist in the case of the French AMF, applying to the asset management industry.

Removing the specific sanctions under Art 32 and 33 of SECR would therefore not deprive NCAs from any power, while it would realign securitisation with other asset classes as regards to the sanction regime.

To summarize our view on the sanction regime, we believe that there is no need to add more administrative sanctions, and that sanctions for non-compliance with applicable requirements should be removed from SEC-R, as National Competent Authorities already have the powers to sanction financial entities who do not comply with applicable regulations, including SEC-R.

It is important to realign the governance of the securitisation market with the one in place for all other types of instruments, in order to remove the stigma, while maintaining a high level of protection through the general financial regulation framework (MIFID, EMIR, UCITS, MMF, AIFMD.).

This is essential to unlock the attractiveness of the EU securitisation market, while addressing the prudential issues remains the main priority to scale-up the market.

**Question 4.23:**

**If you answered no to question 4.22**, which party should be subject to administrative sanctions in case of infringement of the due diligence requirements?

- the institutional investor
- the party to which the institutional investor has delegated the due diligence obligations

Answer to multiple choice:

N/A

## 5. Transparency requirements and definition of public securitisation

Public interventions after the GFC significantly improved the level of transparency in the EU securitisation market starting with the introduction of loan level templates by the European Central Bank. The current transparency regime enshrined in Article 7 of the SECR aims to ensure that investors in a securitisation have all the necessary information for their due diligence needs. In addition, National Competent Authorities (NCAs) should have access to sufficient information to properly supervise the participants in the securitisation market.

However, the application of some legal provisions of the transparency regime have nonetheless shown some gaps and inefficiencies. For instance, the disclosure requirements are seen by stakeholders as overly prescriptive and insufficiently adapted to the actual needs of investors into the various types of securitisations. This limits the usefulness of certain disclosures, i.e. investors/NCAs may not use all the information disclosed under Article 7, because it might not be tailored to their specific information needs.

Under the SECR, public securitisations are those that require publishing a prospectus, and yet this captures only a subset of what the market would consider as public securitisations from an economic perspective. Consequently, only a subset of the ‘truly’ public market is obliged to report to securitisation repositories. However, a separate significant part of the market, in particular many collateralised loan obligations (CLOs), is public in nature but is not classified as such under the SECR and therefore it does not report to the securitisation repositories (“SRs”). This curtails supervisors’ ability to adequately analyse and supervise cross-border markets and might limit overall market transparency.

On the other hand, bespoke transactions or intra-group securitisations (i.e. ones without an external investor) might be subject to unduly high transparency requirements because they have to report using the same disclosure templates as public transactions, which might not be fit for purpose.

Feedback gathered during the preparation of the Commission’s report on the functioning of the Securitisation Regulation showed wide support for amending the definition of private securitisations to focus on truly bespoke transactions, while at the same time reducing the mandatory transparency requirements for these types of transactions. The [Joint Committee report](#)<sup>15</sup> also favoured amending the definition of private securitisations to make it more precise and to exempt from all transparency requirements a sub-set of transactions that are private in nature. At the same time, the Commission report also highlighted that a better definition of private securitisation would be difficult to find. For this reason, it is worth considering whether amending (i.e. widening) the definition of public securitisations would be useful instead. This would have the dual benefit of (i) reducing the reporting burden for truly private transactions should transparency requirements be simultaneously amended, and (ii) ensuring that transactions that are public in nature but currently considered private because they do not have a prospectus (such as CLOs), would be categorised as public, thereby entailing direct reporting to repositories, and enhancing market transparency.

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<sup>15</sup> See [Joint committee report on the implementation and functioning of the securitisation regulation - European Union \(europa.eu\)](#)

Questions to stakeholders:

### Question 5.1:

Please provide an estimate of the total annual recurring costs and/or the average cost per transaction (in EUR) of complying with the transparency regime under Article 7.

Please differentiate between costs that are only due to Article 7 and costs that you would incur during your regular course of business regardless of Article 7.

Please compare the total transparency costs for securitisations with the total transparency costs of other instruments with similar risk characteristics.

See answer to question 4.6.

Transparency is an important feature of the post-crisis reforms and should remain a core element of the securitisation framework. However, the existing transparency requirements are excessively granular, are not an appropriate tool for investors, and are duplicative in particular between ESMA templates and ECB supervisory reporting.

Rather than the potential cost reduction benefit, the most important aspect in the simplification of transparency requirements is to lower the barrier to entry for issuers. This should be combined with addressing the prudential issues.

**Question 5.2:**

If possible, please estimate the total one-off costs you incurred (in EUR) to set up the necessary procedures to comply with Article 7 of SECR.

See answer to question 4.6.

**Question 5.3:**

How do the disclosure costs that you provided in 5.1. compare with the disclosure costs for other instruments with similar risk characteristics?

- Significantly higher (more than 50% higher)
- Moderately higher (from 10% to 49% higher)
- Similar
- Moderately lower (from 10% to 49% lower)
- Significantly lower (more than 50% lower)

Please explain your answer.

Answer to multiple choice:

- **Significantly higher (more than 50% higher)**

Explanation / justification / answer:

The transparency framework implemented for securitisation is uniquely burdensome, and no other financial instrument is subject to comparable requirements.

**Question 5.4:**

Is the information that investors need to carry out their due diligence under Article 5 different from the information that supervisors need?

- Significantly different
- Moderately different
- Similar

Please explain your answer.

Answer to multiple choice:

- **Significantly different**

### Explanation / justification / answer:

As originating banks, arrangers and lead managers of securitisation in the public and private market, our view is that the current data disclosure is too detailed and certain mandatory information is not required / used by the investors, nor rating agencies, nor by supervisors. The transparency is key for the investors, but excessive disclosure reporting is in our view an obstacle to the development of the securitisation market. Supervisors have access to much broader information, at their request, and including private supervisory information. This is for example the case for the SSM when reviewing the SRT eligibility of bank issued transactions. The fact that a supervisor may need an information is certainly not a reason to include it in public disclosure requirements. Such distinction is absolutely essential.

In practice, certain investors require detailed information, but this does not necessarily correspond to the information as set out in the ESMA template. As a result, the ESMA templated disclosure is either not used because investors do not require such level of detail, or because they require different information, so that the disclosure is done in two different formats.

Investors will conduct their assessment depending on some factors including the type of securitisation, the underlying assets (granularity, tenor), the level of seniority of the securitisation position (equity vs senior), the size of the contemplated investment etc. In order to make their investment decision, investors will need some details on the underlying loans (not necessarily on a loan-by-loan basis), details on credit enhancement provided, amortisation & triggers, cash flow models, etc.

Market supervisors shall require only a subset of the information needed for investors, in order to get a broad view of the market (e.g. type of securitisation, asset class, number and size of tranches, risk retention scheme, etc.).

Prudential supervisors are not using ESMA templates either, as they have their own analysis of the transaction in order to assess the Significant Risk Transfer.

To note, as regards the information requirements that the ECB has to value ABSs in its (now expired) ABS purchase program, and in the implementation of its collateral policy, we understand that the information needs of the well-established and certainly prudent “Common Eurosystem Pricing Hub” (CEPH) are only a small fraction of the data currently requested by ESMA templates...

#### **Question 5.5:**

To ensure that investors and supervisors have sufficient access to information under Article 7, please select your preferred option below.

- Option 1:
  - Streamline the current disclosure templates<sup>16</sup> for public securitisations
  - Introduce a simplified template for private securitisations and require private securitisations to report to securitisation repositories (this reporting will not be public).

<sup>16</sup> [Commission Delegated Regulation \(EU\) 2024/1224](#)

- Option 2:
  - Remove the distinction between public and private securitisations.
  - Introduce principles-based disclosure for investors without a prescribed template.
  - Replace the current disclosure templates with a simplified prescribed template that fits the needs of competent authorities with a reduced scope/reduced number of fields than the current templates.
- Option 3: No change to the existing regime under Article 7.

Answer to multiple choice:

- **Option 1**
  - **Streamline the current disclosure templates for public securitisations**
  - **Introduce a simplified template for private securitisations and require private securitisations to report to securitisation repositories (this reporting will not be public).**

**Question 5.6:**

If you are a supervisor, what impact (in percent or EUR) would you anticipate Option 1 would have on your supervisory costs?

N/A

**Question 5.7:**

Assuming that transparency requirements are amended as suggested in Option 1, by how much would the volume of securitisations that you issue, or invest in, change?

While some flexibility would improve operational processes, they are not material for conditioning the participation in the securitisation market.

The main regulatory measure to actually accelerate the development of the EU securitisation market is alleviating prudential measures for banks and insurers.

**Question 5.8:**

What impact (in percent or EUR) would you anticipate Option 1 would have on your one-off and annual recurring costs for complying with the transparency requirements in Article 7?

Please explain your answer.

It is impossible to give a figure, it will depend on the effective revival of the securitisation market which depends mostly on the prudential reforms.

**Question 5.9:**

Do you see any concerns, impediments, or unintended consequences from requiring private securitisations to report to securitisation repositories?

- Yes
- No
- No opinion

Please explain your answer.

Answer to multiple choice:

- **Yes**
-

Explanation / justification / answer:

Private transactions are mostly bilateral or club deals, where information is provided in a tailored, heterogeneous manner, so reporting to securitisation repositories would have no added value for the investors involved in the transaction, and other investors would not be in a position to invest...

Adding further requirements would not be an incentive to enter this market.

For each securitisation transaction, including private ones, a full reporting to ECB is already mandatory for eurozone banks' securitisation, and so supervision of private transactions does not need reports to securitisation repositories for Eurozone.

Requiring private securitisations to report to repositories would not be consistent with the global objective to simplify reporting process for private deals.

**Question 5.10:**

Under Option 1, should the current definition of a public securitisation be expanded to a securitisation fulfilling any of the following criteria: (1) a prospectus has been drawn up in compliance with the EU Prospectus Regulation; or (2) notes were admitted a trading venue; or (3) it was marketed (to a broad range/audience of investors) and the relevant terms and conditions are non-negotiable among the parties?

- Yes
- No
- No opinion

Please explain your answer.

Answer to multiple choice:

- No

Explanation / justification / answer:

The current definition is appropriate in our view, market participants well understand it, and it should not be expanded. The proposed change is likely to create more uncertainty, and potentially generate unintended regulatory arbitrage opportunities.

Issuers should be in a position to choose whether they will issue public or private transactions, for commercial reasons, and not for regulatory reason. Therefore, the core aspects of the regulatory and prudential treatment should be equivalent for public and private transactions, cash or synthetic, etc... Regulation should be agnostic of the legal format of the transaction and focus on risk-sensitivity.

Admission to a trading venue should also not be a relevant criterion unless more narrowly defined to exclude secondary or technical listings.

Marketing on a non-negotiable basis to a broad range of investors may be relevant, provided that these criteria are strictly defined to cover only transactions where investors have no direct relationship whatsoever with the originator/sponsor and are free to trade their paper without permission.

**Question 5.11:**

**If you answered yes to question 5.10.,** what criteria should be used to assess point (3) in the definition above (i.e. a securitisation marketed (to a broad range/audience of investors) and the relevant terms and conditions are non-negotiable among the parties)?

N/A

**Question 5.12:**

If the definition of a public securitisation is expanded (for example, to encompass securitisations fulfilling the criteria set out in question 5.10), what share of your existing private transactions would now fall under this newly-expanded public definition?

N/A

**Question 5.13:**

Under Option 1, what would you estimate to be the impact (in percent or EUR) of changing the definition of public securitisation on your one-off and annual recurring costs for complying with Article 7?

Please explain your answer.

N/A

**Question 5.14:**

Assuming that transparency requirements are amended as suggested in Option 2, by how much would the volume of securitisations that you issue, or invest in, change?

N/A

**Question 5.15:**

What impact (in percent or EUR) would you anticipate Option 2 would have on one-off and annual recurring costs for complying with the transparency requirements in Article 7? Please explain your answer.

N/A

**Question 5.16:**

Under Option 2, what should be included in the principle-based disclosure requirements for investors to reduce compliance costs while ensuring access to information?

How should investors access this information?

Please explain your answer, listing all relevant information that you think investors need to do proper due diligence that could be common across all securitisations.

N/A

**Question 5.17:**

Under Option 2, should intra-group transactions, and securitisations below a certain threshold, be excluded from the reporting requirements in Article 7?

- Yes
- No
- No opinion

Please explain your answer. If you answered yes, how should intragroup transactions be defined and how should the threshold be determined?

N/A

**Question 5.18:**

Under Option 2, what would be the impact (in percent or EUR) on your one-off and annual recurring costs for complying with the transparency requirements of excluding intra-group transactions and securitisations below a certain threshold from the reporting requirements in Article 7?

Please explain your answer.

N/A

**Question 5.19:**

Should the text of Article 7 of the SECR explicitly provide flexibility for reporting on the underlying assets at aggregated level?

- Yes
- No
- No opinion

Answer to multiple choice:

- **Yes**

**Question 5.20:**

**If you answered yes to question 5.19.,** which categories of transactions should be allowed to provide reporting only at aggregated level? You may select more than one option.

- Granular portfolios of credit card receivables
- Granular portfolios of trade receivables
- Other

If you chose “other”, please explain.

Answer to multiple choice:

- **Other**

Explanation / justification / answer:

Granular portfolios of credit card receivables and Granular portfolios of trade receivables, as well as any granular consumer receivables should provide reporting only at aggregated level, but ALL highly granular portfolios should be exempt of loan-by-loan reporting.

In addition, for private transactions, it is useless to require extended mandatory reporting templates when the investors negotiate ad hoc template suited to their own requirements directly with the issuer.

Indeed, for most private securitisations, the reporting used by investors is not just for risk evaluation but also for the active determination of the borrowing base/ utilisation of the transaction. It therefore requires specific information, tests on eligible assets, concentration limits and dynamic calculations that are not part of the ESMA templates and require tailormade templates.

Most of these private transactions are not ECB eligible and not rated by the rating agencies.

In this context, there is no reason to provide detailed line-by-line information in a templated format. The level of



disclosure should only be negotiated on a bilateral basis between the seller and the involved investors, it being specified that the investors shall in all circumstances be able to conduct a proper evaluation.

With regards to asset classes such as factoring / trade receivables having a short maturity and a considerable number of receivables and for which no data template exists for the time being (except the esoteric underlying exposure), a granular LLD is not essential for risk analysis (and not feasible practically). In consequence, it will make sense for sponsors to address disclosure requirements at an aggregate level.

Nevertheless, we do not think it is necessary to remove LLD granularity for certain highly granular asset classes already covered by a dedicated template (such as residential mortgages) unless if it is at the discretion of the originator / issuer / originator (in particular those who have already developed the reporting infrastructure on these asset classes).

Indeed, the current templates are already in place and accepted for public deal issuers, in particular when transactions are eligible to the Eurosystem.

**In the specific case of private securitisations not distributed to institutional investors, such as warehousing lines**, issuers should be allowed to provide the ESMA reporting at aggregate level, in the same way as SECR allows ABCPs to provide ESMA reporting at aggregate level. This reporting can be complemented with a loan-by-loan reporting if requested by the investor.

Indeed, pursuant to Article 7(1) point a and subparagraph 4 of Article 7(1) of the SECR, ESMA reports must currently be generated on the level of individual loans. This also applies to private securitisations not distributed to institutional investors, such as ABCP transactions or warehousing lines. It creates unnecessary costs and efforts when collecting and processing data in the ESMA template format, when the investors already negotiate ad hoc reporting templates suited to their own requirements directly with the issuer. The mandatory requirement to create loan level reports should be removed for private securitisations where banks are providing the senior securitisation financing and not distributed to institutional investors.

The rationale is that, for private transactions where banks provide the senior securitisation funding and not distributed to institutional investors, such as ABCP transactions or warehousing lines, there is no need to require mandatory detailed reporting templates under ESMA format when the banks negotiate ad hoc template suited to their own requirements directly with the issuer. Indeed, for such private securitisations, the reporting used by banks acting as investors is not just for risk evaluation but also for the active determination of the borrowing base/ utilisation of the transaction. It therefore requires specific information, tests on eligible assets, concentration limits and dynamic calculations that are not part of the ESMA templates and require tailor-made templates. Such bespoke templates are contractually agreed between banks and the issuer and are the ones that banks used for monitoring the transactions. Hence the obligation to provide in addition ESMA templates for loan by loan and investor reports creates unnecessary costs and burden. Such private transactions are typically not ECB eligible and not rated by the rating agencies. In this context, there is no reason to provide detailed line-by-line information in a securitisation repository. The level of disclosure should only be negotiated on a bilateral basis between the seller and the involved investors, it being specified that the investors shall in all circumstances be able to conduct a proper evaluation.

**Question 5.21:**

If you are a supervisor, what impact (in percent or EUR) would you anticipate Option 2 would have on your supervisory costs?

N/A

## 6. Supervision

Securitisation entails many actors, in some cases also based in different jurisdictions. This can result in several national competent authorities being involved in the supervision of one transaction. Market participants cite that differences in the supervisory approaches of Member States create uncertainty. This has been raised in the Joint Committee of the ESAs' report on the implementation and functioning of the securitisation framework<sup>17</sup> and in the [Commission 2022 securitisation review report](#). Diverging supervisory practices create resource and cost inefficiencies due to the multiplication of common functions across many Member States. Divergence and ensuing legal uncertainty can create an unlevel playing field and are detrimental to the growth of the securitisation market and its proper functioning. In addition, fragmented responsibility and access to data can create loopholes and potentially lead to the emergence of risks. For these reasons, it is important to consider how to streamline and improve supervision in the EU to ensure consistency, better coordination, and a proportionate approach to avoiding divergent practices. This could be achieved through a more efficient and effective use of the existing powers which are allocated to the ESAs and competent authorities.

<sup>17</sup> See [ESAs report on the implementation and functioning of the securitisation regulation | European Banking Authority](#)

Ideas for improvement include the creation of supervisory hubs, building on the model of the SSM securitisation hub. In the case of cross-border transactions, a lead coordinator could be appointed under the joint oversight of the ESAs. NCAs' participation could be mandatory, requiring all or some NCAs to participate based on a set of relevant criteria. Alternatively, participation could also be voluntary so only interested NCAs join the new supervisory structure. This would, however, limit the degree of supervisory convergence that can be achieved. This section seeks to gather feedback in relation to these ideas.

Questions to stakeholders:

### Question 6.1:

Have you identified any divergencies or concerns with the supervision, based on the current supervisory set up?

- Yes
- No
- No opinion

Please explain and give specific examples.

### Answer to multiple choice:

- Yes

### Explanation / justification / answer:

Here are some concrete examples of divergences in approach among supervisors:

- Regarding the SRT assessment, we believe that the coordination between ECB central supervision and local regulators' supervision should be reinforced. For instance, we observed duplication of requirements on two SRT transactions, in France and in Italy.
- Regarding cash STS deals, redundancy of requests was similarly observed on a number of ABCP transactions implying a pan-European setup, between the French and other EU supervisors.
- In addition, there is a possibility that different national authorities form conflicting views on some interpretative points of the regulation, for example as regards the interpretation of STS criteria, as a reflection of the different views observed at the level of third-party verifiers on some specific points.
- Significant discrepancies exist between the ECB practices in the Eurozone and national authorities in non-Euro countries in the implementation of the SRT framework.
- There are also discrepancies in sanctions regime (administrative of penal)
- The supervision of TPVs also lacks harmonisation.

This situation is also due to the lack of fluidity of the Q&A process by ESAs, which leaves NCAs and market participants with long period where interpretations are not harmonized. The diversity of lending practices and European jurisdictions lead to fine interpretative judgements as to whether a particular securitisation does or does not meet a given STS criterion. The EBA Q&A process takes far too long, in some cases over 24 months. When in doubt, market participants may simply elect not to go the STS route. The EBA clarification process for STS should be reviewed.

**Question 6.2:**

Would you see merit in streamlining supervision to ensure more coordination and supervisory convergence?

- Yes
- No
- No opinion

Answer to multiple choice:

- **Yes**

**Question 6.3:**

If you answered yes to question 6.2., what should be the scope of coordinated supervision?

- STS securitisations only
- All securitisations
- Other (please specify)

Answer to multiple choice:

- **All securitisations**

**Question 6.4:**

If you answered yes to question 6.2., what should be the supervisory tasks of coordinated supervision?

- Compliance with Securitisation Regulation as a whole
- Compliance only with STS criteria
- Compliance with Securitisation Regulation and prudential requirements for securitisation
- Other (please specify)

Answer to multiple choice:

- **Other (please specify)**

Explanation / justification / answer:

The coordinated supervision should cover compliance with Securitisation Regulation and prudential requirements for securitisation, for all types of market participants, and also the SRT process.

Sharing or exchange of information between the ECB, ESAs and local supervisors should be developed in order notably to avoid the duplication of requests.

As regards Compliance with SECR as a whole and in particular STS, it would be helpful to have a single authority forming a consistent view on regulatory issues or requirements, for the sake of homogeneity and level playing field in the European market, including between Eurozone and non-Eurozone markets, and able to accelerate the Q&A process.

**Question 6.5:**

If you answered yes to question 6.2., which model would you prefer?

- Setting up supervisory hubs
- Having one national authority as lead coordinator in the case of one issuance involving multiple supervisors
- Another arrangement (please specify)

Please explain your answer

Answer to multiple choice:

- **Another arrangement**

Explanation / justification / answer:

Rather than a supervisory hub, that would be very complex to establish and may result in additional burden, we would support a better supervisory coordination through a knowledge hub, covering all member states, so that scarce expertise can be leveraged, interpretations would become more consistent and predictable, and this expertise could also be put at work to support the development of securitisation in smaller EU Member States where there is no critical mass for the supervisor to develop such an expertise.

Such a **knowledge hub** should be supported by a **regulatory hub**, for which the existing Joint Committee of ESAs on securitisation is a good starting point. As Paris Europlace has proposed in its September 2024 report, the Joint Committee on Securitisation should be empowered to drive the securitisation horizontal regulatory process in close liaison with DG-FISMA. Securitisation is a technical, and multifaceted topic, as there are multiple legal and regulatory texts addressing various aspects or types of regulated entities. Therefore, the capacity to ensure consistency, in both substance and timeline, across the various regulatory bodies involved is key to ensure a proper implementation and achieve the targeted outcome. An evolution of the role and governance of the Joint Committees could be envisaged as part of the upcoming ESAs review.

These hubs should work on the basis that dialogue with practitioners is essential. This dialogue must be permanent, transparent, and constructive. It needs to include the whole ecosystem, from investors to issuers, but also rating agencies, label providers, law firms, accountants etc... Such a variety of expert profiles do not exist in the existing ESAs Stakeholder Groups. A dedicated Securitisation Experts Group should be created to institutionalize the existing dialogue across various types of players, the Joint Committee, the supervisory hub, and involved national authorities. Leveraging the expertise of the Common Eurosystem Pricing Hub could also be very helpful on quantitative modelling aspects such as valuation, stress testing etc... The EIF could also play an important role, as a major EU-wide participant in the securitisation market, with extensive expertise and risk management capabilities, across the whole EU.

Finally, data sharing across ESAs and competent authorities, including macroprudential ones should be organised, to limit duplicative request, and to replace the current fragmented view that each institution has on its own part of the market, by a holistic view which is essential to monitor financial stability.

**Question 6.6:**

If you answered yes to question 6.2, would you require participation by all NCAs or only some?

- All
- Some
- No opinion

Answer to multiple choice:

- **All**

**Question 6.7:**

If you answered “Some” to 6.6., based on what criteria would you select NCAs? Please specify.

N/A

**Question 6.8:**

If you are a supervisor, how would the changes to supervision suggested in the previous questions affect your supervisory costs?

N/A

## 7. STS standard

The STS standard identifies criteria for simplicity, standardisation and transparency designed to address those aspects of the securitisation practice that had proven problematic during the global financial crisis. It aims to address and mitigate major drivers of operational and agency risks arising in securitisation, by enabling investors to differentiate STS-designated products from more opaque and complex ones.

In recognition of their less complex structure, STS positions entail lower capital requirements than non-STS in the banking and insurance prudential regulations. It was expected that the introduction of the STS standard in the EU would have a significant positive impact on the scaling up of the EU securitisation market, by incentivising standardisation of the securitisation transactions across the EU and attracting new issuers and investors to the market. Stakeholders have flagged some of the STS criteria as burdensome to comply with or otherwise constraining further development of the STS market. Such criteria include the homogeneity of underlying assets, the collateral requirement for on-balance-sheet securitisations, the ban on including exposures to credit impaired obligors, the information to be provided prior to pricing and/or closing, and others.

In order to protect the integrity of the STS standard, it is important to ensure that a transaction that is notified as STS really complies with the criteria. Third-party verifiers (TPVs) are a voluntary, but important link in the chain of verifying that a securitisation complies with the STS criteria, alongside originators, sponsors, national competent authorities and investors. However, in the current text of the SECR, TPVs are authorised at national level but are not supervised after authorisation, and they do not lift the ultimate responsibility from the originator and sponsor for ensuring compliance with the STS criteria.

Some indications suggest that the STS label has been successful – the label is used by the market and recognised by investors. Moreover, some transactions appear to be structured almost exclusively to be STS-compliant, such as prime residential mortgage-backed securities (RMBSs) and auto-loans asset backed securities (ABSs). On the other hand, the size of the securitisation market in general has not shown significant recovery since the introduction of the STS label, and STS-compliant transactions amount to less than half of the public securitisation market, which in itself represents a declining portion of the overall securitisation market. This section seeks stakeholders' feedback on the use of the STS label, including how to increase its attractiveness for both originators and investors.

Questions to stakeholders:

### Question 7.1:

Do you think that the STS label in its current form has the potential to significantly scale up the EU securitisation market?

- Yes
- No
- No opinion

Please explain.

Answer to multiple choice:

- No

Explanation / justification / answer:

The answer is 'No' because the question refers to the 'current form' of the STS label. **While Paris Europlace supports the concept of an STS framework**, the label did not bring to the market the hoped-for new originators or investors. EBA and AFME figures evidence that the STS market share is quite low (around 35% of the 2023 total issuances of € 213 bn – including retained issuance) and that the STS issuance amounts placed in the

market are disappointing. The total amount of STS issuance in 2023 in Europe is € 76 bn, with € 44 bn placed in the market, a level that is far from the € 800 bn per year of additional financing needs announced by M. Draghi...

However, Paris Europlace believes that the STS label has the 'potential to significantly scale up the EU securitisation market', **if and only if, its usability is improved. In addition, improvements in the STS rules should not be done to the exclusion of the necessary improvements of the prudential and regulatory framework for Non-STS.** Practitioners and investors are fully convinced that both traditional and synthetic Non-STS securitisations add value by financing the European economy both by enhancing capital allocation efficiency and by diversifying funding sources.

Therefore, while improvements in the current STS framework would help, in itself, it would be insufficient to significantly scale up the EU securitisation market.

A 'significant scale up of the EU securitisation market' can occur by **addressing the supply side and demand side.** By addressing the issues that affect all types of securitisations, **STS and Non-STS, traditional and synthetic,** the STS label can benefit from the overall market development and represent a be a significant contributor to scaling up the EU securitisation market.

As stated in the September 2024 Paris Europlace Securitisation Report, **the targeted reforms that are needed should be implemented as a package,** given challenges and solutions are different between:

- transactions originated or invested by regulated banks (subject to CRR/CRD) and other types of issuers;
- regulated insurers (subject to Solvency 2) investing in funded instruments or offering unfunded insurance protection and other types of institutional investors;
- senior tranches of public transactions issued for funding purposes (with the LCR impact) and retained senior tranches of private SRT securitisations; and
- risk-bearing non-senior tranches from the STS and Non-STS segments;

noting also the different scopes of application of prudential regulations (EU banks, EU insurers), and of the securitisation regulation SECR (covering all transactions, STS and Non-STS, and all issuers and investors acting in the EU, including when involved in third country transactions).

Given the diversity of the securitisation market (by asset class, type of issuers, investors, structuring features...), a cherry-picking approach, consisting of targeting a specific market segment, or a specific challenge, would be counterproductive as it would not offer the critical mass that issuers and investors need to invest in resources. Indeed, for teams to originate, structure, analyse and monitor securitisation transactions a too small niche within the already subscale securitisation market is not sufficient. Examples of past attempts were to focus on SME securitisation, NPL securitisation, and now green securitisation. If the securitisation framework is appropriately repaired, there will be SME securitisations, NPL securitisations, green securitisations, and in much larger amounts than if sub-niches are addressed in isolation. Indeed, such niches in the niche cannot prosper without a dynamic overall securitisation ecosystem that can attract new investors. Therefore, Non-STS transactions are as relevant as STS transactions to foster the CMU and greatly contribute to the very large financing required for the green and digital transitions of the European economy.

The EU led the way to develop a Simple, Transparent and Standard (STS) framework, which was closely followed in Basel by a (much less restrictive) Simple, Transparent and Comparable (STC) framework. The EU has already taken the lead by expanding the STS framework to synthetic securitisations, acknowledging that financing and risk transfer are both mandatory conditions to enable market growth. The Agency RMBS issued by US GSEs are STS compliant for all issuer-related requirements, which is another testimony of the value of EU STS regulations.

**The EU should take the lead once again** to design a new, more proportionate and risk sensitive framework, supporting a prudent and responsible development of the EU securitisation market. It should not wait for BCBS to solve its problems for the financing of the European economy.

Should the EU decide to implement the required targeted reforms on the demand and supply side, then Paris Europlace expects the STS label to increase its share in a significantly scaled up EU securitisation market.

**Question 7.2:**

Which of the below factors, if any, do you consider as holding back the expansion of the STS standard in the EU? You may select more than one option.

- Overly restrictive and costly STS criteria
- Low returns
- High capital charges
- LCR treatment
- Other

Please explain.

**Answer to multiple choice:**

- **Overly restrictive and costly STS criteria**
- **Low returns**
- **High capital charges**
- **LCR treatment**
- **Other**

**Explanation / justification / answer:**

Issues related to ‘High capital charges’ (and associated ‘Low returns’ (risk-adjusted returns on capital)) and ‘LCR treatment’ are discussed later in this consultation. Paris Europlace focusses in this answer on: ‘Overly restrictive and costly STS criteria’, and ‘Other’.

**1 - Overly restrictive STS criteria (excluding whole areas of the real economy)**

Some asset classes can easily meet the 100+ STS criteria are (e.g., residential mortgages, consumer loans, retail SMEs, etc.). Other assets such as trade receivables, SME loans, corporate loans or revolving credit facilities, most specialised lending (infrastructure financing and energy-based financing that are critical to the green energy transition agenda, commercial real estate loans, transportation – rail, aviation and shipping – financing), mixed and cross-border loans, fail on one or several STS criteria; they are, partially or generally, Non-STS.

Examples of how some STS criteria exclude real economy assets:

- Small banks managing small pools cannot achieve easily portfolios meeting the granularity or homogeneity criteria.
- Some underlying assets cannot meet the STS criteria “repayment not predominantly based on sale of assets”, such as car fleet and car rental deals.
- Commercial vehicles or equipment leasing companies have leases that cannot meet the STS criteria for ABCP (assets residual maturity less than 6 years and the weighted average life of the assets less than 3.5 years).
- The “Criteria for STS securitisations qualifying for differentiated capital treatment” requiring a minimum risk weight at each individual exposure level excludes portfolios of leasing, trade receivables or SMEs.

Examples of how some STS criteria exclude counterparties:

- New issuers (such as Fintechs) that cannot meet the 5 years historic data requirement are excluded.
- Revolving warehouses financing the assets funded before the first payment is made.
- Unfunded credit protection providers ((re)insurers) who are excluded from the Synthetic SRT STS market.

**Crucially, let us keep in mind that the SECR framework (retention, due diligence, disclosure...) applies to both STS and Non-STS transactions, with more stringent rules on non-STS than required by Basel STC principles.**

In addition, SRT requirements provide an additional level of safeguards for both STS and Non-STS.



Therefore, the de-risking of the European securitisation market achieved by all the post-GFC reforms that apply also to both STS and Non-STS would justify, from a risk-based and financial stability perspective, a better treatment.

This is important to avoid a potential cliff effect in case an STS transaction loses its label (see question 10.12 for explanation on the “financial guillotine”)

## 2 – Costly STS criteria

Counterparties need strong dedicated resources for the STS label. The associated costs include:

- developing IT reporting, in addition to existing reporting (maintained);
- implementation of dedicated systems and procedures;
- additional audits for synthetic transactions.

For private ABCP corporate securitisations, the requirements and responsibilities falling on corporate clients go much beyond other financial products backed by the same assets (e.g. factoring).

If any modification or new interpretation of the STS framework occurs, maintaining the STS label should always be assessed through a grand-fathering clause.

## 3 – Synthetic STS (Problem with Article 26e SECR)

Many EU banks are limited in their capacity to use securitisation as they have no access to the STS label, notably smaller and mid-sized SA banks.

Given the gap between STS and non-STS floor on the retained senior tranche, banks in general depend on the STS capital efficiency to make transaction economics work.

However, some banks are unable to meet the Article 26e STS requirement, for example in the following cases:

- the bank is domiciled in a country with CQS 3 rating (BBB) or lower which limits their own rating due to sovereign rating ceiling;
- the bank is domiciled in an EU country that is not part of Euro currency, and so cash collateral is more costly. A Euro SRT contract is less effective due to currency mismatch haircuts.

For these banks, the most viable solution is the simplest and cheapest execution of all: an unfunded guarantee contract. However, for STS, Article 26e only authorises public entities to provide such contracts. If highly rated (re)insurance companies would also be eligible for STS then these banks would have plenty more options to realise SRT projects at an acceptable cost, which would benefit the local economy and improve the level playing field across Member states and between IRB and SA banks.

### Question 7.3

How can the attractiveness of the EU STS standard be increased, for EU and non-EU investors?

#### 1. International attractiveness:

Following the strong objections made in 2014 by EU public institutions to the calibration of the prudential treatment proposed by the Basel Committee on Banking Supervision (BCBS) in December 2013, the idea of transforming the concept of High Quality Securitisations (HQS) into Simple, Transparent and Standardised (STS) securitisations was born.

With the help of the International Organization of Securities Commissions (IOSCO), BCBS adopted many concepts from the European STS, and this became the 2016 Basel Simple, Transparent and Comparable (STC) label.

Only a few countries (EU, UK, Canada, South Africa, China (except for ABCP), Australia) have onboarded the ‘optional’ STC label. For the EU and UK, **the 2018 STS label corresponds to the STC label which has been burdened with additional criteria (hence significant goldplating).**

Post-Brexit, it is key that the EU set up an equivalence regime between the EU and UK STS frameworks, otherwise this unduly restricts investment options for investors located in the EU (or this makes them more onerous while UK investors recognise EU STS from a prudential perspective). At present, the UK has extended

to EU STS label the same prudential benefits as to UK STS label until 1<sup>st</sup> July 2026. At the same time, the UK STS label is not prudentially recognised in the EU. This significantly reduces the pool of investable STS securitisations for EU investors, and this reduces the attractiveness of the STS label internationally.

Japan has adopted the BIS guidelines for STC, and domestic transactions have been granted the relevant STC label. There is an understanding that the Japanese regulator can accept STC label for foreign transactions both from jurisdictions with the relevant STC framework. It is the responsibilities of the Japanese investor in such STC transactions to justify their treatment as STC under Japanese regulatory framework.

In the case of Australia, the STC label is not used by issuers, as no prudential or regulatory benefits have been granted.

Given the disparity in implementation, access to international markets are quite fragmented. Convergence should be promoted at least on substance, to allow for equivalence, without requiring the full compliance to EU complex disclosure requirements, as long as decision-relevant information is made available, and is commensurate with the risk of the instrument.

## 2. Intra-EU attractiveness:

Mentioned in the September 2024 Paris Europlace Securitisation Report are the need to address the prudential treatment for (re)insurers of Non-STIS securitisations (Recommendation 4) (and discussed in Section 10 of this consultation) and to make Synthetic STS an investable market for credit protection providers who conduct their business on an uncollateralised basis (Recommendation 5) (and discussed in questions 7.4 to 7.8 of this consultation). Those two fundamental issues are the EU's own making, and their resolution relies solely on the EU authorities (European Commission, Council of the European Union, European Parliament), and not on international agreements.

For potential EU-investors, the administrative sanctions by Competent Authorities and criminal sanctions by Member States (respectively Articles 32 and 34 of SECR) may also be a deterrent. See our answers to questions 4.18, 4.22 and 4.23.

## 3. Market attractiveness with increased STS issuance:

The attractiveness of the STS market for investors would increase if there were more STS issuance. For this, some technical parameters present in Level 1 text (rather than in Level 2 or Level 3) need amending.

For example, Article 243 (*Criteria for STS securitisations qualifying for differentiated capital treatment*) of the CRR should be deleted, or at least amended (see answer to question 9.7 on this subject).

The LCR treatment of Senior STS transactions would also be a game changer. Overall, implementing the package of recommendations included in this consultation would concur in making securitisation more attractive, of which the STS segment should be an important part, if some current impediments as explained above are removed.

### STS criteria

#### Question 7.4:

In the case of an unfunded credit protection agreement<sup>18</sup> agreement where the protection provider provides no collateral to cover his potential future liabilities, should such an agreement be eligible for the STS label, to facilitate on-balance-sheet STS securitisations?

<sup>18</sup> According to Article 26e(8)(c) eligible credit protection for STS on-balance-sheet securitisation should be "secured by collateral meeting the requirements laid down in paragraphs 9 and 10 of this Article".

- Yes
- No
- No opinion

Answer to multiple choice:

- Yes

**Question 7.5:**

**If you answered yes to question 7.4.,** what safeguards should be put in place to prevent the build-up of financial stability risks arising from the provision of unfunded credit protection?

- The protection provider should meet a minimum credit rating requirement.
- The provision of unfunded credit protection by the protection provider should not exceed a certain threshold out of their entire business activity.
- Other

Please explain.

Answer to multiple choice:

- **The protection provider should meet a minimum credit rating requirement.**

Explanation / justification / answer:

The answer to question 7.4 is ‘Yes’. The answer to the associated question 7.5 needs context.

**The terminology ‘unfunded’ does not refer to the funding equivalent that an issuer receives as part of traditional securitisations, but to the presence or not of collateral against a guarantee,** and thus ‘unfunded STS’ means ‘uncollateralised STS’. While the market and SECR use the terminology ‘unfunded’ credit protection, a more appropriate and legally exact terminology would be ‘uncollateralised’ credit protection, because a collateralized credit protection should not be seen as funding, the collateral being segregated and hence not available for funding new loans.

The presence of collateral against a guarantee has nothing to do with the technique of securitisation *per se*. Whether a collateral requirement is needed against a guarantee is dependent on the counterparty that provides the protection. There are already criteria in the CRR on credit risk mitigation (CRM), and there is no reason to add additional safeguards specific to securitisation.

The issue of “uncollateralised STS” arises since the STS label was enlarged to Synthetic transactions, as part of the Capital Markets Recovery Package (CMRP). This text contained a complex interactions of rules that makes the STS market non accessible for unfunded credit protection providers apart from public banks. Only the non-STIS market remained investible for EU (re)insurers acting as credit insurers, although this activity is not a priority for French insurers. (see September 2024 Paris Europlace Securitisation Report -Recommendation 5 for details)

The problem is not caused by the banking CRR, it is created in the 2021 amendment of the SECR. **Unintended market fragmentation, detrimental to the European economy, should be fixed as soon as possible.**

If a bank enters into an unfunded synthetic SRT securitisation, it takes the risk that the protection seller may not honour its contractual obligations to compensate the bank for losses on the pool. This risk is already fully accounted for in the CRR framework. The bank must allocate capital to this counterparty risk: for a AAA/AA rated counterparty, a 20% risk-weight capital requirement on the protection is imposed.

The Credit Mitigation Rules (CRM) of the CRR already defines eligible providers of unfunded credit protection as well capitalised entities having an external rating equal or better than CQS 2 (i.e., AAA, AA and A) when a transaction is signed, and that it should be maintained at CQS 3 or better (i.e., AAA, AA, A and BBB) during the life of the transaction for the credit protection to remain uncollateralised.

The CRM framework also includes provision by which the exposure of the bank to the provider of unfunded credit protection must be capitalised, according to the usual credit framework, by which the RW of the exposure varies as a function of the credit quality of the counterparty. This rule applies to uncollateralised securitisation

and **there is no need to add any further safeguard specific to securitisation in the SECR regulation, from a micro-prudential perspective.**

Some market participants have also suggested that the unfunded protection provider could be a non-regulated entity such as an SPV provided that such entity is itself fully collateralised and the collateral is ringfenced. In other words, the collateralisation could be taken into account whether it is posted to the protection buyer or ringfenced in favour of the protection buyer at the level of or on behalf of the protection provider.

**Question 7.6:**

What would be the implications for EU financial stability of allowing unfunded credit protection to be eligible for the STS label and the associated preferential capital treatment?

By definition, risks to overall financial stability are macro-prudential risks that arise from the accumulation of vulnerabilities. The question whether allowing unfunded synthetic SRT transactions could result in an excessive growth of this market segment, leading to the build up of financial stability risks, is therefore legitimate.

Examples of such financial stability risks could include hypothetical situations where a majority of those transactions were all backed by a handful of counterparties, or counterparties in the same jurisdiction, or counterparties all exposed to correlated risks. A concern expressed by bank supervisors has also been that providers of protection may be unable, or unwilling to provide protection at times where it would be most needed by the banking sector.

Fundamentally, the answer to the question depends on the type of counterparty that provides the uncollateralised credit protection. The reliability of the counterparty is taken into account in the CRR rules, and also, on a case-by-case basis, by the ECB when assessing the Significant Risk Transfer. If the competent authority had doubts about the capacity of the counterparty to comply with its commitment, it would consider that the credit risk has not been efficiently transferred, and the SRT assessment would be negative, resulting on the banks having no capital benefit (and, in all likelihood, renouncing to the transaction).

From originating banks' perspective, until highly regulated, well-capitalised and well-diversified EU and non-EU credit protection providers are allowed to provide credit protection to synthetic securitisations with the STS label, the choice of risk-takers is restricted. Broadening the choice of available risk-takers would enable banks:

- to reduce their costs on synthetic STS transactions by increasing competition;
- to have access to high quality regulated counterparties with 'permanent' capital, i.e., that will be present in the market during periods of financial stress (unlike credit hedge funds currently present in the STS market with leveraged collateral) and are not sensitive to the same factors of systemic risk;
- to increase capital velocity which directly benefits the European economy, contributing to growth and economic resilience;
- to increase their volumes of SRT STS transactions and thus more risks would be transferred away from the European banking system;
- In case of crisis, to benefit from a proven, well-established credit protection framework to limit their credit losses on the protected portfolios, reducing negative impact on their capital adequacy, and helping them to continue lending to the economy.

**Allowing the participation of highly-regulated, well-capitalised and well-diversified credit protection providers on an uncollateralised basis in the market eligible to the STS label would actually improve financial stability.**

**Question 7.7:**

How would allowing unfunded credit protection to be eligible for the STS label and the associated preferential capital treatment impact EU insurers' business model of providing credit protection via synthetic securitisation (for example, would EU insurers account such transactions as assets or as liabilities)?

Please explain your answer.

European credit (re)insurers are well-rated, well-capitalised, and well-diversified. Quite a few are specialised and play a vital role in the economic fabric, being central to trade finance, to corporate loans, to specialised lending, to banks' limit management on a single name basis, and increasingly to banks' capital management on a portfolio basis with synthetic securitisation. Their participation in those markets is on an uncollateralised ('unfunded') basis, with the (re)insurers settling in cash the claims when they occur. This is a fundamental tenet of insurance that liquid assets, such as cash, is held for honouring claims of clients and customers when they arise; they are not to be used as collateral against all potential scenarios of future claims.

(Re)insurers can play **two complementary roles** in securitisation and are in the scope of **prudential regulations** (Solvency II) and **supervisory oversight** dedicated to their investments/risk taking in securitisation transactions.

1. As **funded ('cash') investors on the asset side of their balance-sheet**, (re)insurers can hold bonds in true sale securitisations, and/or credit linked notes (CLNs) (direct or via an SPV) in synthetic on-balance-sheet securitisations.
  - Because there is an underlying assumption in the regulatory capital charge calibration for (re)insurers that they will sell their assets under distressed market conditions, these investments are treated as "market risk" ('spread risk shocks') under Solvency II. The capital charges for STS are less unfavourable than for Non-STs.
  - The originator bank issuing STS CLNs is exposed to collateral management issues, having to maintain cash on deposit being at least CQS 2 (which means that countries such as Italy were until recently unable to execute STS transactions – the problem was fixed in June 2024 with a granting by the EBA of a regulatory exemption given to Consob, lowering the requirement to CQS 3. To the best of our knowledge, the exemption has not been granted to far to any other Member State, in particular, to Central and Eastern European countries in a similar situation).<sup>3</sup>
2. The credit insurance arm of well-diversified<sup>4</sup> non-life (re)insurers can also provide **uncollateralised ('unfunded') credit protection from the liability side of their balance-sheet**, and cover losses in specific tranches of securitisations. Accessing or not the STS label will not change the risk appetite of those (re)insurers that do **not** provide credit protection.
  - Contracts can take the form of credit insurance policies, non-payment insurance, risk participation agreements or guarantees. These contracts are treated as "Non-life underwriting risk" in Solvency II regulation. The strategy is to hold the risk.
  - As stated by the EBA in its October 2024 report on credit insurance: "**It is worth noting that no default on credit insurer has been observed in the EU.**"<sup>5</sup> In the unlikely event of an insurer defaulting, these credit protections that are underwritten are – by Solvency II – senior to bondholders and other non-insurance credit obligations of the insurer. Thus, their recovery rates in Europe should be high. This is linked to the strong regulatory regime to which (re)insurers are subject to.

With regard to the **business model itself**, (re)insurers allocate capital to various activities, based on their business strategy, asset and liabilities management and other parameters. This allocated capital is then deployed where investment opportunities exist. The fact that Europe has reduced investment opportunities to European (re)insurers in the synthetic securitisation area, by forbidding them (albeit inadvertently) to provide credit protection on their liability side to originating banks executing STS transactions has led to three important consequences:

- a) Investment teams specialising in securitisation products do not grow to their full potential in Europe.
- b) European (re)insurers are not fully able to build the diversified portfolios that they would like to create, across European countries, across SA and IRB banks, across the asset classes in which they have expertise.
- c) Europe has global champions in the (re)insurance sector. Global (re)insurers invest globally, and allocated capital that could have been deployed in Europe on synthetic STS is currently deployed in other regions of the world where they are eligible.

Paris Europlace supports adding a new point (d) in Article 26e(8) of SECR to explicitly say that highly regulated, well-capitalised and well-diversified (re)insurers (under Solvency II or equivalent) can provide banks with uncollateralised ('unfunded') credit protections guarantees on securitisation benefiting from the STS label. **The credit risk mitigation rules (CRM) that would apply are the ones currently present in the CRR.**

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<sup>3</sup> EBA/Op/2024/03, June

<sup>4</sup> Well-diversified insurance companies have sophisticated risk managers applying industry standard diversification techniques.

<sup>5</sup> EBA/Rep/2024/21, October

**Question 7.8:**

If you are an originator, what impact on the volume of on-balance-sheet securitisations that you issue do you expect to see if unfunded credit protection becomes eligible for the STS label and the associated preferential capital treatment?

According to a survey done by IACPM (April 2024), the volume of transactions executed by (re)insurers in the classic uncollateralised ('unfunded') format shrank in 2023 compared to 2022, despite credit protection providers' growing appetite for credit risk. The reason is that the non-STs portion of the market is reducing, with the STS portion increasing, as policymakers intended.

Opening STS eligibility to unfunded credit protection investors may increase and diversify demand in the market, foster competition and eventually lead to larger securitisation volumes. Also, some asset classes (e.g., residential mortgages, specialised lending, transaction banking) are historically better known by (re)insurers: at least in the first few years, banks would expect STS transactions to be originated from these asset classes (subject to STS criteria) and distributed to unfunded credit protection providers if such credit protection format became eligible to STS.

**Question 7.9:**

**If you answered no to question 7.4.,** do you see merit in expanding the list of eligible high-quality collateral instruments in Article 26e(10) to facilitate on-balance-sheet STS securitisations?

- Yes
- No
- No opinion

Answer to multiple choice:

- **Yes**

**Question 7.10:**

**If you answered yes to question 7.9.,** which high-quality collateral instruments should be added to the list?

Although the answer to question 7.4 is 'Yes', Paris Europlace is of the view that the requirement to hold cash collateral in a third-party bank that is CQS 3-rated or better is equivalent to holding a standby letter of credit (LOC) of bank that is CQS 3-rated or better.

A standby letter of credit (LOC) is an unfunded instrument. It has the same strength as a first demand guarantee from a similarly rated institution; it has the same strength as a guarantee from a CQS 3-rated or better, multi-line (re)insurance company.

When the cash is held by the originator bank, the rating requirement is increased to CQS 2 or better. But only for STS.

However, regulators should take a step back and think about the financial stability implication of SECR Article 26e(10). This article imposes to move the collateral away from the third-party bank when it is downgraded to below CQS 3, or when the originator bank is downgraded to below CQS 2. And if this is not possible, it would cause the SRT transaction to end, with the risk-weighted assets returning back on the originators' balance sheet.

It is difficult to understand why STS-related collateral requirement should differ from normal practices. Serious thoughts should be given as to whether it is better to remove SECR Article 26e(10) altogether and rely instead on the sound Credit Risk Mitigation techniques that are already in place in the CRR for all the other asset classes.

This would enable banks requiring collateral to use other forms than cash, and to remove the maximum maturity

(currently three months), by contemplating longer securities subject to higher over-collateralisation level, agreed between the parties (or any other security agreement to remove the bank counterparty risk for investors).

Furthermore, removing Article 26e(10) would level the playing field in Europe. One reason many banks in Italy did not issue SRT STS is linked to the country sovereign rating ceiling. It was impossible for Italian originator banks to retain the cash deposit, as they could not be CQS 2. That was until the Italian Consob obtained in 2024 a derogation from EBA (EBA/Op/2024/03), allowed under the CRR, to lower the CQS threshold for Italian originator banks. No such derogation has been granted so far to similarly rated countries in the Central and Eastern Europe.

**Removing this requirement would be an essential step to allow all EU member states to participate in the SRT securitisation market, allowing their banks to play their part in the financing of EU green and digital transitions, which is especially crucial in Member States where domestic capital markets are underdeveloped.**

**Question 7.11:**

What would be the implications for EU financial stability of extending the list of high-quality collateral arrangements under Article 26e(10)?

While Paris Europlace is of the view that serious thoughts should be given to the full removal of Article 26e(10), to revert to the usual CRR CRM framework, we would also be in favour of extending the list of high-quality collateral arrangements under Article 26e(10), also to improve financial stability.

There are legal arguments that can be found in the September 2024 Paris Europlace Securitisation Report (Recommendation 5), proposing the authorisation of Letters Of Credits from well rated banks from 2025 as a ‘quick win’ or ‘quick fix’ until the legislation is amended to authorise uncollateralised credit protection from appropriate counterparties for STS transactions.

**Addressing the issue of banks/member states that are not allowed to hold the cash due to their sovereign rating would also improve financial stability in the EU, as it would develop private risk sharing across the EU.**

Some market participants have proposed to extend the list of suitable collateral, with EIB issues (longer dated) paper in non-EUR currencies as well. If longer-dated collateral would be STS eligible (with appropriate haircut/margining) this would very suitable for CEE countries.

**Question 7.12:**

Do the homogeneity requirements for STS transactions represent an undue burden for the securitisation of corporate loans, including SMEs? Please explain your answer.

The following is an extract from the September 2024 Paris Europlace report (Appendix 7 – Ideas for the STS framework) that discuss some issues linked to the homogeneity requirements.

Article 20.8 (On Homogeneity): Criteria is prone to restrictive interpretations, which especially impacts smaller specialised-lender originators by preventing them to reach critical mass for public transactions. For instance, could Consumer Loans and Auto Loans which do not benefit from the pledge of the vehicle constitute a homogenous asset class? Same question for German and French portfolios originated by a single Fintech or regular Residential Loans backed by a mortgage mixed with Residential Loans guarantees by other financial assets (Lombard loans).

At the very least, market participants should have the ability to receive guidance from the EBA on these subjects within a reasonably short timeframe.

Relative size of sub-portfolios in question should also be considered, to avoid that fringe questions on homogeneity affecting 10% of a pool jeopardize the STS status of the entire transaction.

Also, compatibility with pan European programs shall be clarified with the supervisor. For instance, can an originator bundle French and German consumer loans originated by the same sponsor if underwriting and servicing procedures are defined consistently across different jurisdictions?

The issues discussed above **do not represent an undue burden** for the securitisation of corporate loans, including SMEs, but are **an obstacle for some originators – especially the pan-European ones**.

However, to change the STS standards on the homogeneity criteria as an issue is the equivalent of treating symptoms rather than root causes. The pressure comes from the fact that many transactions cannot be executed under the numerous penalties associated with the Non-STS status (the capital cost is high: twice the capital surcharge, a floor that is 50% more expensive). If the Non-STS treatment were more aligned with actual risks, real economy transactions could be executed under the Non-STS format at acceptable costs, without having to lower the homogeneity standards for STS.

Furthermore, on a non-technical level, the homogeneity criteria is a ‘Simplicity’ criteria. To mix assets from different jurisdictions and/or different servicers and/or originators will make the transactions more ‘complex’ from a risk analysis point of view.

Finally, if the various targeted amendments on prudential, due diligence and disclosure considered in this consultation are implemented, this will reduce fixed costs of transactions and make smaller securitisations viable. There will be less need to reduce homogeneity criteria, and it will facilitate the deployment of the securitisation technique in smaller Member States.

**Question 7.13:**

Should the STS criteria (for traditional, asset backed commercial paper (ABCP) or on-balance sheet securitisation) be further simplified or amended? Please explain your answer and provide suggestions.

- Yes
- No
- No opinion

Answer to multiple choice:

- **Yes**

Explanation / justification / answer:

The September 2024 Paris Europlace report (Appendix 7 – Ideas for the STS framework) discuss what should be done with regards to the STS criteria. For more detail, the reader is invited to read the report.

Paris Europlace supports a simplification of the STS criteria via their entire removal or their amendment. Adding criteria to the pre-existing ones, as “safeguards” should be avoided!

For traditional STS securitisations (including ABCP):

- The territoriality provision in article 18 may be viewed as too restrictive for some private pan-European securitisations notably in the context of ABCP transactions. This can be addressed by enabling the transactions with non-EU originators to be eligible to the EU STS label when the sponsor bank is an EU-regulated bank (and, naturally, the transaction fits all the other STS criteria).
- In relation to articles 20(1) and 24(1), securitisations in the context of private ABCP transactions should qualify for the STS label even if no SSPE is involved, notably for full-support ABCP programs;
- In relation to article 20(11), the credit-impaired obligors criterion should be significantly simplified and/or lightened, especially for corporates, since those obligors can still be acceptable risks (e.g. secured auto loans or trade receivables).
- Besides, a recognition of the UK STS label (equivalence regime) would be welcome for EU institutional investors currently facing a competitive disadvantage.
- In relation to article 22(1), the length of historical data to be provided for STS qualification (currently 5 years or 3 years for trade receivables or other short-term assets) should be reduced.



In relation to article 24(15), the criterion limiting residual maturity should be removed, or at least significantly extended (this would be particularly relevant for the corporate movable property leasing industry).

Below are some highlights for Synthetic STS:

- Pool homogeneity (criterion 26.b.8) is understandable, however this requirement can lead to limitation for certain businesses (despite the relevant RTS on homogeneity), e.g., excluding very diversified trade finance portfolios including Corporate & Financial Institutions borrowers or excluding cross-border portfolios which include SMEs and other businesses.
- The requirement to specify the servicing procedures that apply to the underlying exposures (criterion 26.c.7(c)) is not appropriate, as the bank usually needs to draft a specific document as a synthesis of servicing procedures with a focus on the relevant asset class, while this requirement is already fully addressed during the on-site due diligence performed by the investors.
- Criterion 26.e.4: exhaustive verification of the Eligibility Criteria by the Verification Agent is not always appropriate in the case the eligibility criteria to be verified are not 'factual'. This requirement should instead be addressed by the originator through appropriate representations and warranties in the documentation.
- Criteria 26.e.8 and 26.e.10: the requirements on the collateral are too restrictive:
  - Unfunded protection provided by highly-regulated, well-capitalised and well-diversified credit protection providers should be allowed for the STS transactions. So, there should not be any financial stability risk here. In addition, the interim credit protection payment should be viewed as sufficient to secure the payment under the credit protection.
  - Unfunded upper mezzanine tranche should also be allowed when low mezzanine and first loss tranches are funded. This would improve financial stability.
  - In addition, for the derogative treatment, the Credit Quality Step (CQS) 2 rating requirement may be a concern for some originating banks whose rating is limited by the country rating ceiling (e.g., CEE banks). This paragraph should be amended to allow a rating being a minimum between CQS 2 and the country rating.
  - Debt securities as collateral: more flexibility should be introduced regarding the maximum maturity (currently three months): e.g. allowing longer maturity securities subject to higher over-collateralization level, to be agreed between the parties (or any other security agreement to remove the counterparty risk for the investors). In addition, letters of credit should be allowed as an alternative to collateral in the form of cash held with a third-party credit institution.

## Third-Party Verifiers (TPVs)

### Question 7.14:

On a scale of 1 to 5 (1 being the least valuable), please rate the added value of TPVs in the STS securitisation market.

1 / 2 / 3 / 4 / 5

Please explain.

### Answer to multiple choice:

- 5

### Explanation / justification / answer:

The answer to question 7.14 is “5” (5 being the most valuable). But to understand the rating of the ‘added value’ of Third-Party Verifiers in the STS securitisation market, some historical context is necessary.

Unlike other market participants, TPVs are a creation of securitisation regulation. Their role did not exist before the STS regulation.

In 2015, when the large number of criteria (100+) that needed to be complied with became public, securitisation investors explained to the European Commission and the European Parliament that they had no intention to check all the criteria themselves given the already considerable burden of Article 5 (due diligence of SECR). The counterproposal at the time was that investors should rely on the representations of the originator. The European Parliament refused, asserting that one of the causes of the Global Financial Crisis was the result of securitisation investors not doing their due diligence and relying on the representations of originators. It was unimaginable that STS, a solution to the problems perceived as inherent to securitisation, would therefore be based on the absence of due diligence and trust in the originators.

A compromise was sought by the European authorities that suggested that, maybe, the burden of checking the compliance with 100+ STS criteria would be done by regulators or supervisors. That idea was short lived... and replaced with a new idea: independent entities would do the checks; they would be paid by originators but working for the benefit of investors.

But, in order to avoid the recurrence of the problems that surfaced during the crisis with the rating agencies, it went without saying that these entities should be approved and supervised. Hence the TPVs.

It was never the intention of the European Parliament to create TPVs to lift the ultimate responsibility from the originator and sponsor for ensuring compliance with the STS criteria. It was to help investors, by ensuring that the burden of compliance does not end up, in its entirety, on investors.

Below are examples of added value created by Prime Collateralised Securities (PCS), as Paris-based TPV – with observer status at Paris Europlace.

- The majority of STS transactions are very straightforward in the determination of their STS status. However, the intersection of the number of STS criteria – over 100 – with the multiplicity of assets, lending practices and European jurisdictions not infrequently lead to fine interpretative judgements as to whether a particular securitisation does or does not meet a given criterion. The legislation has provided a path to clarifying such uncertainties: the EBA Q&A process. This process, when it is completed, has generated helpful clarifications. Nevertheless, it is almost never used. This is because the average time for a response is over 18 months and oftentimes over 24 months. It is not possible for market participants to proceed with a transaction knowing that they will not receive an answer for two whole years. As a result, market participants have little choice but to fall back on their own interpretations assisted by legal firms and TPV agents such as PCS.

- The interpretations given by PCS are homogeneous across Europe. It helps the harmonisation of the STS label on a cross-border basis.
- PCS organises a series of symposia across Europe, with an emphasis on Central and Eastern Europe, on the benefits of the securitisation technique, and the benefits of the STS label.
- PCS maintains for market participants on its website <https://pcsmarket.org/>
  - there is a ‘Transaction page’ that is widely accessed by market participants.
  - the “Great Library”, which contains the most important documents related to European securitisation regulation, and the genesis of such regulations.
  - a database of STS notifications with visualisation tools (with [www.storieddata.com](http://www.storieddata.com)).

**Question 7.15:**

If you answered yes to [question 4.10.\(iv\)](#), should the TPVs be supervised to ensure that the integrity of the STS standard is upheld?

- Yes
- No
- No opinion

Please explain your answer to the above, including where necessary whether TPVs should be supervised at EU level.

Answer to multiple choice:

- Yes

Explanation / justification / answer:

In the case of Paris-based Prime Collateralised Securities (PCS), a Third-Party Verifier (TPV) with observer status at Paris Europlace, it is **already** supervised by the AMF, the National Competent Authority (NCA). For its UK-related activities, it is also supervised by the FCA. In both cases, after having gone through a mandatory agreement process, PCS is regularly subject to supervisory questions, as supervisors monitor their ongoing activity.

Maybe question 7.15 refers to whether TPV should be supervised at an EU level (ESMA?) rather than by an NCA. This raises two separate questions.

Does the question infer 1) a supervision with regards to conduct issues (management of conflicts of interest, non-discriminatory billing policy, maintenance of files, etc.) which AMF currently performs for PCS, or 2) does the question infer a supervision of the content of verifications (i.e. interpretations).

On the first point, the current setup works, and there is no need to perform conduct supervision at an EU level.

On the second point, there is already a process at the EU level to harmonise the interpretations of the STS criteria: the EBA Q&A process. This process, when it is completed, has generated helpful clarifications. Nevertheless, it is almost never used (and when it is, EBA’s “guidance” on STS has brought even more uncertainty, while making some verifications more burdensome and restrictive (e.g. first payments)). This is because the average time for a response is over 18 months and oftentimes over 24 months. It is not possible for market participants to proceed with a transaction knowing that they will not receive an answer for two whole years. As a result, market participants have little choice but to fall back on their own interpretations assisted by legal firms and TPV agents such as PCS. Thus, the supervision of content could make the role of TPVs impossible if this supervision were to be modelled on the supervision of rating agencies: it would require stopping any securitisation which raised an unprecedented problem of interpretation until a decision is taken by European regulators. This would take months and entire sections of the market would completely grind to a halt. This would particularly be marked for securitisations coming out of the CEE countries where the lack of enough precedents requires more interpretation.

This said, the role of TPVs could be expanded to reduce investors' Article 5 obligations: not by removing the obligation of investors to verify the STS status – a solution at first glance attractive but which risks not surviving the European Parliament – but by authorising investors to rely on the TPVs' judgment. This would follow from the same principle which, under Article 5.5, allows investors to rely on the judgment of a fund manager for credit due diligence. This would not be mandatory. As with article 5.5, the investor could always choose to do their own verification work and therefore not use a TPV.

**Question 7.16:**

To what extent would supervision of TPVs increase the cost of issuing an STS securitisation?

- To a large extent
- To a moderate extent
- Limited or no effect
- No opinion

Please explain your answer, and if available, estimate the total costs in EUR.

Answer to multiple choice:

- **No opinion**

Explanation / justification / answer:

In the case of Paris-based Prime Collateralised Securities (PCS), a Third-Party Verifier (TPV) with observer status at Paris Europlace, it is already supervised by the AMF and by the FCA. So, maintaining current supervision would not entail any additional cost.

If the question was meant to be what the cost would be of switching to an EU-level supervision (implied in question 7.15), then the subscriptions costs would be expected to be around €150,000 per year (as ESMA asks other market participants) – with 150 operations per year, this will add €1,000 per operation. If ESMA asks PCS to hire a compliance officer and an assistant, it will probably be €150,000 and more. So, the direct cost per operation would be 'Limited or no effect'.

If the contemplated securitisation targeted reform would be implemented and the EU securitisation market would scale up, the fixed costs above could be absorbed more easily.

As explained in the answer to question 7.15, the creation of market instability caused by a) the possibility of changes in STS criteria interpretations, with a consequential capital requirement increase ('financial guillotine effect') for those few (re)insurers (see Section 10) that have invested in STS securitisations, and b) generating delays for issuers to obtain future interpretations, would be the source of major opportunity costs. Those costs would be huge, when compared to the direct costs. In this case the answer 'To a large extent' does not come even close to be an appropriate answer.

## 8. Securitisation platform

One issue which is mentioned in the public debate is the possibility of setting up a securitisation platform, with various ideas being put forward on the possible characteristics and functions of such a platform. One of the proposals (see [Noyer report](#)<sup>19</sup>), inspired by the US model, envisages the use of public guarantees both at national and EU-level to scale up the market and create a new common ‘safe asset’ across the EU. Other suggested designs are more circumspect (for example see [TSI report](#)<sup>20</sup>) and entail the pooling of resources and information to reduce issuance costs and encourage standardisation.

<sup>19</sup> Developing European capital markets to finance the future: Proposals for a savings and investments union. Available at: <https://www.tresor.economie.gouv.fr/Articles/2024/04/25/developing-european-capital-markets-to-finance-the-future>

<sup>20</sup> The challenge of financing the transformation for companies and banks in Germany – securitisation as an instrument for linking bank loans and capital markets. Available at: [https://www.true-sale-international.de/fileadmin/tsi-gmbh/tsi\\_downloads/aktuelles/Final\\_Report\\_German\\_Securitisation\\_Platform\\_convenience\\_translation.pdf](https://www.true-sale-international.de/fileadmin/tsi-gmbh/tsi_downloads/aktuelles/Final_Report_German_Securitisation_Platform_convenience_translation.pdf)

In its statement of [7 March 2024, the ECB Governing Council highlighted](#) the need to explore ‘whether public guarantees and further standardisation through pan-EU issuances could support targeted segments of securitisation, such as green securitisations to support the climate transition’.

Questions to stakeholders:

### Question 8.1:

Would the establishment of a pan-European securitisation platform be useful to increase the use and attractiveness of securitisation in the EU?

- Yes
- No
- No opinion

Answer to multiple choice:

- Yes

### Question 8.2:

**If you answered yes to question 8.1.**, which of the following objectives should be main objective(s) of the platform? You may select more than one option

- Create an EU safe asset
- Foster standardisation (in the underlying assets and in securitisation structures, including contractual standardisation)
- Enhance transparency and due diligence processes in the securitisation market
- Promote better integration of cross-border securitisation transactions by offering standardised legal frameworks
- Lower funding costs for the real economy
- Lower issuance costs
- Support the funding of strategic objectives (e.g. twin transition, defence, etc.)
- Other

Please explain how the platform could be designed to achieve the objectives that you selected in your answer to question 8.2.

Answer to multiple choice:

- **Create an EU safe asset**
- **Foster standardisation (in the underlying assets and in securitisation structures, including contractual standardisation)**
- **Enhance transparency and due diligence processes in the securitisation market**
- **Promote better integration of cross-border securitisation transactions by offering standardised legal frameworks**
- **Lower funding costs for the real economy**
- **Lower issuance costs**
- **Support the funding of strategic objectives (e.g. twin transition, defence, etc.)**
- **Other**

Explanation / justification / answer:

Paris Europlace supports the proposal contained in the Noyer report, of a European securitisation platform, to provide a national and European guarantee to standardise and scale-up the securitisation market.

However, we believe that the European Union should rather consider leveraging the European Investment Bank (EIB) or the European Investment Fund (EIF) with a view to scale-up an existing efficient framework, as a robust and innovative alternative to the US government-sponsored enterprises Fannie Mae and Freddie Mac. However, such project is likely to be a long-term ambition, and it should not prevent from working as a priority on addressing immediate regulatory and prudential obstacles, to encourage the private sector to engage in the securitisation market.

Therefore, this subject is not a priority to revive the securitisation market, which has ample room to grow by unlocking targeted prudential obstacles, without involving any public money.

**Question 8.3:**

**If you answered yes to question 8.1.,** how would access to a pan-European securitisation platform increase the use and attractiveness of securitisation in the EU?

It is difficult to answer as the design of such platform remains very unclear.

The first step would be to define a vision of what the EU expects from such platform:

- The idea of a safe asset implicitly assumes that the platform would issue low risk-low return AAA tranches. It would have mainly a funding goal but not a risk absorption goal, and would not target significant risk transfer, which means that it would not free up lending capacity by banks.
- The idea of scaling up the EIF, on the contrary, would focus on small size junior and mezzanine tranches, absorbing risk away from the banking sector, and therefore freeing up additional lending capacity for banks.
- Other options include the setting up of a data sharing platform, providing easy access to data but no financial capacity.

In the meanwhile, it is definitely possible to increase the use and attractiveness of securitisation in the EU by addressing prudential and regulatory hurdles as per our responses to other questions.

**Question 8.4:**

Should the platform target specific asset classes?

- Yes
- No
- No opinion

Answer to multiple choice:

- **No opinion**

**Question 8.5:**

If you answered yes to question 8.4., which asset classes should the platform target? Please provide a justification.

- SME loans
- Green loans (i.e. green renovation, green mobility)
- Mortgages
- Corporate loans
- Other

N/A

**Question 8.6:**

Are guarantees necessary?

- Yes
- No
- No opinion

Answer to multiple choice:

- **No opinion**

**Question 8.7:**

If you answered yes to question 8.6., please explain who (private or public) would provide it and how you would design such a guarantee.

N/A

**Question 8.8:**

What do you view as the main challenges associated with the introduction of such a platform in the EU, and how could these be managed?

A structural project such as a European securitisation platform with or without public guarantees, is likely to be highly complex, both technically and politically, while at the same time, there are targeted amendments to be implemented quickly, to promptly scale-up the securitisation market across the EU.

Therefore, the subject of the platform should be addressed at a later stage and should not delay the short-term priorities to address all regulatory (SECR) and prudential (CRR3, Solvency II and LCR Delegated Act) barriers.

**Question 8.9:**

What key considerations need to be taken in designing a pan-European securitisation platform, for such a platform to be usable and attractive for originators and/or investors?

N/A

**Question 8.10:**

Besides the creation of a securitisation platform, do you see other initiatives that could further increase the level of standardisation and convergence for EU securitisations, in a way that increases securitisation volumes but also benefits the deepening and integration of the market?

N/A



## 9. Prudential and liquidity risk treatment of securitisation for banks

Banks are central players in the EU securitisation market. On the issuer side, securitisation is a useful tool in banks' toolkit for diversifying funding sources, and for balance sheet and credit risk management purposes. On the demand side, while banks hold significant exposures towards EU securitisation transactions and in particular to senior tranches, most are in the form of retained securitisations, including asset-backed securities (ABS) that are used as collateral for central bank operations to obtain liquidity. Exposures to other banks' securitisations are overall limited. The high percentage of retained securitisations limits the depth and liquidity of the securitisation market in the EU.

The prudential treatment of securitisation is set out in [Regulation \(EU\) No 575/2013 \(Capital Requirements Regulation - CRR\)](#). It specifies requirements for the prudential treatment of securitisation exposures by banks, acting as originators, investors and sponsors in securitisation. The main features of the prudential treatment are defined in the Part Three, Title II, Chapter 5 of the CRR, which sets out the regulatory capital calculation approaches, a specific risk-sensitive treatment for STS securitisations and additional criteria for the STS securitisations to be eligible for that treatment, the framework for the significant risk transfer (SRT), specific treatment for securitisation of non-performing exposures and other specific requirements. Besides, the prudential treatment under the CRR, the liquidity risk treatment of the securitisation exposures under the [LCR Delegated Regulation \(Delegated Regulation \(EU\) 2015/61 on liquidity coverage requirements for credit institutions\)](#) is also relevant for banks.

In their [advice from December 2022, the European Supervisory Authorities \(ESAs\)](#) concluded that the prudential and the liquidity treatment of securitisation is not the key obstacle to the revival of the securitisation market, and that the subdued status of the securitisation market is rather the result of a series of factors, including the interplay between low supply and low demand. At the same time, the ESAs also recognised in their report that it is possible to increase the risk sensitivity of the prudential framework. Many stakeholders consider the prudential and liquidity treatment as having a decisive impact on the attractiveness of the securitisation instrument for banks and in addition point out in particular to a relative disadvantage of the prudential treatment for some types of securitisations in comparison with other financial instruments.

Questions to stakeholders:

### Question 9.1:

What concrete prudential provisions in the CRR have the strongest influence on the banks' issuance of and demand for those types of traditional, i.e. true sale, securitisation which involve the senior tranche being sold to external investors and not retained by the originator?

There are several prudential and regulatory issues that need to be addressed in the CRR, in Solvency II and in SECR that affect the issuance and demand of traditional securitisations. Within the limited remit of question 9.1, Paris Europlace can cite three concrete provisions for the banks: 1) the fixed value risk weight floor that arbitrarily favours certain sectors of the economy over others, without any rationale, 2) a flawed design in the securitisation capital formula that departs absurdly from the neutrality principle, and 3) the liquidity coverage ratio eligibility and haircuts applied to senior tranches of securitisations.

**On the first provision, the revision of the risk weight (RW) floor on all regulatory methods, i.e., IAA, SEC ERBA, SEC SA, SEC IRBA, is the simplest and the most impactful measure.** It should be more risk sensitive and therefore could be based on a fraction of the risk weight of the underlying asset pool ( $RW_{Pool}$ ). A distinction between STS and Non-STS could remain so that for STS, such that RW Floor equals 7% of  $RW_{Pool}$ , and for Non-STS, RW Floor equals to 12% of  $RW_{Pool}$ .

To understand the lower volumes of traditional RMBS placed with investors and backed by bank-originated residential mortgages, one needs to look at the ratio of the senior tranche risk weight, often set at the RW floor, in comparison to the risk weight of the underlying pool. It is too close to parity for most IRB banks for pools of low LTV mortgages. In France, the average risk weight of a retail mortgage portfolio from four large IRB banks is 10.3%. The securitisation of high-quality mortgage assets is, thus, not efficient in case of risk transfer. Consequently, banks keep the risk of these loans on their balance sheet, or, in case of funding only, generally use

the collateral for other less expensive instruments, such as covered bonds. RMBS are most often issued to create retained collateral eligible as repo (notably for the central banks), which can be used in case of liquidity stress (contingent liquidity) and helps improving the bank liquidity ratios.

Introducing a risk-sensitive risk weight floor will increase traditional and synthetic European residential mortgage securitisations volumes, enabling banks to redeploy funding and capital to areas that contribute more to GDP growth, boosting employment opportunities within the European Union. As European bank financial ratios improve, lenders would be more resilient in the event of financial crisis, as they would have a higher capacity to absorb shocks. The introduction of a risk-sensitive risk weight floor, a simple modification in the current capital framework, would boost activity in European securitisation for other asset classes too.

The Risk Control paper *Rethinking the Securitisation Risk Weight Floor*<sup>6</sup> presents possible designs and calibration for a risk-sensitive risk weight floor, including the one mentioned above that differentiates between STS and Non-STS.

**On the second provision, the capital formula needs to depart sensibly, not unreasonably, from capital neutrality.** This can be easily achieved by extending Article 465 (“Boyer amendment”), which is a transitional approach with reduced p-factor on the standard measure authorised solely for the calculation of the floor, so that it becomes permanent and applicable beyond the output floor calculation for the SEC-SA approach.

In general, SEC SA is too punitive, especially considering its use as an output floor, and too far from the economical allocation of risks. Other changes are thus necessary to reduce the capital non-neutrality and come closer to the inverted-S curve mentioned by the ESAs in the report JC/2022/66. Other improvements have been presented in the Risk Control paper *Reviving Securitisation in Europe by Scaling Inputs to Capital Formulae*.

**On the third provision, the revision of LCR eligibility and haircuts for senior ABS is required to make them consistent with alternative fixed income instruments.** This should lead to the promotion of senior STS of rating AA- to AAA to Level 2A, (based on CQS1 definition prior to the unintended removal of AA rating from the bucket), the inclusion of AAA to AA- Non-STS senior tranche of securitisation to Level 2B. Further adjustment could extend to the scope of eligibility to any kind of ABS and multiseller ABCP and remove the WAL limitation for the RMBS senior tranches.

This improved treatment of securitisation in the LCR is necessary to support the liquidity of the senior ABS for all investors. Bank treasuries play a role that is complementary to the ECB repo eligibility. Both actors are necessary to attract more investors both in number and volume, even when they do not invest directly in the product, because they are able to bring liquidity that might be required, in case of need, which would bring more stability to the primary market.

**Question 9.2:**

Please explain how possible changes in the prudential treatment would change the volume of the securitisation that you issue, or invest in (for the latter, split the rationale and volumes for different tranches).

As stated in the Risk Control paper on *European Competitiveness and Securitisation Regulations*<sup>7</sup>, European policymakers have argued that Europe needs “massive private investments” to advance the climate agenda and generate higher productivity and competitiveness. While equity markets can provide EU corporates with some risk capacity to invest more, it will be for debt markets to finance the bulk of the needed investment. European banks, as key intermediators of surplus funds from European and international savers, could alleviate this pressure if they were able to create more lending headroom by transferring risks through securitisation. By doing this, they would generate ‘capital velocity’, by which securitisation permits a bank to deploy its risk capacity more than once, having reduced prior its risk by more than the capital freed up. Covered Bonds (CBs) are no substitute for securitisation in this regard because the credit risk of the loan pool covered by a CB remains on the issuing bank’s balance sheet and, hence, no additional capacity to make new loans is generated. Boosting securitisation would require some relatively small, though judiciously chosen, adjustments, aimed at aligning regulatory rules with actual risk.

<sup>6</sup> <https://www.riskcontrollimited.com/wp-content/uploads/2024/05/20240503-Rethinking-the-Securitisation-Risk-Weight-Floor-v61.pdf>

<sup>7</sup> <https://www.riskcontrollimited.com/wp-content/uploads/2024/08/European-Competitiveness-and-Securitisation-Regulations-v56.pdf>

In this regard, a key change in regulations is needed that would bring capital requirements for senior securitisation tranches in line with risk, namely the introduction of a risk-sensitive risk weight floor (i.e. a risk weight for senior tranches that is a fraction of the risk weight of the pool). There are other prudential changes that are important, namely the LCR treatment of senior tranches, and the overall capital requirement for mezzanine tranches which should be better aligned with actual risks.

If all key blockages in European securitisation regulations were to be removed, how much might the market in placed traditional securitisations grow sustainably? Growth would come first from banks as cross-border flows increased (this would require introducing a risk-sensitive risk weight floor and better LCR treatment). Subsequent growth would likely come from insurance companies (this would require better Solvency II treatment and other improvements in matching rules). The latter would require re-establishing investment teams with the required expertise. Once a large market develops, pension funds would likely increase their allocation to this instrument class.

As the European Union would be starting from a low base, prudent and sustainable growth could reach 25% per annum over a five-year period for traditional securitisations. This would represent a trebling of issuance once the five-year period finished, i.e., around €300 bn by 2029, compared to the level of just under €100 bn at end 2023. Such growth would be a major step to achieving the ‘massive private investment’ mentioned by the ECB Governing Council. Still, more could be achieved through growth in the synthetic Significant Risk Transfer (SRT) market, as shall be discussed in the relevant question related to SRT.

Is it possible to be more ‘mathematical’ about the sensitivities to a specific change in the securitisation ecosystem? It is difficult but let us try. If securitisation risk weights for senior tranches become proportional to the RW of the underlying pool,

- then securitisation would be more efficient as a tool to redistribute risks (through SRT) on any portfolio (including those attracting lower capital charges).
- portfolios with low risk that cannot currently be used in SRT transactions represent a huge potential pool of assets.
- if the LCR is fixed as well, it will support both the primary and the secondary market of ABS in terms of pricing and liquidity, thanks to a broader and more stable investor base. Moreover, non-bank investor value LCR eligibility for their investments, hence it will help develop the market on non-banks.

If we let alone the impact of the development of new assets or the impact on non-banks, assuming that the current floor is in majority around 10% and will migrate to  $7\% \times 75\% = 5\%$  (assuming a majority of STS retail assets with RW of 75%), then we can easily expect a doubling in volume. As this is only a floor measure, this would not be detrimental to financial stability, as structures will remain protected up to the required amount for achieving a given rating equivalent (economic measure of risk remains the same).

There is no doubt that this effect will create a momentum and together with developments concerning non-banks (such as the Solvency 2 treatment) could lead to a strong expansion on the securitisation market of low-risk portfolios (such as RMBS). This is by far the sector with the highest potential, with enough capacity to free up a significant portion of the € 800 bn of new investment envisaged by the Draghi report.

**Question 9.3:**

Based on your answer to 9.1, please explain how possible changes in the prudential treatment could support the supply for and demand of SME and corporate exposure-based securitisation transactions.

The majority of corporate exposure-backed securitisations transactions are executed in Europe on a synthetic basis, rather than via true sale (except for leveraged loans with a well-established global CLO market). There are structural reasons linked to true sale and the bespoke documentation, especially for SMEs, and the associated credit risk mitigation techniques that banks use to reduce their risk (different types of collateral and surety) which are difficult to move via ‘true sale’.

Therefore, financing growth for SMEs and corporates in Europe depends also on the health of the synthetic market.

Furthermore, even though there are difficulties, there is an increasing number of synthetic securitisations that are labelled ‘STS’. (Re)insurers are unable to access this market (as discussed in questions 7.4-7.11). For some asset

managers, the 20% limit per issuer where the issuer is the SPV (rather than the originator bank), creates size limits where some tranches fall below minimum investment size.

On the supply side, the prudential treatment of banks should be changed, by introducing a risk weight (RW) floor that is proportional to the RW of the securitised pool.

- This would remove the disconnection between the RW of the senior tranche and the RW of underlying pool, which the current fixed value floor creates (15% for Non-STS and 10% for STS). The proportional RW floor is risk sensitive.
- It would allow senior tranches to benefit from the SME supporting factor (0.7619) which the European Parliament granted to this asset class.

In Europe, unlike the US, many SMEs are financed through ABCP programmes financing trade receivables. If the risk-weighted assets associated with the SME and corporate asset was more appropriate, financing volumes would increase.

Beside the volume increase expected from the passing of reforms for a risk-sensitive RW floor, the LCR could also lead to an improvement on the demand side if the SME and corporate exposure-based securitisation transactions benefit from the envisaged enlargement of buckets.

Below are concrete numerical examples.

- a) Assuming a 10% proportion of the risk weight of the underlying pool  $RW_{Pool}$ , senior tranches at the floor level, backed by granular pools of:
- High RW B-rated leveraged loan exposures ( $RW_{Pool}$  of 150%) would have a RW of 15%, the same as today;
  - Medium RW BBB-rated investment grade corporate exposure ( $RW_{Pool}$  of 100%) would have a RW of 10%;
  - SME exposures ( $RW_{Pool}$  of 75%) would have a RW of 7.5%;
  - SME exposures benefiting from the supporting factor of 0.7619 ( $RW_{Pool}$  of 57.1%) would have a RW of 5.7%;
  - Low RW A-rated investment grade corporate exposures ( $RW_{Pool}$  of 50%) would have a RW of 5%; and
  - Very low RW of AAA/AA rated investment grade corporate exposures ( $RW_{Pool}$  of 20%) would have a RW of 2%.

Currently, the market for traditional CLOs of Leveraged Loans is thriving, as the RW floor that currently applies to senior tranches of Non-STS securitisation in this asset class is a fixed value of 15%, which represents a 10% proportion of the underlying risk weight (RW of 150%). It would not benefit from any improvement, in line with its intrinsic risk, while low risk assets such as mortgages would benefit the most, realigning the regulatory incentives on economic risk and limiting arbitrage opportunities.

- b) The extension of the transitional measure for the output floor calculation will divide by two on a permanent basis the p-factor under SEC-SA. Alternatively, the scaling of the SA pool capital  $K_A$  input for pools of SME and corporate exposures by the coefficient 0.65, would limit the capital surcharge to a maximum of 30% under the SSFA formula in SEC-SA, while ensuring financial stability for those transactions. Currently, the capital surcharge for Non-STS SMEs is 100% for STS SMEs 50%.
- c) The improvement of the LCR categories and haircuts as explained in the LCR section (questions 9.40-9.49 in this consultation) applied to SME and corporate-backed traditional securitisation transactions would enable some volume increase for this asset class (although it would not change the structural issues with true sale).

**Question 9.4:**

Does the prudential treatment of securitisation in the CRR appropriately reflect the different roles a bank can play in the securitisation chain, concretely the roles of originator (limb 'a' and limb 'b' of the definition of the originator in the [Securitisation Regulation](#)<sup>21</sup>), servicer and investor?

<sup>21</sup> According to Article 3(2) of the [Securitisation Regulation](#), an originator can be an entity that has originated the exposures that are securitised (letter (a)), or has purchased a third party's exposures on its own account and then securitises them (letter (b))

- Yes
- No
- No opinion

Answer to multiple choice:

- No

**Question 9.5:**

**If you answered no to question 9.4.,** please explain and provide suggestions for targeted amendments to more appropriately reflect the different roles of banks as originator, investor, and servicer.

Article 2 (3) of the CRR defines originator as follow:

*'originator' means an entity which:*

- (a) *itself or through related entities, directly or indirectly, was involved in the original agreement which created the obligations or potential obligations of the debtor or potential debtor giving rise to the exposures being securitised; or*
- (b) *purchases a third party's exposures on its own account and then securitises them;*

[...]

Article 2 (5) of the CRR defines sponsor as follow:

*'sponsor' means a credit institution, whether located in the Union or not, as defined in point (1) of Article 4(1) of Regulation (EU) No 575/2013, or an investment firm as defined in point (1) of Article 4(1) of Directive 2014/65/EU other than an originator, that:*

- (a) *establishes and manages an asset-backed commercial paper programme or other securitisation that purchases exposures from third-party entities, or*
- (b) *establishes an asset-backed commercial paper programme or other securitisation that purchases exposures from third-party entities and delegates the day-to-day active portfolio management involved in that securitisation to an entity authorised to perform such activity in accordance with Directive 2009/65/EC, Directive 2011/61/EU or Directive 2014/65/EU;*

There is no reason to differentiate investor and originator/sponsor roles.

On one hand, originator/sponsor know quite well their portfolio unlike a third-party investor that will have to deal with asymmetry of information.

On the other hand, securitisations are structured with eligibility criteria, some of which are dictated by STS criteria, which skews the portfolio towards its best parts (no delinquency, no restructuring, etc.). They are now subject to extensive due diligence and disclosure requirements and market practices in the EU (even if the unwieldy, current template-based disclosure is replaced by less prescriptive and more user-friendly principles-based disclosure and due diligence). This goes a very long way to addressing data asymmetry issues. Securitisation market growth requires regulatory facilitation of banks' investments in transactions originated by other institutions.

In the EU regulation, the asymmetry of information is relatively well balanced and there is no reason that could justify that one role should benefit from a favourable treatment.

In both situations, the securitisation should be seen as transforming the risk of the pool, with a small but now well contained inefficiency, which means that the new capital allocation should be quite close to capital neutrality.

What is more relevant to investors is whether the underlying assets have been ‘regulated’ at the time of origination, i.e., whether they were subject to regulated origination guidelines or not, or whether the underlying assets were the subject of bank capital rules or not. There is a strong academic case to give favourable regulatory and prudential treatment for securitisation backed by bank assets subject to regulated origination guidelines.

This is also why the market in SRT in Europe is successful, their investments are backed by such assets.

Prior to the GFC, most European underlying assets were originated by banks and subject to Basel II rules. European securitisations backed by such assets experienced a low level of default.

Currently, some traditional securitisations market (such as Dutch RMBS) have been primarily based on non-bank financial institutions (NBFIs) origination. Agency risk is naturally greater in such transactions compared to securitisations backed by assets that were the subject of the EBA origination guidelines.

The current definition of ‘originator’ and ‘sponsor’ makes no difference to this fundamental notion. The SRT market does.

**Question 9.6:**

Have you identified any areas of **technical inconsistencies** or ambiguities in the prudential treatment of securitisation in the CRR (other than the ‘quick fixes’ identified by the [ESAs in the report JC/2022/66](#)) that could benefit from further clarification?

- Yes
- No
- No opinion

Answer to multiple choice:

- **Yes**

**Question 9.7:**

**If you answered yes to question 9.6.,** please explain and provide suggestions for possible clarifications.

Below are examples of technical inconsistencies in the prudential treatment of securitisation in the CRR.

**Part 1: The CRR Article 243 should be deleted (or strongly amended) to avoid inconsistencies.**

The prudential treatment of the retained tranche has a cost in the economic viability of the transaction. That is why the additional limitations imposed for benefiting from the STS prudential treatment, as per Article 243 of CRR (“*Criteria for STS securitisations qualifying for differentiated capital treatment*”), may discourage banks to issue some transactions under the STS standard. Similarly, when a bank provides senior securitisation funding to clients, under STS format, the prudential benefit of STS for the bank is subject to compliance with Article 243 – (and balance with related costs).

Under Article 243 (1) (a) for ABCP programs and Article 243 (2) for non-ABCP programs, positions shall be eligible for the STS related prudential treatment (Articles 260, 262 and 264) if the underlying exposures meet, under the Standardised Approach, a risk weight equal to or smaller than 75 % on an individual exposure basis where the exposure is a retail exposure or 100 % for any other exposures. This excludes the portfolios with one single corporate loan with external rating of B+ or below and risk weight of 150%, for instance portfolios of leasing, trade receivables or SMEs.

Hence, Paris Europlace believes that Article 243 of CRR should be deleted. Otherwise, it would be necessary to amend Article 243 of CRR either to increase the risk weight cap from 100% to 150% or to introduce a materiality threshold above which the STS benefit is no longer applicable. This would also be needed for residential and commercial mortgages, especially as the 40% and 50% risk weight criteria were calibrated in CRR2 and have to be recalibrated in line with the changes on standard risk weight in CRR3.

In addition, the derogation for ABCPs, provided the risk weight of the liquidity facility is below 100%, is limited to institutions applying Internal Assessment Approach (IAA). Paris Europlace believes that this derogation should apply to all approaches.

## Part 2: Other inconsistencies:

- **Concerning the floor of the RW at 10% or 15%**, it can be higher than the RW of the underlying pool, which makes it inefficient to have SRT securitisation with low risk-weight pools. European markets have unduly suffered from this post-crisis US-inspired miscalibration, having lower risks on their mortgage activities compared to the US.
- **The different methods (IAA, SEC-ERBA, SEC-SA, SEC-IRBA)** should lead to a similar risk weight, this is not always the case, as can be seen for example with the quality step 12 to 14 that attracts a RW of 600%-900% when non senior, where it would be 1250% under SEC-IRBA or SEC-SA methods. The 1250% risk weight in SEC-IRBA or SEC-SA methods imposed up to a threshold equal to the pool capital can lead to illogical results.
- **The treatment of the excess spread in the SRT framework should be re-examined.** Future revenues are simply removed from own funds in the banking framework, which is like a deduction. It should not be included in the ratio used for measuring the transfer of Risk (PBA/CRT) since it can only be more favourable after securitisation.
- In synthetic transactions, the STS “**interim payment in excess of provisions for restructuring events**” **problem needs to be fixed.** For a full explanation of the issue, please read Appendix 2 “*When Level 1 text departs from principles*” of the August 2024 Risk Control paper entitled “European Competitiveness and Securitisation Regulations”.
- Regarding the EBA RTS on Kirb calculations ((effective since Q3 2024), IRB banks investing into the senior tranche of securitisations backed by pools originated or serviced by clients can only use the IRB PD, but not the IRB LGD as per their internal models. Instead, the LGD of the underlying assets is set arbitrarily at 50% for senior exposure, both for secured and unsecured, i.e., **irrespective of the security interest**, and 100% for sub exposures. **Paris Europlace proposes to align the LGD to the Foundation IRB LGD**, i.e., 25% LGD for secured, 40% for senior unsecured and 75% for subordinated exposures.
- Credit Conversion Factors (CCF) limit the financing of private securitisation facilities that are needed for warehousing new origination ahead of public ABS issuance. The CCF applied to liquidity facilities and undrawn credit lines, defined in Article 248, is binary: 100% CCF in general or 0% for liquidity facilities that are super senior and cancellable. There is no such binary rules for corporate facilities where the CCF of Revolving Credit Facilities (RCF) is 40%. There are many strong risk mitigants in securitisation financing, so that **a CCF of 30% should be applied instead (to be inserted in between bucket 3 and 4 of annex I of CRR3) for the targeted scope of the senior financing of clients’ assets, either via ABCP lines conduits or warehousing lines.**

### Question 9.8:

Are there national legislations or supervisory practices which in your view unduly restrict banks in their potential role as investor, originator, servicer or sponsor of securitisation transactions?

- Yes
- No
- No opinion

Answer to multiple choice:

- Yes

**Question 9.9:**

If you answered yes to question 9.8., please explain and provide examples.

**1. National legislations or supervisory practices:**

On 19 November 2024, AFME produced its annual report “Capital Markets Union - Key Performance Indicators – Seventh Edition”. One of the indicators is the “Loan Transfer Indicator”, covering securitisation and portfolio sales. For the first semester, this indicator is set at zero for Bulgaria, Croatia, Czech Republic, Denmark, Estonia, Hungary, Lithuania, Luxembourg, Malta, Poland, Romania, Slovakia, Slovenia and Sweden.

In some cases, the issues are linked to the size of potential issuances (e.g., Malta), or structural (e.g., Denmark). There are cases where it is the national legislation or supervisory practices that have hindered the creation of a harmonious European securitisation market, by throttling the issuance of both traditional and synthetic securitisations. The most notable of these examples is in Sweden, where the securitisation activity had been severely restricted due to the national regulator’s concern on a hypothetical ‘flowback risk’ that would affect (only) Swedish banks.

There is distinct lack of evidence on ‘flowback’ risk. But this is an academic debate as to whether the risk is real and / or whether the risk is associated to currency risk.

The situation has only been recently revisited by the Swedish national regulator with a more, albeit timid, pro-securitisation stance.

**2. European legislations or supervisory practices:**

From a market perspective, there are other regulatory and supervisory practices at the EU level that have more consequences.

For example, the EBA guideline for SRT introduces some ratios (especially the CRT ratio) that are not economically linked to the transfer of risk or that are too prescriptive.

Another example is the EBA guideline on the WAL calculation that introduces too much complexity for a simple variable. This variable is capped at 5 years usually in banking regulation and floored at 1 year. WAL calculation should be simplified.

There are more examples. The ones mentioned above simply provide evidence of the existence of national legislation and supervisory practices that hinder the market. This is not the place for an exhaustive list.

**Question 9.10:**

How do banks use the capital and funding released through securitisation?

Please explain your answer and if possible, quantify how much of the released capital and funding is used for further lending to the EU economy.

This question is about the economic concept of **capital velocity** for traditional and synthetic SRT securitisations, and the use of **funding** in true sale securitisations.

The use of funding and capital released through securitisation depends on the strategy of the banks.

On the funding side, securitisation provides credit institutions with a diversification of their funding sources. In the financing toolbox of a credit institutions, various debt instruments coexist, with different features, investor bases and costs: covered bonds, senior unsecured, MREL eligible... The mix of tools evolve across banks and



over time, depending on lending growth, monetary policy (including TLTRO), market trends, credit spreads, etc... Securitisation tends to be a rather expensive source of funding, but it can bring specific benefits:

- For specialised credit institutions which do not have a deposit base
- For banks with large issuance programs, who need to tap all investor types, and who can benefit from the fact that securitised exposure, not being an exposure on the bank, do not count in the concentration limits of investors. Therefore, it can provide additional room on top of credit limits.
- For banks having little access to covered bonds due to investors' concerns, who may prefer to have direct access to the portfolio.
- Securitisation can play a useful role in a stress situation, as we have seen with the development of NPL securitisation in Greece and Italy on the back of the Euro crisis. It is a countercyclical and contingent liquidity instrument.

Overall, the funding generated by cash securitisation is part of the overall liabilities of the bank, without being specifically channelled to specific businesses.

On the capital side, SRT securitisation provides capital relief, which can be used depending on the capital management and business strategy of the bank.

- Securitisation creates value: if the capital released can be reinvested at a return superior to the cost of securitisation, it increases the Return on Equity (if not, the SRT securitisation would just not happen). Improving RoE is a key challenge for European banks, and one of the reasons why their price to book is lagging behind non-EU peers.
- In a context of poor price-to-book, raising equity in the market is not an option. And retaining earnings is not an attractive option either, as any € retained is worth below par... Hence, theoretically, shareholders expectations to be distributed a decent share of the earnings, to be able to reinvest this money at a better price to book. In practice, distribution strategies are closely monitored by the SSM and have remained prudent.
- However, the retained earnings have not been invested to finance growth, but rather to adapt to ever higher capital ratios requirement. In 2024, the average total CET1 requirement has reached 11.1% (Source ECB), an increase of 40bps compared to 2023. In the meantime, banks have on average generated 50bps of retained earnings. This means that 80% (40/50) of the retained earnings have been used to increase the capital covering existing exposures, rather than to finance growth in the economy. The upcoming implementation of CRR3 will put further pressure.
- In this context, securitisation is a welcome tool to increase capital velocity, making room for new lending without putting additional pressure on capital.
- Supervisors and policy makers have expressed concerns that banks may become excessively reliant on securitisation. It should be noted that the capital relief obtained through SRT securitisation only affects the risk-based capital ratios (CET1, T1, Total Capital). Given that assets remain on balance sheet, if a bank were to excessively rely on securitisation, it would at some point become bound by the leverage ratio requirement, which would play its backstop role.
- As for funding, the capital released by securitisation is fungible and is not specifically allocated to specific businesses. However, some investors may require such "use of proceeds" approach, such as the EIF. The bank can also communicate proactively on the strategy to reinvest the released capital, for example toward sustainable finance.

The fungibility of liquidity and capital should be preserved, in order to accommodate different business models, and different market environment.

## Risk weight floors

The risk weight floors, the p-factor and the requirement of risk weighting at 1250% for the securitisation positions up to KIRB/KSA are key measures, ensuring the non-neutrality of the securitisation capital framework.

The main objective of non-neutrality is to protect against certain structural risks, including agency and model risks, that are more prevalent for securitisations than for other financial assets and give rise to some degree of uncertainty in the calculation of capital requirements for securitisations, even after all appropriate risk drivers have been taken into account. To capture those risks adequately, the CRR sets out a 15% risk-weight floor for non-STS securitisation positions and a 10% risk-weight floor for STS securitisation positions<sup>22</sup>, irrespective of the approach for calculation of capital requirements and the role of the bank in the securitisation (originator or investor with respect to the securitisation position).

ESAs contend that originators, unlike the investors, are subject to reduced model and agency risk in relation to their own originated securitisation. The ESAs found that the current risk-weight floors on retained tranches are unjustifiably high and operate to dissuade banks from originating a larger volume of SRT trades. Accordingly, the ESAs recommend lowering the risk weight floors for originators being the original lenders<sup>23</sup> (in STS deals, under SEC-IRBA, from 10% to 7%, and under non-STS for all approaches, from 15% to 12%), subject to safeguards. These safeguards would seek to ensure an adequate reduction in the credit risk of the underlying exposures retained by the originator and prevent undercapitalisation of the underlying risk of the respective securitisation positions retained by the originator (criteria in relation to the thickness of the sold non-senior tranches, amortisation structure, granularity and, for synthetic securitisations only, counterparty credit risk).

<sup>22</sup> Positions in resecuritisations – generally not admitted under the EU securitisation framework – when allowed by supervisors, are subject to a more conservative 100% risk-weight floor.

<sup>23</sup> For instance, only originators involved in the origination of the underlying exposures as referred to in point (3)(a) of Article 2 of the Securitisation Regulation. This would exclude any originator that “purchases a third party’s exposures on its own account and then securitises them”, according to point (b) of the same Article, to avoid that credit institutions would expand beyond core businesses just for the purpose of securitising the respective exposures in order to benefit from the reduction in the risk weight floor.

While the safeguards aim to ensure the resilience of the transactions, they have been conceived for future issuances, rather than for existing trades (indeed only a minority of the existing transactions would pass the criteria). The criterion on the thickness of the non-senior tranche has been perceived by various stakeholders as particularly conservative and prescriptive.

## Question 9.11:

Do you agree that securitisation entails a higher structural model risk compared to other financial assets (loans, leases, mortgages) due to, for example, the inherent tranching? Please explain your answer.

- Yes
- No
- No opinion

### Answer to multiple choice:

- No

### Explanation / justification / answer:

The answer to question 9.11 is primarily ‘No’. To paraphrase the French mathematician and chemist Antoine de Lavoisier — a sceptic of alchemy: securitisation transforms the credit risk of the underlying pool, it does not make it disappear, it does not create it. There is no alchemy in the securitisation technique; there should not be capital requirement created spontaneously.

The tranching redistributes the risks differently, with a dedicated priority of payments, but there is no additional source of risk. Some true sale securitisations enable interest proceeds to be redirected towards the fast amortisation of principal of (usually senior) tranches (via so called interest waterfall diversions). This enables the improvement of the external rating of a given tranche, or to use the benefit of this transformation to lower the attachment point of a tranche given a rating. In effect securitisation uses the concept of future margin income (FMI) that can be economically and legally used to offset future principal losses, and this during the entire life of the pool of assets.

The structural model risk that exists is the one introduced by the regulators themselves. Indeed, there is a difference in the way regulators assess the risk pre- and post-securitisation. Indeed, in December 2013, the Ratings and Securitisation Workstream (RSW) of the Basel Committee on Banking Supervision (BCBS) has said it calibrated the losses during the entire life of the pool of assets (rightly so), but only gave partial recognition of the FMI past the one-year horizon. That benefit is only granted to the senior tranches and it assumes (incorrectly so) that non-senior tranches received no FMI. This is why SEC-IRBA has parameters A, B, C, D and E for senior tranches that differ from non-senior tranches, when calculating the ‘p-factor’. It is obvious to any market participant that income on non-senior tranches exists, and that the level of coupons / spread is taken into account in any investment decision. But the existence of FMI is denied for non-senior tranches, when the 2013 calibration was proposed to Basel by the US members of the RSW.

As a reminder, before an asset is securitised, its capital requirement is determined on the basis of the ‘marginal value at risk’ (MVaR) of that asset present on a diversified bank’s balance sheet, which is subject to a systemic shock at a 99.9% confidence level at the one year horizon, with a mark-to-market maturity adjustment for the expected cashflows past the one-year horizon. While this definition was correctly adhered to for the wholesale regulatory framework, it was simplified for the retail framework by an increase in the regulatory correlation in exchange of the removal of a maturity adjustment. This was done during the Basel negotiations in 2002-2004.

Based on the above definition, the ‘marginal value at risk’ of a securitisation tranche to a diversified bank’s balance sheet can be obtained by a regulatory capital model. A correct model for this is Pykhtin & Dev (2002). This model requires a conditional pool correlation (rho-star), that was generalised in multi-periods in Duponcheele, Totouom-Tangho & Perraudin (September 2013)<sup>8</sup>. The Basel Committee on Banking Supervision has said that it took into account a conditional pool correlation of 6% for the calibration of the parameters A, B, C, D and E in SEC-IRBA (December 2013), for all asset classes (even though it was shown that this conditional pool correlation is asset class dependent).

So, the answer to question 9.11 could also have been ‘Yes’, in the sense that there is a higher structural model risk, but it is not derived from tranching per se as implied in the question 9.11, but from insufficiently sensitive regulatory parameters. This risk can be quantified, and this was done by Perraudin (2024) in a research note entitled “Calibration of a Securitisation Capital Floor”<sup>9</sup>. Perraudin (2024) has shown that stressing the value of rho-star at a 95% confidence level leads to residual risk in the senior tranche that does not exceed 10% of pool capital when the attachment point of the senior tranche is above the scalar of 1.5 times pool capital (See Table 3.3 page 4 of that paper).

**Question 9.12:**

Do you consider that scope and the size of the reduction of the risk weight floors, as proposed by the ESAs, is proportionate and adequate to reflect the limited model and agency risks of originators and improve the risk sensitivity in the securitisation framework, taking into account the capital requirements for other financial instruments?

- Yes
- No
- No opinion

Answer to multiple choice:

- No

<sup>8</sup> [https://www.riskcontrollimited.com/wp-content/uploads/2015/02/Maturity\\_Effects\\_in\\_Securitisation\\_Capital.pdf](https://www.riskcontrollimited.com/wp-content/uploads/2015/02/Maturity_Effects_in_Securitisation_Capital.pdf)

<sup>9</sup> <https://www.riskcontrollimited.com/wp-content/uploads/2024/07/Calibration-of-a-Capital-Floor-for-Securitisations-24-37a-07-03-24-v10.pdf>

**Question 9.13:**

If you answered no to question 9.12., should the scope and size of the reduction of the risk weight floors be amended?

For example, should it be extended to investors in a targeted manner (such as, for example, to investors in STS securitisations and under SEC-IRBA approaches only, to prevent discrepancies with the prudential treatment of covered bonds under the SA approach)?

Or, on the contrary, should the scope be reduced to only include originators who are servicing the underlying exposures?

Please justify your reasoning.

The answer is ‘Yes’; **both** the scope and the **sizing** of the risk weight (RW) floor (rather than the **size of the reduction** as stated in question 9.13) need to be amended.

**1) In terms of sizing the risk weight floor**

The issue was extensively studied in a Risk Control paper entitled “*Rethinking the Securitisation Risk Weight Floor*”, a paper prepared with the participation of the Paris Europlace Securitisation Committee Experts Group on Prudential Regulation.

By imposing an arbitrary minimum risk weight on securitisation tranche capital, the RW floor strongly affects which type of assets can be securitised. If the RW floor is high, then the retained senior tranche in typical synthetic securitisations becomes too costly in capital terms for the issuing bank. This is especially true when the underlying assets are low risk.

The primary issue that needs to be addressed in the design of the RW Floor is the notion that a floor needs to be a fixed value. Any fixed value is not risk sensitive. The absolute level of the fixed value can be assessed as a **relative proportion of the underlying pool risk weight**.

In some instances, it ceases to be a proportion, and it becomes a whole multiplier of the underlying pool risk weight (e.g., with prime European residential mortgages of IRB banks). It is a situation where the capital requirement of the senior tranche (typically AAA-rated) is higher than the capital requirement of the unsecuritised assets. **This financial incoherence has consequences: by freezing de facto the prime European residential mortgages on the banks’ balance sheets, it results in a major impediment for a proper functioning of the CMU.**

The 2022 JC’s proposal only touches upon the calibration, and not the design. Paris Europlace is of the view that the European Commission should address both.

**2) In terms of the scope**

An appropriate RW floor should be designed for all banks, regardless of whether they are an originator, an investor, or a sponsor. It should be redesigned as a proportion of the RW of the pool for all methods (SEC-SA, SEC-IRBA, SEC-ERBA and IAA).

Since the asymmetry of information is different between an (external) investor and an originator, the floor for an investor could be based on SA RW of the pool, whereas for an originator it could follow its internal method (respectively the IRB or SA RW).

If regulators want to propose a different RW Floor for STS and Non-STS as a policy tool to steer the market towards the STS label, then a variation around the 10% proportion is possible. The RW Floor could thus be 7% of the RW of the pool for STS, and 12% of the RW of the pool for Non-STS (such as in the September 2024 BVB/TSI Securitisation Report).

It would be preferable to make it transparent that the lower RW floor is a policy decision to steer the market in a particular direction rather than something based on a quantification of STS vs. Non-STS.

**Question 9.14:**

Do you consider that the ESAs' proposed accompanying safeguard, with respect to the thickness of the sold non-senior tranches, is proportionate and adequate in terms of ensuring the resilience of the transactions?

- Yes
- No
- No opinion

Answer to multiple choice:

- No

**Question 9.15:**

**If you answered no to question 9.14.**, please provide and explain alternative proposals to ensure a sufficient thickness of the sold non-senior tranches to justify a possible reduction of the risk-weight floor in an efficient and prudent manner.

This specific issue was discussed in a Risk Control paper entitled "*Rethinking the Securitisation Risk Weight Floor*", a paper prepared with the participation of the Paris Europlace Securitisation Committee Experts Group on Prudential Regulation. Below is summary of the relevant section.

Regulators are aware that the senior tranche thickness can be optimised by originators in a way that was not intended (i.e., the senior tranche absorbing mezzanine risk until the senior tranche RW matches the fixed value RW Floor). The December 2022 JC report states:

*"Moreover, the thickness of the non-senior tranches does not feed in all cases into the final risk weight assigned to a securitisation position in an adequate manner due to the relatively high risk weight floor. In fact, the buffer of the attachment point of the senior tranches on the K affects the risk weight assigned to the senior securitisation position."*

Over the years, regulators have attempted to answer the question of what is 'senior enough' in terms of the attachment point of the senior tranche, which is the same as asking: what should be the thickness of the credit enhancement? The question was raised in the 2002 Basel II Working Paper 11, where the notion of  $L^*$  was introduced,  $L^*$  being the solution to an equation involving the floor value itself. Note that this effect occurs when the floor is a fixed value rather than a proportion of the RW pool.

The Eligibility Criteria 3 ("Thickness of the sold non-senior tranches") of the December 2022 JC report attempts to grapple with the same issue by imposing the attachment point of a pre-floor formula that would produce half the value of the 'no-benefit' floor. This process is arbitrary and lacking calibration. While it makes sense that an answer on the resilience of a tranche is being sought to avoid the optimisation that is currently taking place in the market due to the badly designed Basel II and Basel III floor, **to fight a regulatory optimisation by proposing a second regulatory optimisation is not a sound idea.**

In this regard, the approach that the Bank of England takes in imposing a minimum attachment point in SEC-SA SRTs is preferable. It defines as a multiple of pool capital (the scalar), i.e.,  $x1.5 K_{SA}$ , the minimum attachment point A that a senior tranche should have to qualify for SRT purpose (irrespective of complex Monte Carlo simulations showing that this attachment point could be lower). This constraint (with  $1.5 K_{SA}$  as attachment point) corresponds to a level of RW on the tranche that is still above the risk sensitive floor Paris Europlace proposes (i.e.  $12\% K_{SA} * 12.5$  for non-STs, resp.  $7\% K_{SA} * 12.5$  for STs).

When regulators are assessing if the non-senior tranches are sufficiently thick, it is the same as determining if the attachment point of the senior tranche is 'senior enough'. The UK scalar approach for SRT trades has the merit of being truly simple and transparent. In a similar fashion, to determine the resilience criteria, regulators could refer to the underlying capital of the pool,  $K_{IRB}$  or  $K_{SA}$ , and decide that the reduction in the RW floor, or the application of a proportional RW floor, is only applicable for "sufficiently high scalars" (and the scalar of "x1.5" is a reasonable level – see the 2024 Risk Control paper entitled "*Calibration of the Risk Weight Floor*").

For the purpose of coherence, if the RW Floor is proportional to the SA RW of the pool, then the resilience scalar should also be based on a multiple of the SA RW of the pool, such as  $\times 1.5 K_{SA}$  (or  $K_A$ ), although it is quite likely that this criteria will become redundant with the evolution of the floor. The adoption of a sufficiently high scalar would remove the optimisation described above, leading to insufficiently thick non-senior tranches.

**Question 9.16:**

Do you consider that the other three safeguards as proposed by the ESAs (amortisation structure, granularity and, for synthetic securitisations only, counterparty credit risk) are proportionate and adequate in terms of ensuring the resilience of the transactions?

- Yes
- No
- No opinion

Answer to multiple choice:

- No

**Question 9.17:**

**If you answered no to question 9.16.**, please provide and explain alternative proposals for safeguards that would effectively ensure the resilience of the transaction and would justify the reduction of risk-weight floors.

For the three Eligibility Criteria in question 9.16, the answer is ‘Yes’ for the first one, a tentative ‘Yes’ for the second one and a definite ‘No’ for the third one. Thus, the final answer is ‘No’.

The primary consideration of the 2022 Joint Committee of the ESAs (JC) report in focussing on a reduction of the RW Floor (only for originators) is that it can be done without affecting the deeper questions of design and calibration of the underlying SEC-IRBA and SEC-SA regulatory models, which the JC consider should be negotiated at the Basel — rather than the European — level.

But the upcoming Basel work programme will likely not include securitisation. This is important because the ESAs cannot argue that the EU should wait for Basel, as it would be another three years before it is on the agenda. Besides, recent geopolitical shifts mean that Basel is unfortunately much weaker, so the EU has to take its decision for itself.

Besides, Paris Europlace considers that reforms should benefit the entire European securitisation market, traditional and synthetic, STS and Non-STS, and the benefits not limited to few IRB originators.

In exchange for a reduction in the RW Floor, the JC wants ‘thicker’ mezzanine tranches sold to the non-bank investor market (Eligibility Criterion (“Thickness of the sold non-senior tranches”) discussed in question 9.15) and on three additional Eligibility Criteria discussed below.

**The answer to question 9.16 is a ‘Yes’ for Eligibility Criterion (“Amortisation”).** It states:

*“Sequential amortisation or non-sequential amortisation provided that the transaction includes performance-related triggers to switch to a sequential amortisation which should be compliant with the EBA RTS on performance-related triggers”.*

The supervisory approaches (SEC-IRBA and SEC-SA) both define a tranche by its attachment point  $A$  and detachment point  $D$ , the difference being the tranche thickness  $T$ . Implicit in the definition of the loss allocation is that tranches amortise (the non-loss part) sequentially. Internal models used by sophisticated investors can handle more complex situations, in which amortisation is pro-rata under low loss rate situations but switch to sequential when relevant amortisation triggers are exceeded. However, banks are not allowed to use such models for the purpose of capital requirements and instead must use simplified regulatory models. Thus, a model risk introduced by the use of a simplified regulatory model requires reasonable safeguards such as the performance related triggers referred to in Eligibility Criterion (“Amortisation”).

**The answer to question 9.16 is a tentative ‘Yes’ for Eligibility Criterion (“Good granularity”).** It is a ‘Yes’ for the concept, but a ‘No’ for the calibration. It states:

*“The exposures in the pool shall comply with a concentration limit of 0.5% determined in accordance with point (a) of Article 243(2) CRR. This will imply that, at origination, the minimum effective number of exposures  $N$  requested will be 200 or more, depending on the distribution of the exposures.”*

The granularity notion is fundamental, but the threshold is not only too high, but it also introduces granularity cliff-effects. For the threshold, it is commonly accepted that 30 is the minimum number required for a group of events following the same statistical law to estimate its average value. The setting of the value  $N$  at 200 seems to be overestimating this required level. The level of 50 (which corresponds to the current STS threshold) is a conservative enough level.

When  $N$  is less than 50, a special granularity adjustment is required to cater for the loss distribution distortion in extremely low granularity pools. There are more than one technical solution available depending on the regulatory choice for the RW Floor of a single asset. Paris Europlace is open to discuss those technical solutions.

**The answer to question 9.16 is ‘No’ for Eligibility Criterion (“Counterparty credit risk (synthetic only”).** This is discussed at length in the Risk Control paper. Besides, this criterion has a side effect of creating potential for financial instability, as this STS requirement leads potentially to an unsound recycling of capital in the financial system via investor banks’ trading books. It will also stop (re)insurers from participating in the European STS market, when the policy objective is to grow this market. See our answers to questions 7.4 to 7.8.

To conclude:

- the first consideration with regard to the level of the RW floor should be the RW of the pool;
- it should be proportional to the RW of the pool;
- it should be applied to senior tranches with a sufficiently high scalar (such as  $\times 1.5 K_{SA}$ );
- it should be applied for pools with sufficient granularity ( $N$  greater than 50, the STS threshold). When  $N$  is less than 50 (which may be the case for some Non-STS transactions), a granularity adjustment could be required.

**Question 9.18:**

**If you answered no to question 9.16.,** as an alternative, instead of these three safeguards, taking into account the need to ensure simplicity, would it be preferable to limit the reduction of the risk weight floor to STS transactions only?

Please explain.

Calculating a RW Floor that is proportional (10%) to the SA RW of the pool is a simple solution.

To ensure that the pool is sufficiently granular ( $N$  at 50) is a simple check. All STS deals comply by nature of the STS criteria, and a very large percentage of Non-STS deals would comply. In any case, calculating granularity is a simple calculation for banks.

One can add a small regulatory variation to steer the market in particular direction, such as setting the STS factor of proportionality at 7% and the Non-STS factor of proportionality at 12%. This is a simple policy solution.

Finally, for the minority of the market, and is Non-STS with low granularity, a simple granularity adjustment can be added.

Paris Europlace only sees simplicity in the above points, there is no complexity.

The solution of a risk-sensitive RW Floor has the merit of simplicity and appropriate safeguards. As this is only a floor measure, this would not be detrimental to financial stability, as structures will remain protected up to the required amount for achieving a given rating equivalent (economic measure of risk remains the same).

Furthermore, Paris Europlace considers that reforms should benefit the entire European securitisation market, traditional and synthetic, STS and Non-STS, and the benefits not limited to only half the European market (proxy for the future STS market).

**Question 9.19:**

What would be the expected impact of a possible reduction of the risk weight floor on EU securitisation activity?

Please explain any possible impact on different types of securitisations (traditional securitisation, synthetic securitisation), from both supply and demand sides.

If a fixed value risk weight floor (RW Floor) is reduced, it will do little for the European economy. It will create winners and losers, and different market distortions than the ones Europe already has, as such market inefficiencies are inherent to the design of a fixed value RW Floor that is disconnected from the underlying risk of the pool.

The winners will be securitisations of low-quality assets that have high risk weights, as the reduction of a fixed value RW Floor will make such securitisations even more attractive. The losers will be the high-quality assets with low risk weight that will remain unsecuritisable economically, as the ratio of the reduced RW Floor to the risk weight of the underlying risk weight of the pool — as proposed in the 2022 ESAs report — will still be too high. Evidently, the winners will approve such a change, and the losers will still not contribute their assets to what the European economy needs: ‘capital velocity’.

To avoid the creation of economic winners and economic losers, the most important change that the European securitisation market needs is a RW Floor that is linked to the risk of the underlying assets in the pool. This link can be achieved if the RW Floor is set, not as an arbitrary percentage without any rationale, but as proportion of the risk weight of the underlying pool. This proportion can be quantified and calibrated on actual risks. In a 2024 Risk Control paper entitled “*Calibration of the Risk Weight Floor*”, it is shown that correlation risk is less 10% for SMEs and less for other asset classes of the risk of the underlying assets when the attachment point is at x1.5 times the pool capital.

This is why Paris Europlace proposes that for Non-STS, the RW Floor should be set at 12% of the risk weight of the pool, and for STS at 7% of the risk weight of the pool.

If such changes were adopted by the European Commission, then the securitisation technique would be asset-neutral, and could be used on any kind of portfolios. Banks would have a strong interest to remove some of the risks (through SRT) from their balance sheet to optimise the use of their capital. The effect is to increase the supply. Currently some portfolios with very low risks cannot be economically included in a SRT securitisation: a proportional RW Floor will thus make possible the transfer of risk for assets such as residential mortgage which is one of the largest asset classes of the European banking system.

On the demand side, by combining LCR reforms with making the risk weight proportional to the underlying risks, demand on senior tranches of traditional securitisations will increase.



### The (p) factor

The (p) factor is the main parameter of non-neutrality in the securitisation framework. Besides incorporating the capital non-neutrality, it also serves as a smoothing parameter to mitigate the so-called ‘cliff effects’ that arise when small changes in input parameters under the current risk weight functions result in comparably large changes in risk weights (the lower the (p) factor, the higher the cliff effect). The (p) factor aims to capture the structural risks of securitisation<sup>24</sup> in particular agency and model risks, and to some extent correlation (risk of correlated defaults, particularly present in non-granular pools). A p-factor of “1” means that for the whole securitisation structure (i.e., all the tranches) there is 100% more capital required (doubling the capital required) compared to the requirement that applies to the underlying portfolio of assets.

<sup>24</sup> Under SEC-SA, there is a fixed (p) factor of 1 (for non-STS securitisations) and 0.5 (for STS securitisations). Under the SEC-IRBA, banks may calculate their own supervisory parameter based on four risk factors, i.e., the framework (correlation effect), the granularity of the securitised pool for wholesale, the capital charge for the underlying exposures, the average loss given default of the securitised pool, plus one non-risk parameter (tranche maturity MT, capped at 5 years), which is subject to a floor of 0.30. There is no (p) factor in SEC-ERBA where the capital requirements are set out in the look-up tables, to ensure consistency compared with the capital requirements with SEC-SA.

In their [2022 advice, the ESAs](#) did not support the reduction of the (p) factor. In particular, they considered that lowering the (p) factor, without making other changes to the risk-weight function underpinning the SEC-IRBA and the SEC-SA formulae, might increase the risk of cliff effects and of undercapitalisation of the mezzanine (non-senior) tranches. Overall, the reduction of the (p) factor seems to have the most significant impact on the capital treatment of the mezzanine tranches, where more bank investments may not be desirable, and a less significant impact on the capital treatment of senior tranches, where the risk weight floor has a more significant impact.

The issue is whether the (p) factor could potentially be reduced, in a targeted manner and on a limited basis only (equivalent to, for example, a [x%] reduction, compared to the existing treatment), to improve the coherence between the actual risks and the capital treatment, while avoiding the unwarranted risk of increased cliff effects and undercapitalisation of the mezzanine tranches in particular. Possible targeted reductions could focus on originators, STS transactions, or senior tranches.

Questions to stakeholders:

### Question 9.20:

Do you consider that the current levels of the (p) factor adequately address structural risks embedded in securitisation, such as model risk, agency risk and to some extent correlation, as well as the cliff effects?

- Yes
- No
- No opinion

Answer to multiple choice:

- No

### Question 9.21:

**If you answered no to question 9.20.**, please provide the justification, and provide quantitative and qualitative data, for whether and how the (p) factor overestimates the risks and inappropriately mitigates the cliff-effects, for specific types of securitisation exposures.

To understand in detail how the p-factor came about, Paris Europlace refers the reader to Appendix 1 of the 2024 Risk Control paper entitled “*How to calibrate securitisation capital and liquidity risk*”. Below is a summary of the key elements relevant to questions 9.20 and 9.21.

Regulators have used the terminology “halfpipe design”<sup>10</sup> to describe the Basel III formula. It is the engineered assembly of two disparate regulatory models: the first is a ‘flat table’ at 1250% RW, and the second plays the role of the ‘transition’ from 1250% RW to 0% RW.

As the length (threshold  $K_{1250\%} = 1.0 * K_{Pool}$ ) of the ‘flat table’ is too long, **a junior tranche detaching at the current too-high-a-threshold ( $K_{1250\%} = 1.0 * K_{Pool}$ ) already produces the same amount of capital requirement as the entire pool**. This length’s historical ‘raison-d’être’ goes back to the Basel I environment of 1990s. It is a regulatory overlay designed to put a stop to undesirable capital arbitrage only possible with Basel I rules. It is neither scientific nor based on regulatory conservatism.

The transition uses a decreasing exponential function (SSFA) with the pool capital  $K_{Pool}$  as a variable and a parameter ‘p’ (the ‘p-factor’). It generates a capital requirement equal to ‘p’ times pool capital when all the tranche portions above the threshold  $K_{1250\%}$  are added up.

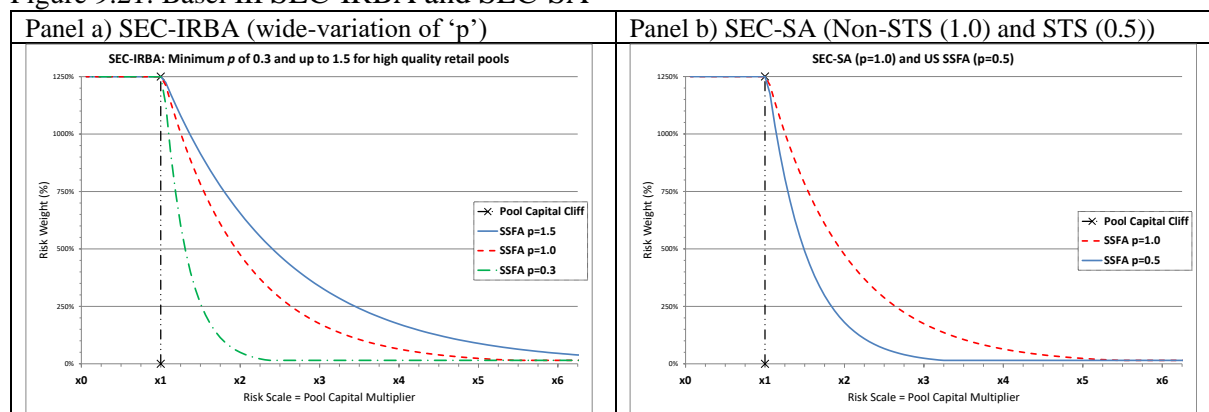
Together, the two models lead to a total tranche capital in excess of pool capital, i.e., there is non-neutrality. The excess is referred to as the ‘capital surcharge’. Since the Basel I length of the ‘flat table’ already generates tranche capital equal to the pool capital, the primary role of ‘p’ as a smoothing parameter for the transition has thus been distorted as being solely responsible for the ‘capital surcharge’. It is unfair on ‘p’. The primary cause of non-neutrality is the length of the ‘flat table’. Focussing on ‘p’ alone will lead to the wrong solution.

After the GFC, Basel had a cliff-effect problem caused by the old Basel II SFA formula (with a p-equivalence of 0.07, and which could not be increased). A new formula was needed without cliff-effect, and to reduce reliance on ratings. In 2011, the US rediscovered a 2001 Basel working paper that proposed the current SSFA with low values of ‘p’ to be used with  $K_{IRB}$ . It set the ‘p’ at 0.5 and applied it to  $K_{SA}$ .

In a regulatory race as to who would manage to kill securitisation first, Basel proposed to set the ‘p’ at 1.5 in 2012, moderating its stance in 2013 by choosing 1.0. Having just gone through the European Sovereign Crisis and realising the importance of securitisation for the EU economy, the BoE and the ECB objected in 2014, and the concept of STS was launched. For which, the ‘p’ was simply halved to 0.5.

For IRB, Basel proposed in 2012 a new and incorrect model (MSFA) that had a numerical equivalence of ‘p’ at 2.0, before abandoning it in 2013, extending instead the use of the US SSFA. Instead of a constant ‘p’ value to be applied to  $K_{IRB}$  as in the 2001 working paper, it made ‘p’ a function of a blend of risk factors and non-risk factors. Officially calibrated on data, this function could produce very low ‘p’. So it was floored at 0.3, knowing that any values below 0.3 would recreate the dreaded ‘cliff-effect’. But no ceiling was set, therefore, the ‘p’ can go sky high in the 1.4 to 1.6 territory for very high-quality assets.

Figure 9.21: Basel III SEC-IRBA and SEC-SA



The ‘half-pipe’ is not a risk model, simply it needs to be calibrated against one. A p-factor at 1.5 is plain absurd (it is generated by a questionable linearisation of the blend of risk and non-risk factors), at 1.0 it massively overcapitalises everything (although it is probably appropriate for US subprime mortgages), and at 0.3 it can undercapitalise some asset classes (high risk weight corporates).

As long as the length of the ‘flat table’ is based on Basel I, the p-factor will not play its main smoothing role against the cliff-effect, it will be the source of a material capital surcharge, perceived (incorrectly) as such by

<sup>10</sup> <https://en.wikipedia.org/wiki/Half-pipe>

non-specialist stakeholders who look only at capital surcharge outcomes (which are far in excess of the calibrated capital surcharge based on asset characteristics).

Therefore, a reduction of the p-factor is part of the solution, but not ‘the solution’. Indeed, it is the combined effect of high p-factor values with the high length of the ‘flat table’ that creates the misalignment between regulatory capital and actual risks. To render the regulatory formula more effective, the solution is simple: a ‘two-p’ solution, i.e., a separate calibration of the length of the ‘flat table’ and of the ‘transition’. In the case of SEC-SA, it can even be easily achieved with a scaling factor to the pool capital input to the SSFA formula (discussed in question 9.28).

**Question 9.22:**

Do you consider that potential targeted and limited reductions to the (p) factor may increase securitisation issuance and investment in the EU, while at the same time keeping the capitalisation of the securitisation tranches at a sufficiently prudent level?

- Yes
- No
- No opinion

Please explain your answer.

Answer to multiple choice:

- **Yes**

Explanation / justification / answer:

The absence of capital neutrality is a strong limiting factor to securitisation issuances for three reasons:

- The RW floor;
- The 1250% RW of the  $K_{IRB}$  (or  $K_{SA}$ ) first loss tranche (the ‘flat table’); and
- The p-factor (the ‘transition’).

The RW floor is an important limiting factor for high quality pools (low risk weight). Those portfolios represent the largest source of assets on European banks’ balance sheets. They are currently untapped for SRT securitisation. Moreover, the RW floor issue impacts all methods (IAA, SEC ERBA, SEC SA, SEC IRBA).

However, as the RW that applies to a senior tranche is currently designed as the greater of the RW floor and the RW obtained with the SSFA formula used in SEC-IRBA and SEC-SA, for those methods, the p-factor is relevant for senior tranches too.

Evidence that the p-values are too high is provided in the ‘Single p’-factor calibration (Senior and Non-Senior) table in Appendix 2 of the 2024 Risk Control paper entitled “*How to calibrate securitisation capital and liquidity risk*”. The methodology for the Risk Control ‘Single-p’ calibration ensures that the upper mezzanine area (defined as the scalar at x2.0 pool capital) is not undercapitalised, thus addressing the concern expressed in question 9.22.

The highest p-value for senior tranches in the ‘Single p’-factor calibration is 0.58 for non-granular corporate pools (where the correlation risk is at its maximum), and the lowest p-value at 0.21 for short-dated specialised lending (commodity finance), where the short pool maturity effect overwhelms the correlation risk. The value for granular short term corporate exposures, i.e., trade receivables, the key asset class for European ABCP conduits is 0.27, where the short pool maturity effect overwhelms the correlation risk. This provides a strong support that there should be a data-based ceiling at 0.75 for senior Non-STS tranches and a policy-driven ceiling at 0.5 for senior STS tranches.

For SRT transactions, or for ABCP financing or Warehouse financing, where the senior tranche is retained, the sizing of the non-senior portion placed with investors or corporate originators is linked to the ‘p’ for senior tranches. If that value is too high (such as the ‘p’ at 1.0 in SEC-SA, or above 1.0 for SEC-IRBA for high quality

pools), the size of the non-senior tranches placed to the market can be too large (much thicker than x2.0 pool capital) and this may become uneconomical, especially when the STS label is not attainable.

The STS calibration with a ‘p’ at 0.5 is about right for the upper mezzanine area, but it could be lowered for short term assets further to a ‘p’ at 0.25. There is not a lot of scope for reduction for other asset classes based on the Risk Control calibration.

The Basel calibration in SEC-IRBA for non-senior tranches assumes no future margin income (FMI). When recognition is partially given (the real world is that such tranches bear coupons and produce income margin for the holder), the ‘p’-factor for non-senior tranches in the Risk Control has the highest value for 0.89 for high risk weight residential mortgages (translate, US subprime mortgages). Therefore a ‘p’ at 1.0 is excessive, in any case. There is strong argument that ‘p’ for non-senior tranches should have a ceiling at 1.0.

Table 9.22: ‘Single p’-factor calibration (Senior and Non-Senior)

Table 2: Calibration of the SSFA with one parameter

	Securitisation Regulatory Asset Class	Senior	Non-Senior
		<i>p</i>	<i>p</i>
Wholesale	Granular Short Term Bank/Corporate	0.27	0.29
	Granular Low RW Medium to Long Term Bank/Corporate	0.47	0.54
	Granular High RW Medium to Long Term Bank/Corporate	0.36	0.52
	Granular Small- and Medium-sized Entities	0.43	0.49
	Specialised Lending (Commodities Finance)	0.21	0.28
	Specialised Lending (Project Finance)	0.55	0.69
	Specialised Lending (Object Finance)	0.50	0.77
	Specialised Lending (Income Producing Real Estate)	0.55	0.62
	Specialised Lending (High Volatility Commercial Real Estate)	0.52	0.62
	Other Granular Wholesale	0.54	0.62
	Other Non-Granular Wholesale	0.58	0.67
Retail	Low RW Residential Mortgages	0.44	0.66
	High RW Residential Mortgages	0.44	0.89
	Revolving Qualifying Retail	0.23	0.41
	Other Retail	0.16	0.61

The direct implication of the Risk Control table is that a ‘p’ value of 1.0 for all assets in SEC-SA for Non-STS is equivalent to having treated European assets on a par with what would be a reasonable level of ‘p’ for US subprime mortgages (which would classify as high risk weight residential mortgages). It is thus not surprising that in 2014, Yves Mersch, then ECB’s Executive Board Member, criticised the 2013 calibration work done by the Basel Committee on Banking Supervision (BCBS) by saying: *“It makes little sense to calibrate the international rules solely based on US experiences. It would be like calibrating the price of flood insurance for Madrid [located on a high plateau] on the experience of New Orleans. The current rules lump all ABS together and are much too conservative. They effectively question their existence.”* (ECB (2014)). Following this reaction, it is not surprising that Europeans slashed the ‘p’ value by half for STS transactions.

This said, while increased issuance is expected for a targeted reduction of the p-value, one should be careful not to reduce the ‘p’ value too much. This is because ‘p’ is in the denominator of an exponential function, whose starting point is the 1250% RW threshold. The latter is set at  $K_{Pool}$  due to Basel I. This threshold is the source of the cliff-effect when the lower mezzanine is calibrated appropriately, and it is this threshold that is primarily responsible for non-neutrality that is impacting materially the securitisation product.

**Question 9.23:**

If you answered yes to question 9.22., what criteria should be considered when considering such targeted and limited reductions? You may select more than one option.

- Exposures held by originators versus investors
- Exposures in STS versus non-STS securitisations (beyond the differentiation already provided for in Article 260 and in Article 262 CRR)
- Exposures in senior versus non-senior tranches
- Exposures calculated under different capital approaches
- Other criteria

Please explain your answer

The question 9.23 trying to define rules irrespective of policy objectives is interesting as it is reflexion of how far the Lamfalussy architecture has been transformed from its initial intent. There should first be policy objectives, and this is clearly lacking in the consultation. Then with the policy objectives, one can make proposals of rules that would be fit for such policy objectives. Post GFC, the European regulatory tradition is now to first make rules, to ignore warnings from the industry, to implement the rules come, and to measure their effects five to ten years later, and then ask for proposals of improvement, still without having any policy objectives.

Thus, let us rephrase this question assuming that one day, the European Commission or the Council of the European Union will state clearly what it wants to achieve with the securitisation technique. Let us assume that the policy objective is to ensure that the securitisation technique helps the European economy grow, that this tool is available to all countries in the European Union, to all banks in the EU whether under SA or IRB, for all sectors of the economy (all types of credit exposures).

Therefore, taking into account all the progress made over the last decade regarding the EU Securitisation framework, which has significantly reduced agency risk (greater control on the underlying assets) and model risk (greater understanding of the correlation issues), the benefits of such progress is for all to share: originators in the EU, investors in the EU, holders of senior risk, holders non-senior risks.

Nevertheless, the 'p' factor is more than a capital surcharge. One can think of this capital surcharge first, independently of the 'p' value. For that Paris Europlace believes that the capital surcharge for SEC-SA should be set so that it departs from capital neutrality for technical reasons and data calibration. The means to reduce principally the capital surcharge, in a way that maintains financial stability, to reduce the outdated Basel I 1250% RW threshold of the 'flat table' described in question 9.21.

The capital surcharge should not exceed 30% for Non-STs. Then if the policy objective is to grow the STS market, this amount can be 'politically' reduced to let us say 10% or 15%. A political reduction is not based on data, it is based on policy objectives, which is to steer the market towards greater volume with the European label.

By equating the 'p' as a capital surcharge, the p-factor under SEC-IRBA should be floored at 0.2 for STS, while keeping the existing p-floor value at 0.3 Non-STs. The 'p' value should have a ceiling, at 0.5 for STS and 0.75 for Non-STs.

If a reduction of the 'p' factor is implemented, it should also be made clear that the p-factor reductions apply to banks in all roles (originators, sponsors, and investors), and a similar adjustment should be done for the SEC-ERBA and the IAA by an adjustment of the risk weights.

Then market mechanics are such that the risk weight floor adds to the overall capital surcharge, and this can be controlled in terms of departure from capital neutrality by ensuring a risk weight that is proportional to the underlying risk weight of the pool. It should be accessible for all banks, SA and IRB, ensuring a level playing field in the EU. It can be differentiated by STS and Non-STs, again to meet policy objectives to steer the market towards more STS. This is why the proposal is to have 7% of the risk weight of the pool for STS, and 12% of the risk weight of the pool for Non-STs. Furthermore, all the methods SEC-IRBA, SEC-SA, SEC-ERBA, IAA should have a level playing field on this issue too.

**Question 9.24:**

As regards your answer to 9.22., please provide quantitative and qualitative data on the likely impact of possible targeted and limited reductions to the (p) factor as investigated above, in particular how such targeted reductions would avoid cliff effects and undercapitalisation of mezzanine tranches and, how they would not create incentives for banks to invest in mezzanine tranches.

Considering the progress made in the last decade regarding the EU Securitisation Framework, which has significantly reduced agency and model risks for securitisations, an efficient allocation of risk would be capital-neutral (except for the technical surcharge), with a moderate increase concentrated on the floor on senior tranches.

In addition, a reduction of the p-factor is only a mean to get closer to a capital-neutral allocation. The cliff effect resulting from the current framework is linked to the presence of the Basel I 1250% RW threshold.

Maybe, it is best explained graphically, that the focus should not be on the ‘p’ value, but on a shift of the exponential smoothing curve.

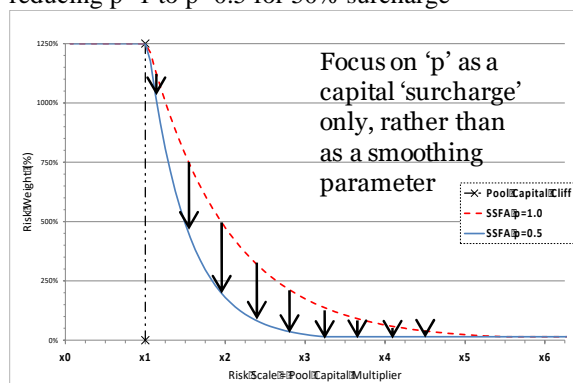
To change only the value of ‘p’ is to focus on the vertical direction shown in Figure 9.24.1 Panel a), which shows the 50% reduction in the capital surcharge when moving from SEC-SA (p = 1.0) to the US calibrated version (p = 0.5) (also STS in Europe). The exponential function is starting at a fixed point (the threshold  $K_{1250\%}$  set at x1.0 pool capital on the x-axis, and 1250% RW on the y-axis). Reduction in the value of ‘p’ will immediately impact the steepness of the smoothing and the allocation (it acts as a ‘vertical force’ on a hard table and a flexible membrane, to take an engineering analogy).

With a ‘p’ of 1.0, everything is overcapitalised unnecessarily. With a ‘p’ of 0.0, everything after the hard table is undercapitalised dangerously (the infamous ‘cliff-effect’). It is clear that most of the unnecessary overcapitalisation is the result of wanting to smooth the cliff-effect in the first place.

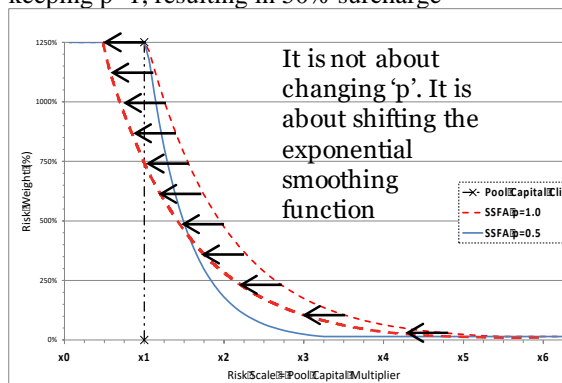
To remove this unnecessary overcapitalisation can be done by looking at a horizontal shift of the exponential curve without changing the p-factor’s capital allocation role. This is shown in Figure 4.2.1 Panel b). In this figure, both SSFAs generate a 50% surcharge. In that case, the smoothing parameter ‘p’ cannot be read directly as a surcharge. By doing the parallel shift of the exponential, one has split the role of the allocation from the role of the surcharge and removed the problem of the smoothing of the outdated Basel I 1250% cliff-effect, as the distribution is no longer flat up to x1.0 pool capital.

Figure 9.24: Tackling the Basel I ‘regulatory taboo’: it is not about ‘p’ value, it is about the ‘shift’.

Panel a) Joining the US, with 50% more capital, reducing p=1 to p=0.5 for 50% surcharge



Panel b) A new solution, with a parallel shift by keeping p=1, resulting in 50% surcharge



The scaling factor SF of 0.65 applied to the pool capital as it enters the formula, while keeping the p-factor at 1.0, discussed in the answer to question 9.28, applies the same ‘force’ horizontally and vertically, a sort of diagonal force. It controls the capital surcharge, while avoiding undercapitalisation at the mezzanine level. The resulting curve is displayed in Figure 9.28.

As was visible in previous explanations, the current Non-STs SEC-SA formula overstates the risk on mezzanine tranches and on the senior tranche when the pool has a low risk weight.

A regulatory formula that is more in line with the economic risk would thus reduce the cost of issuance of those tranches and allow the development of securitisation on high quality portfolios.

A regulatory improvement focused on portfolio of high quality would be a really positive differentiation in the market, and it would bring new resources to help European banks finance the economy while keeping global risks controlled.

**Question 9.25:**

**As regards your answer to 9.22**, please provide the data on how they would have a positive impact on the issuance of securitisation, the investments in securitisation, and the placement of securitisation issuances with external investors, for different types of securitisations (traditional securitisation, synthetic securitisation).

Concerning the reduction of the floor — not as an absolute value, but as the result of moving to proportion of the underlying risk weight of the pool — it will have an impact on the securitisation of low risk portfolios. Currently mortgage pools, which have a very low default rate in Europe, are mainly financed through the balance sheet of banks.

In the case of France, 1.5 trn euros in residential mortgages resides on the banks' balance sheets, and an important amount, 380 bn euros, is funded via covered bonds. It is a fallacy to want to avoid reforms for securitisation because of the incorrect view that STS securitisation will displace covered bonds. Covered bonds and securitisation play different roles: covered bonds are funding instruments, not financing instruments. They provide no capital velocity to the economy.

Combining the reform on the RW Floor, with a treatment of the LCR that corrects the existing miscalibration, will have the largest impact on the potential for growth for the European securitisation market. This will provide banks with floating rates amortising securities for LCR purpose, improving the liquidity on markets, and reducing the spreads. Bank treasuries will also be able to better diversify their investment sources with senior well-rated instruments less subject to idiosyncratic risk (and hence improve their risk diversification).

Concerning a targeted reduction of the p-factor, or better, the reduction of the 1250% RW threshold on the upper part of the  $K_{IRB}$  or  $K_A$ , the main impact is on mezzanine tranches. This is important for SRT transaction that will be more efficient with a lower cost. The best solution is to have a lower 1250% RW threshold combined to a small reduction in the 'effective p'. This measure should be combined with the risk-sensitive RW Floor.

Paris Europlace understands the benefits of reducing only the 'p' value, but it is not the optimum solution to correct alone the existing problems of overcapitalisation and undercapitalisation of some tranches.

**Question 9.26:**

Do you consider that the current approach to non-neutrality of capital requirements as one of core elements of the securitisation prudential framework, leads to undue overcapitalisation (or undercapitalisation) of the securitisation exposures, in particular when compared to the realised losses and distribution of the losses across the capital structure (different tranches of securitisation) over a full economic cycle?

- Yes
- No
- No opinion

Please explain your answer.

Answer to multiple choice:

- Yes

Explanation / justification / answer:

The question can be answered, either with a focus on historical data, or with a focus on the formula.

**1) Empirical evidence using long time series covering several past crises**

Below are two table extracts from the S&P 2024 report (for the whole universe of European structured finance) and from the S&P 2023 report (that provides a breakdown for the whole universe of European RMBS), giving the cumulative default rates, conditional on survival:

- The average cumulative default rate over a 3-year horizon for a BBB rating is 1.35% (based on S&P European structure finance historical data covering the period from 1983 to 2023 as shown in Table 9.26.1). This corresponds to a bit below 0.5% yearly default rate. A BBB-rated mezzanine tranche results approximately in a 220% RW based on SEC-ERBA (that could be even higher using SEC-IRBA) and is historically as risky on average over a cycle as the investment in an investment grade corporate. However, an investment grade corporate with the equivalent 0.5% 1-year PD would receive approximately a 60% RW under A-IRBA and around 100% RW under SA. The ratio of overcapitalisation is between x3.7 and x2.2.

Table 9.26.1: S&P European structured finance cumulative default rates, conditional on survival, 1983-2023

(%)	Time horizon (years)									
	1	2	3	4	5	6	7	8	9	10
AAA	0.11	0.27	0.49	0.77	1.05	1.27	1.43	1.51	1.58	1.63
AA	0.10	0.26	0.57	0.95	1.52	1.95	2.26	2.45	2.56	2.68
A	0.11	0.33	0.65	1.01	1.48	1.94	2.35	2.62	2.80	2.97
<b>BBB</b>	0.24	0.70	<b>1.35</b>	2.16	3.18	4.09	4.86	5.42	5.85	6.25
BB	0.51	1.55	2.92	4.28	5.49	6.53	7.49	8.22	8.77	9.28
B	1.80	4.24	6.81	9.23	11.15	12.17	12.83	13.31	13.55	13.66
CCC	10.34	18.64	24.44	28.38	29.96	30.99	31.70	32.21	32.63	32.79
CC	29.31	45.27	55.59	58.08	58.67	59.13	59.48	59.85	60.28	60.28
IG	0.13	0.36	0.70	1.12	1.65	2.09	2.45	2.68	2.85	3.01
SG	4.28	8.09	11.26	13.65	15.14	16.16	16.95	17.55	17.98	18.29
Overall	0.92	1.83	2.70	3.48	4.19	4.73	5.17	5.47	5.69	5.86

Note: IG--Investment-grade. SG--Speculative-grade. Source: S&P Global Ratings Credit Research & Insights.

Table 9.26.2: S&P European RMBS cumulative default rates, conditional on survival, 1988-2022

(%)	Time horizon (years)									
	1	2	3	4	5	6	7	8	9	10
<b>AAA</b>	0.06	0.09	0.11	0.11	0.11	0.11	0.12	0.12	0.12	<b>0.12</b>
AA	0.01	0.04	0.09	0.10	0.12	0.16	0.23	0.25	0.27	0.29
A	0.01	0.05	0.11	0.15	0.21	0.33	0.44	0.51	0.60	0.65
BBB	0.06	0.18	0.44	0.72	0.98	1.28	1.60	1.77	1.95	2.07
BB	0.34	0.98	1.79	2.36	2.96	3.38	3.84	4.28	4.39	4.39
B	1.00	2.18	3.36	4.43	5.46	6.35	6.58	6.65	6.75	6.87
CCC	8.45	15.05	18.21	19.71	20.38	20.77	20.77	20.77	20.77	20.77
CC	27.27	42.42	52.02	55.45	55.45	55.45	55.45	55.45	55.45	55.45
IG	0.04	0.08	0.16	0.22	0.28	0.37	0.47	0.52	0.57	0.61
SG	1.81	3.51	4.81	5.71	6.49	7.08	7.40	7.67	7.76	7.80
Overall	0.30	0.58	0.84	1.02	1.18	1.34	1.46	1.54	1.59	1.63

Note: IG--Investment-grade. SG--Speculative-grade. Source: S&P Global Ratings Credit Research & Insights.

- The average cumulative default rate for a AAA EU RMBS over a 10-year horizon is 0.12%, based on S&P historical data covering the period from 1988 to 2022 as shown in Table 9.26.2). Hence a yearly default rate which is factually below the IRB PD-floor for the 1-year PD for IRBA calculation. This level of average risk is in line with the highest rated corporates, that receive less than 10% RW in A-IRB. This can also be



compared with the average A-IRB 12% RW on French residential mortgages. In comparison, the current risk weight for a 5-year Non-STS senior tranche is at least 20% RW (and could be 70% RW if the AAA tranche were not senior), even though there is an additional layer of protection. The ratio of overcapitalisation is at least x2.

**Therefore, the current approach to non-neutrality of capital requirements leads to a systemic overcapitalisation based on relevant historical data.**

Even if they are not public, it would be informative for the European Commission to consult the backtestings that are mandatory on SRT issuances losses (that should be available from 2015). One would expect to find explicit proof that senior tranches are unduly overcapitalised in Europe.

**2) Mathematical evidence using calibration of risk models**

Question 9.26 raises the important issue of whether the calibration of a risk model to assess the quality of the capital allocation, determining overcapitalisation and undercapitalisation, from SEC-IRBA and SEC-SA, includes the **full economic cycle**. The 2013 calibration performed by Risk Control presented in the answer to question 9.22 was done based on IRB data at the time from a consortium of banks, which covered at least the previous 10 years. This means that the Global Financial Crisis and the European Sovereign Crisis periods are embedded in the IRB data used in 2013.

Furthermore, the conditional pool correlation calibrated in 2013 used data from the rating movements during the GFC<sup>11</sup>. Should this calibration be updated with more recent data that is impacted by the benefits of the many regulations in Europe that were passed post GFC for both the securitised exposures and the securitisation positions, the resulting calibration would be even better. In that case the calibration of the capital surcharge in question 9.22 should be seen as being on the very conservative side.

This would support the argument that a data-based calibration of capital surcharge of 30% for Non-STS is more than appropriate and the political 10%-15% capital surcharge for STS may be justified. But 1250% RW threshold (or length of the table in the 'half-pipe' design) needs to be shortened to ensure that this surcharge is allocated properly to cater for the conditional pool correlation risk.

If regulators intend to keep the 1250% RW threshold at one times pool capital, one cannot have a capital surcharge that is both based on data and no undercapitalisation of the upper mezzanine area. The best solution to ensure that there would be no undercapitalisation in the regulatory formula is to have a lower 1250% RW threshold combined to a higher value of 'p', while controlling the capital surcharge to a low level.

Paris Europlace understands the benefits of reducing only the 'p' value, but it is not the optimum solution to correct the existing problems of overcapitalisation and undercapitalisation of some tranches.

**Question 9.27:**

**If you answered yes to question 9.26**, please justify your reasoning and provide quantitative and qualitative data to show the extent of the undue non-neutrality (overcapitalisation or undercapitalisation), in particular when compared to the realised losses and distribution of the losses across the capital structure, taking into consideration the need to cover a full economic cycle.

**If one uses the historical comparison from question 9.26, based on the average default rate over the several economic cycles, the senior tranches and the mezzanine tranches receive significant overcapitalisation.**

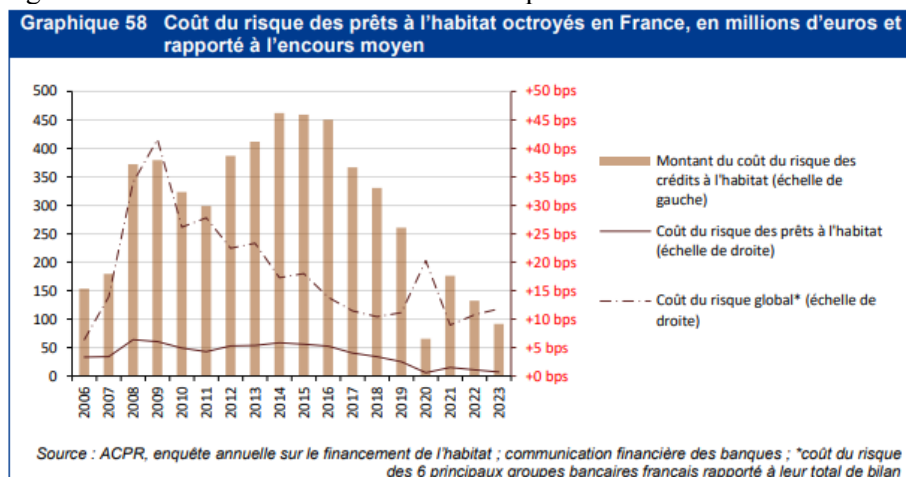
This is clearly linked to unjustified levels of capital non-neutrality.

**Example based on residential mortgages securitisation:**

As an example, under A-IRB (whose models are backtested by banks and regularly controlled by the ECB), French residential mortgages have approximately a 12% RW (or around 1% capital requirement), where the average yearly cost of risk is lower than 0.05% in France (meaning a capital requirement x2 the 10-year cumulated cost of risk, which includes the impact of recoveries).

<sup>11</sup> [http://www.riskcontrollimited.com/public/Regulatory\\_capital\\_for\\_securitisations.pdf](http://www.riskcontrollimited.com/public/Regulatory_capital_for_securitisations.pdf)

Figure 9.27: Extract from French ACPR's report on cost of risk for residential mortgages



The relevant risk weight on a AAA senior tranche for such a pool should be far below 10%, in particular, the securitisation floor is massively overstated:

With a cumulative average default rate of 0.12% over 10 years on European RMBS AAA notes, the 20% minimum risk weight for Non-STS AAA senior tranches (SEC-ERBA approach) represents a capital requirement of more than x13 the average cumulative gross loss over 10 years (based on defaults in Europe, before recoveries).

Assuming a very conservative 50% recovery, this is x26 the average cumulative net loss over 10 years (it was x2 on French residential Mortgages).

**Example based on corporate loan securitisation:**

Let us compare a BBB-rated mezzanine tranche risk weight with a similarly rated corporate with IRB risk weights.

For a securitisation tranche of BBB rating, the loss would be consistent with a capital requirement at a x12 stress (assuming 0.5% default/year). This would generate a capital requirement of 6%, corresponding to 75% risk weight. This 75% estimation is consistent with the RW measure for an investment grade corporate with the equivalent 0.5% 1-year PD: it would receive approximately a 60% RW under A-IRBA and around 100% RW under SA. However, it is far below the 220% risk weight level in SEC-ERBA (based on a 1-year BBB mezzanine tranche), the ratio of overcapitalisation is around x3.

**Question 9.28:**

**Based on your answer to 9.26.**, do you consider that alternative designs of the risk weight functions, such as an inverted S-curve, or introducing a scaling parameter to scale the  $KA^{25}$  downwards, within the current halfpipe design, as investigated in the Section 3.3.2 of the [EBA report](#), have potential to achieve more proportionate levels of capital non-neutrality and capital distribution across tranches, address the potential cliff effects more appropriately and achieve prudential objectives?

<sup>25</sup> KA factor as specified in paragraph 2 of Article 261 of the CRR, for the purpose of calculation of the capital charge under the standardised approach (SEC-SA)

- Yes
- No
- No opinion

Please explain your answer

Answer to multiple choice:

- Yes

Explanation / justification / answer:

Any risk-based model for a granular pool would produce an inverted S-curve. The inverted S-curve is the most economic capital allocation. Basically, it can be summarised as having an implicit pivot around the attachment point equal to the pool capital value at around 625% RW and reaching near 0% RW when the attachment point is sufficiently high. The CMA developed by Risk Control is such a model.

The inverted-S curve could even be made explicit by having a pivot set to be equal 625% RW at  $K_{IRB}$  and  $K_A$  and 0% at  $x2.0$  times  $K_{IRB}$  or  $K_A$ . The RW Floor would override the 0% RW value (or could even be added as an add-on).

The SEC-ERBA table for mezzanine tranche with 1 year tranche maturity is relatively in line with this inverted S-curve, except for the upper part. (The Basel I 1250% RW threshold has not survived in this approach and should be removed elsewhere. It is also important to remove discrepancies between regulatory methods, which could be addressed by mapping all methods to a single approach.)

Once can build an inverted S-curve by calibrating two points: the pivot point and end point. At 1 times pool capital and 2 times pool capital, the inverted S-curve is capital neutral.

The 2014 ‘two-p’ calibration of the SSFA by Risk Control is similar in spirit. It attempts to approximate the effect of the inverted-S curve, while keeping the overall design of the Basel formula. Also, the calibration point at 2 times pool capital is used to calibrate the capital requirement based on the calibrated capital surcharge and the correlation risk. The ‘two-p’ calibration results in capital surcharges slightly above the calibrated capital surcharge of the CMA.

The proposal made by Risk Control in 2022 to introduce a scaling factor (SF) to the capital input  $K_A$  as it enters the SEC-SA is a generalisation of the ‘two-p’ calibration aimed at minimising a potential amendment in the legislative text, while obtaining a similar effect as the two-p calibration with an appropriate capital surcharge. It is in the spirit of the Basel rules, while making a very small change to the letter of the Basel rules.

**While keeping the official ‘p’ value at 1 for all transactions (STS and Non-STS), a SF value can be calibrated for STS and Non-STS.**

For example, a SF value of 0.65 leads to:

- an effective 1250% RW threshold at 0.65 times  $K_A$
- an ‘effective p’ value of 0.65 (while the official ‘p’ remains unchanged at 1), generates a capital requirement of 0.65 times  $K_A$
- thus, this results in an overall capital surcharge of 30% ( $=0.65 + 0.65 - 1$ )

**This function would address the problems of undercapitalisation of the upper mezzanine area when the ‘p’ value is too low as it is the case currently in SEC-IRBA, for some (not all) transactions.**

For example, a SF value of 0.55 leads to:

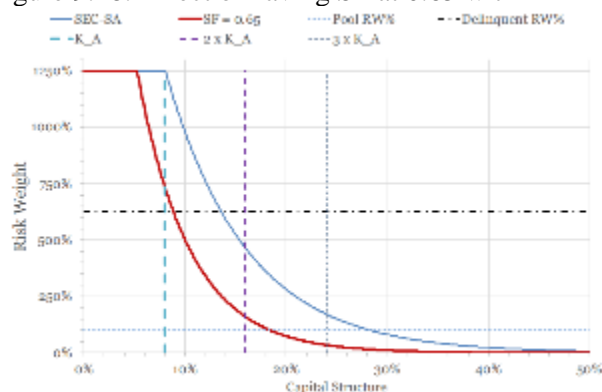
- an effective 1250% RW threshold at 0.55 times  $K_A$
- an ‘effective p’ value of 0.55 (while the official ‘p’ remains unchanged at 1)
- an overall capital surcharge of 10% ( $=0.55 + 0.55 - 1$ )

As the parameter ‘p’ in SEC-IRBA is already a function of  $K_{IRB}$ , and as it can reach a low level of 0.3 for which undercapitalisation of the upper mezzanine area already exists for some asset classes, it is not possible to apply this solution directly, for any value of SF greater than 0.3 (at which capital neutrality without surcharge can be achieved, leading to an undercapitalisation of the upper mezzanine area). More changes would be required on the Basel ‘p’ in SEC-IRBA to correct the situation. Instead, it would be better to combine a reduction in the 1250% RW threshold, to winsorize the ‘p’ with a higher minimum than the current 0.3 (to cover for the capital surcharge and correlation risk) and put a ceiling due to linearisation issues inherited from the US-calibration. This would require more legal changes than the simple adjustment proposed by Risk Control in 2022 for SEC-SA.

To conclude, an inverted S-curve is the most appropriate way to allocate capital requirements in a securitisation, whether the bank is an originator (or ABCP sponsor) or an investor. It has other benefits as it would simplify the SRT ratio, and capital and risk would be more aligned. This said, it would be best if all methods (IAA, SEC ERBA, SEC SA, SEC IRBA) are adapted to the principle of an inverted S-curve.

As a caveat, the inverted-S curve results from having a granular pool of performing loans. This cannot be extended to very low granularity pools or to NPL portfolio or other non-loan categories.

Figure 9.28: Effect of having SF at 0.65 with KA



**Question 9.29:**

**If you answered yes to question 9.28,** please specify the impact of such alternative design compared to the existing risk weight functions and explain an appropriate calibration of such alternative designs and possible safeguards for the measures to achieve prudential objectives.

The calibration of the alternative is included in the answer to question 9.28.

Firstly, this alternative design will allow more assets to be securitised.

Secondly, the reduction of the mezzanine risk weight will reduce the costs of insurance for SRT trades.

Such a solution will be all the more necessary that CRR4 significantly increases the RWA on the underlying assets.

As a result of this double effect for the mezzanine portion of the capital structure of securitisations, when combined with a risk weight floor that is made to be proportional to the risk weight of the pool, it is expected that the volume of issuance will grow for low-risk assets.

In other words, the proportional risk weight floor affecting the senior area will be the main source of volume increases, whereas the alternative design for the mezzanine area will make such increases more economical.

### Significant risk transfer (SRT)

The concept of significant risk transfer ('SRT'), i.e. transfer of a sufficient quantum of credit risk from the bank's balance sheet to a third party, is a crucial regulatory and supervisory concept in the EU securitisation framework. It is a precondition for a bank originator to benefit from capital relief from securitisation, and therefore one of the critical considerations for a bank originator when structuring a securitisation transaction. Achieving SRT requires complying with various quantitative and qualitative tests that are defined in high level terms in the CRR. The current framework provides for two 'mechanical' tests (the 'mezzanine' and 'first loss' tests), which the competent authority supplements with a case-by-case assessment, as to whether the originator has transferred an amount of credit risk which is 'commensurate' to the capital relief. The 'permission-based' approach is an alternative to the existing mechanical tests and may ensure that a commensurate transfer of risks is achieved. The originator has an interest in receiving the assessment of compliance with those tests by the Competent Authorities for reasons of legal certainty, and the Competent Authorities' decision on SRT is consequential for the economic viability and ultimate structure of a securitisation executed with a capital relief intent.

In its [report published in 2020<sup>26</sup>](#), the EBA identified a series of structural limitations of the existing SRT regulatory framework in the CRR and it proposed a set of recommendations to enhance the efficiency and robustness of the SRT framework and strengthen the consistency in the SRT outcomes (in particular in three areas: in relation to the SRT tests, the process applied by the competent authorities to assess the SRT, and the structural features of securitisation transactions which may affect the effectiveness of the risk transfer).

<sup>26</sup> See [the EBA calls on the European Commission to harmonise the significant risk transfer assessment in securitisation | European Banking Authority](#)

As one of the recommendations, the EBA recommends replacing the mechanical tests with a single comprehensive test based on the principle-based approach (PBA) test which aims to make the SRT framework less complex and more flexible. Under the PBA test, the SRT can be achieved in case at least 50% of the unexpected losses (UL) are transferred to third parties. The EBA also provides recommendations with respect to the allocation of the lifetime expected losses (LTEL) and unexpected losses to the tranches for the purposes of the PBA test. Those recommendations have received only limited support from stakeholders, given the alleged conservativeness of the proposals as regards the suggested back-loading of UL in a stressed scenario.

Recently, improvements have been achieved in both the convergence of assessment and the process of the SRT assessments. The recent market data confirm a considerable increase of SRT securitisation transactions. Generally, the SRT market continues to grow as these transactions allow banks, that operate in an environment with capital pressure, to benefit from a capital relief. Synthetic transactions continue to dominate the SRT segment, with a share of more than 85% in the overall notional.

Questions to stakeholders:

#### Question 9.30:

Do you agree with the conditions to be met for SRT tests as framed in the CRR (i.e. the mechanical tests - first loss and mezzanine tests, and the supervisory competence to assess the commensurateness of the risk transfer, as set out in Articles 244 and 245 of the CRR)?

Are the SRT conditions effective in ensuring a robustness and consistency of the 'significant risk transfer' from an economic perspective?

- Yes
- No
- No opinion

Please explain your answer.

Answer to multiple choice:

- Yes

Explanation / justification / answer:

Under the current framework, there are no issues with those tests (mechanical, first loss, mezzanine) as described in Level 1 articles 244 and 245.

Concerning the commensurateness of the risk transfer, the Level 1 text leaves the decision to the competent authority. This is the correct approach.

What needs to be reviewed are the Level 3 measures, the EBA guidelines that have been issued, that are too restrictive and go beyond the Level 1 text.

Based on the experience of Paris Europlace members, competent authorities are willing to assess the behaviour of a transaction under a loss scenario coherent with the ICAAP stress, in order to check that the loss is adequately transferred to a third party (i.e., greater than 50%). This approach makes sense, is logical and significantly different from the approach described in the EBA Guidelines.

Indeed, the CRT test in the EBA Guidelines does not fit any definition in the Level 1 text (Regulation 2017/2401, article 244(2)) which states:

*“Where the possible reduction in risk-weighted exposure amounts, which the originator institution would achieve by the securitisation under points (a) or (b), is not justified by a commensurate transfer of credit risk to third parties, competent authorities may decide on a case-by-case basis that significant credit risk shall not be considered as transferred to third parties”*).

In other words, as the SRT requires that more than 50% of risk weighted assets (RWA) are transferred, the regulator should check the appropriate transfer of credit risk using an economic measure of the risk transferred to third party (i.e. the ICAAP stress designed by the bank). It could also require that more than 50% of this economic risk is transferred. The EBA guidelines defines the CRT test as a comparison of those two measures of risk transfer (with a prescriptive ‘ICAAP’ measure), but they are not comparable. It would be more appropriate to compare each of them with 50% (i.e., both of them has to be higher than 50% which would better fit with the Level 1 regulation paper) than to compare one with the other (for example, this comparison could reject for SRT a transaction with 95% of regulatory transfer vs. 90% of economic risk transfer without consideration of the obviously high level of risk transferred).

The necessary revision of the EBA guidelines should lead to the introduction of a measure of risk transferred based on the application of an ICAAP stress defined by the bank on the cash flow of the envisaged securitisation, as a replacement of the CRT test.

**Question 9.31:**

**If you answered no to question 9.30**, do you consider that the robustness and efficiency of the SRT framework could be enhanced by replacing the current mechanical tests with the PBA test?

The PBA test could be based on the recommendations in the EBA report, while the recommendations on the allocation of losses to the tranches could be reconsidered.

While the answer to question 9.30 is a ‘Yes’, a response to question 9.31 is still provided as it raises an important point.

The PBA test from the EBA report is unnecessarily complicated but it is a liveable indicator.

It should be noticed that with a capital neutral formula, this test is simply the ratio of regulatory capital that is transferred (hence very similar to condition 244.2.a and 245.2.a), so the practical use of this test is debatable.

On a broader point, historically, many of the tests to validate the level of risk transfer were introduced to compensate for the deficiencies of the old 2006 Basel II Supervisory Formula Approach (SFA). This is because

it had a 'p' equivalence of 0.07 which severely undercapitalised the upper mezzanine area, leading the Bank of England to suspend its use until additional tests were met. The EU has inherited the work initiated by the UK, and complexified the tests instead of addressing the deficiencies of the regulatory formula. Most of those tests would not be needed, or more exactly would become redundant with an automatic 'tests being met' with more than 50% of RWA transferred, if the regulatory formula was aligned with actual risks. In other words, the complex rules had to be introduced for SRT to control problems introduced by other parts of the regulation.

**Question 9.32:**

Do you consider the process of the SRT supervisory assessments to be efficient and adequate?

- Yes
- No
- No opinion

Please explain your answer.

Answer to multiple choice:

- No

Explanation / justification / answer:

There is no clear supervisory assessment since the 2020 guidelines from the EBA were never put in place in practice (although there is a recent ECB consultation on national options and discretions). Each bank refers to the relationship with its competent regulatory authority. One cannot say, however, that the process is "efficient and adequate" (burdensome templates to exchange with the JST, with still grey zone concerning the mandatory fields), especially for repeat deals.

The September 2024 Paris Europlace Securitisation Report addresses this issue in Recommendation 3. Here is summary.

There are three prominent issues for banks applying for a supervisory assessment of the "Significant Risk Transfer":

1. Ensuring a more fluid SRT assessment process by the competent authorities;
2. Adopting a more pragmatic and less costly approach to the "market test"; and
3. Clarifying that SRT tests should be performed at inception only.

To improve supervisory certainty and time-to-market, and although they do not rank first among the priorities Paris Europlace sees, three aspects should be looked at:

- **The assessment process should be further improved:**

SRT assessment has become more efficient over time and dialogue between banks and their JSTs have improved overall. In this context, implementing EBA recommendations laid down in the 2020 SRT report on the SRT assessment process (e.g. "structural features", "stop-the-clock", "self-assessment") would be a huge step backwards.

The "structural features review" processes proposed by the EBA in many recommendations (# 1, 6, 19) are too long, whether for "simple" or more complex transactions: all in all, the effective assessment time period of some transactions would likely largely exceed 6 months, which is excessive and significantly longer than the recently improved process implemented by the ECB. And the fact that at any time, the Competent Authority could "stop the clock" removes any benefit from the intended improvement of the process.

Finally, there is a need for Competent Authorities' permission or non-objection prior to execution: banks cannot take the risk of executing a transaction if the SRT is rejected and the existence of regulatory calls is not a sufficient safeguard because of the upfront costs of the structuration and of the

negative impact on investor appetite. In this regard, the EBA proposal is also a significant step backwards compared to the current setup.

- **The “Market test” threshold should be lowered:**

In line with the EBA’s recommendation #12 on the PBA test, selling no more than 15% of each of the tranches that are not 1,250% risk-weighted is sufficient to demonstrate that the pricing of those tranches is consistent with market conditions, a criterion deemed important to avoid that risk transfer might be reduced by subsidising the structure through interest payments lower than market prices.

- **Fixing a regulatory loophole: SRT tests calculation at inception:**

In its recommendation #14, EBA recommends running the SRT tests at the initial assessment of the transaction but not on an ongoing basis for the monitoring of the SRT. They indicate that those tests should be re-run only in case of missing or inaccurate information at the time of the original assessment or in case the bank execute any transaction as defined in CRR article 250 and some specific cases as contemplated by the EBA in its guidelines on implicit support.

**Moving forward:**

Overall, Paris Europlace’s proposals intend to make the SRT assessment process more efficient to improve time-to-market and pricing visibility, a pre-requisite for opening the scope of portfolios that could be securitised by banks in an economically viable way, and a prerequisite for many investors to enter this market with confidence.

Paris Europlace would welcome further dialogue with the ECB and the EBA as regards the improvement of the efficiency of the SRT assessment process.

**Question 9.33:**

**If you answered no to question 9.32.,** please provide justifications and suggestions how the SRT assessment process could be improved further.

Paris Europlace welcomes the fast track SRT working group to normalise the basis of this relationship.

SRT assessment should be done:

- At origination only;
- Based on Level 1 text, with a commensurate risk transfer estimated using one ICAAP stress run by the bank on the transaction;
- As a simple ‘tick-the-box’ report based on the requirements of Level 1 Articles 244 & 245 and with estimation of one ratio of transfer under the ICAAP stress estimated by the bank. All that should allow for a quick validation with the competent authority (other indications such as the profitability indicator for the transaction are also of importance in this regard, but do not qualify the transfer of risk).

**Question 9.34:**

Should the process of the SRT supervisory assessments be further specified at the EU level (e.g., in guidelines, based on a clear mandate in Level 1), or should it be rather left entirely to the competent authorities to set out their own process?

- Yes
- No
- No opinion

Please explain your answer

Answer to multiple choice:

- No



Explanation / justification / answer:

EBA is already in charge of specifying the SRT supervisory process through guidelines. This is the right approach as it frames the approach of competent authorities, whether the SSM or national competent authorities, in particular in non-EURO member states. However, the EBA guidelines are too prescriptive, and they introduce unnecessary restrictive conditions, to the point that competent authorities are not applying them, and discrepancies continue to exist.

Indeed, the EBA guidelines are going beyond the Level 1 text, by introducing complex requirements:

- The CRT test defined in those guidelines does not measure the transfer of risk and introduces an uncertainty in the structuration of a transaction.
- The use of excess spread as a new tranche with 1250% RW after securitisation does not take into account the fact that in the banking regulation, on the securitised pool, future revenues are excluded from own funds as well (which is similar to being 1250% Risk Weighted).
- Running a loss scenario (under a stress consistent with ICAAP) is much more efficient and accurate to qualify the transfer of risk. It will be also less time consuming for banks and it will reduce the execution risk compared to the guidelines.

**Question 9.35:**

If you answered yes to question 9.34., please provide suggestions.

N/A

**Question 9.36:**

If you are a supervisor, how would a change in the SRT regulatory framework (in particular on the SRT tests and the process of SRT supervisory assessments) impact your supervisory costs?

N/A

### Transitional measure in Article 465(13) of the CRR

The transitional measure in Article 465(13) of the CRR as amended by [Regulation \(EU\) 2024/1623](#) aims to mitigate possible unintended consequences of the introduction of the output floor on the calculation of capital requirements for securitisation exposures. It introduces a targeted relief for exposures risk-weighted under the SEC-IRBA and internal assessment approach (IAA) by halving the (p) factor in the calculation of the output floor for those IRB securitisation positions (i.e. the (p) factor is halved to 0.25 for the STS securitisation positions eligible for the preferential capital treatment under the CRR, and to 0.5 for all other securitisation positions). The introduction of this targeted relief acknowledges the fact that the (p) factor levels embedded in the securitisation standardised approach formula (SEC-SA) when used in the context of the output floor would produce unduly punitive results for securitisations structured based on the SEC- IRBA by banks using internal models. The transitional measure will be in application from 1 January 2025 until 31 December 2032.

Questions to stakeholders:

#### Question 9.37:

Do you consider that the transitional measure will remain necessary and should be maintained, in case of introduction of other changes to the prudential framework?

- Yes
- No
- No opinion

Answer to multiple choice:

- **No opinion**

#### Question 9.38:

**If you answered yes to question 9.37.**, please explain why and whether there are any alternative measures that could be more appropriate to achieve the original objective of the transitional measure.

The answer to question 9.37 is ‘no opinion’ because it largely depends on what ‘other changes to the prudential framework’ entail.

In the case of the expansion of transitional measure (which halves the p-factor values) beyond the output floor for securitisation transactions under SEC-SA, by construction, transitional measures for the output floor and permanent calibration under SEC-SA will be fully aligned. Transitional measures would remain to apply to SEC-IRBA transactions for the output floor calculation, then answer is ‘No’.

The answer is conditional on the quality of the changes in the prudential framework. If a risk-weight floor proportional to the underlying risk weight of the pool is introduced, and if a scaling factor of 0.65 to the capital input in SEC-SA is introduced, then the answer should also be ‘No’.

If the changes to the prudential framework ignore those two key changes, then the answer is ‘Yes’, as it means that the European authorities persist in maintaining rules or formula designs that will maintain the problems which Article 465 is trying to minimize.

On one hand, at a technical level, **with the current rules**, transitional measures are only necessary because of the changes introducing a sudden increase in capital requirements or a sudden change in solvency ratios. They are needed with the introduction of CRR3 since there is such a sudden increase in requirements, and Paris Europlace would welcome the extension of article 465 on the calculation of the SA Output floor.

On the other hand, in theory, the situation where reduced risk weights on securitisation are introduced that match actual risks, transitional measures would not be necessary. This said, it is possible that some transactions may still be impacted (in particular, the few among many that have an undercapitalised mezzanine area). But if new rules apply to new transactions, problems with past transactions will fast go away as those transactions will amortise.

**Question 9.39:**

**If you answered yes to question 9.37, do you consider that a potential targeted and limited reduction of the p-factor might affect the effectiveness of the transitional measure under the output floor?**

- Yes
- No
- No opinion

Please explain your answer

Answer to multiple choice:

- **No opinion**

Explanation / justification / answer:

The reduction of the p-factor is already effective for the calculation of the SA Output Floor (Article 465).

This measure reduces the impact of the output floor on securitisation for IRB banks, an aspect that had never been taken into account in the design of the Basel III framework, not any QIS, and appear late in the legislative process. It should be seen as a placeholder to be replaced by a more coherent adjustment, either of the p factor, or preferably through a scaling factor, and applying consistently to all approaches, in order to not create unlevel playing field between SA banks (notably in smaller member states) and large IRB banks.

**As a matter of principle, it is always best to let past transactions be ‘grand-fathered’.** This would reduce regulatory uncertainty for all market participants. Applying new rules to old transactions is a recipe for triggering ‘regulatory calls’ and destabilising the efficiency of transactions done by banks and destabilising the investment portfolios of investors. **New rules should apply to new transactions only.**

## Liquidity risk treatment in the LCR Delegated Regulation

The liquidity coverage ratio (LCR), transposed in the [LCR Delegated Regulation \(Delegated Regulation \(EU\) 2015/61 on liquidity coverage requirements for credit institutions\)](#), seeks to ensure that banks maintain a liquidity buffer to meet net outflows under severe idiosyncratic and market wide stress conditions. The LCR Delegated Regulation allows senior tranches of STS traditional securitisations to be included as level 2B high quality liquid assets (HQLA), capped at 15% of the liquidity buffer. Non-senior tranches of STS traditional securitisation, non-STs traditional securitisations, synthetic securitisation and resecuritisations are ineligible for inclusion in the HQLA.

In terms of eligible asset classes, in addition to securitisations with underlying mortgages (RMBS) in line with the Basel Standards, the EU transposition allows inclusion of securitisations with underlying auto-loans, consumer-loans and SME-loans, subject to different haircuts, credit quality steps (CQSs) and other requirements<sup>27</sup>. This expansion of eligible securities in the EU was motivated by the expectation that it would increase diversification of banks' liquid assets.

Some consider that the liquidity treatment of securitisations in the LCR Delegated Regulation has a major impact on banks' investments in STS securitisations and issuance thereof and have advocated for the relaxation of eligibility conditions for securitisations in the LCR.

Currently, banks make only negligible use of the capacity of their liquidity buffers to invest in securitisations as level 2B HQLA, with the share of securitisations in banks' liquid assets ranging from 0.2% to 0.7%. This may suggest that most banks do not consider securitisations to be effectively liquid and marketable during stress. It also shows a minimal impact of securitisations on the liquid assets' diversification in the LCR buffers – the diversification being one of the primary motivations for the expansion of eligible securitisations in the EU beyond Basel.

On a more technical aspect, several stakeholders propose to introduce an amendment to the LCR Delegated Regulation, with the aim to reflect the increased granularity of CQSs under the amended CRR and the related amendment to the Implementing Regulation on the mapping of credit assessments for securitisation positions by external credit assessment institutions' (ECAIs)<sup>28</sup>. They recommend modifying the reference from CQS 1, to CQS 1 to 4, in the Article 13(2) of the LCR Delegated Regulation regarding the long-term rating. In the absence of the updated reference, the STS securitisation tranches with ratings between AA+ and Aa- would unintentionally not be eligible as Level 2B securitisations and the eligibility would be limited to tranches with AAA rating.

<sup>27</sup> In addition, as clarified by [Q&A 2019\\_4786](#), securitisations, including NPL securitisations, that are explicitly guaranteed by the central government of a Member State can qualify as level 1 liquid assets in the LCR in accordance with Article 10(1)(c)(i) of the LCR Delegated Regulation.

<sup>28</sup> [Implementing Regulation \(EU\) 2016/1801](#) as per [Commission Implementing Regulation \(EU\) 2022/2365](#)

Questions to stakeholders:

### Question 9.40:

Does the liquidity risk treatment of the securitisation exposures under the LCR Delegated Regulation have a significant impact on banks' securitisation issuance and investment activities and on the liquidity of the securitisation market in the EU?

- Yes
- No
- No opinion

Answer to multiple choice:

- Yes

**Question 9.41:**

As regard to your answer to 9.40., please explain the impact on banks' issuance of securitisation, investment in securitisation, and relative importance of the liquidity treatment under the LCR in the activity of the primary and secondary securitisation markets.

The answer to question 9.40 is an unequivocal 'Yes'. The LCR treatment of securitisation impacts the liquidity and placement of those securities, and consequently it impacts their price (and indirectly the cost of issuance) and issuance volumes. The September 2024 Paris Europlace Securitisation Report discussed this issue. Our answer below borrows heavily from the report.

**Having an appropriate treatment in the LCR creates a virtuous circle** that reduces the cost for the originator, and that helps develop a primary and secondary market, which in turns leads to more issuances. The mere fact of having more capacity to repo the security with the central banks and the private sector, in itself, leads to increased liquidity and as a consequence more investors outside the banking sector interested in developing such investments.

Banks could be legitimate and sizeable investors in senior tranches of third-party securitisation, as part of their High-Quality Liquid Assets buffer. However, they were crowded out of the market, given a combination of obstacles:

- **the LCR treatment of senior securitisation tranches, even when STS, imposed a significant haircut, which made them inefficient to play a role in the management of the liquidity buffer;**
- The due diligence obligation at loan level is time consuming and not efficient compared to other products;
- The universe of ABS securities eligible to the LCR is too restrictive (only STS, only AAA, etc.);
- The RW applied to those senior tranches is not commensurate with the risk, negatively affecting the risk/return of the asset; and
- There is no equivalence regime allowing EU banks to invest in non-EU securitisation.

Liquid assets eligible in the LCR are divided into various categories:

- Level 1 (the most liquid), such as coins and banknotes or assets guaranteed by the European Central Bank, national central banks or regional governments and local authorities; This category also includes Covered Bonds of "extremely high quality";
- Level 2A, such as assets guaranteed by regional governments, local authorities, or public sector bodies in the EU with a weighted risk of 20%; This category also includes other Covered Bonds; and
- Level 2B, such as asset-backed securities, corporate debt securities, shares provided they meet certain requirements and certain securitisations which must satisfy a range of strict conditions to be accepted as a Level 2B asset, with a haircut of 25/35%.

Indeed, **the haircuts are totally dissuasive**, and according to EBA Risk Dashboard, Level 2A and 2B combined (the most granular figure published by EBA, which includes STS securitisation, represent on average only 4% of the Total HQLA portfolio for European banks, which amounts to EUR 5.5tr.

**Consequently, European bank treasuries are not very active as investors in other European banks' securitisations.** In fact, their main exposure to securitisation is:

- the senior retained tranches eligible to ECB refinancing;
- the retained tranches from own account securitisation (schematically, senior tranches when the focus is risk transfer, junior tranches when the focus is funding);
- the exposures linked to client securitisations (liquidity lines, private transactions secured by a portfolio of receivables; and
- for structuring banks, some warehousing exposure, and positions in their market making role.

**The existing shortcomings in the Liquidity Coverage Ratio (LCR) classification of securitised products, and corresponding haircuts, should be overcome to unlock bank investments in third-party securitisation public senior tranches, thus favouring market liquidity, prudent private sector risk sharing and financial stability.**

**Question 9.42:**

Do you consider that the existing liquidity risk treatment of securitisation, in particular in terms of credit quality steps (CQSs) and haircuts applied to securitisations eligible for Level 2B HQLA, are adequately reflecting the liquidity and stress performance of securitisations, across the full economic cycle, including in crisis conditions, and in comparison, with the treatment of other comparable financial instruments?

- Yes
- No
- No opinion

Answer to multiple choice:

- **No**

**Question 9.43:**

**If you answered no to question 9.42.,** please justify your reasoning, providing quantitative and qualitative data on the impact, and provide suggestions for what you would consider as appropriate and justified treatment in terms of CQSs, haircuts and other relevant requirements, without endangering financial stability.

The answer to question 9.42 is an unequivocal ‘No’.

Liquidity is not a permanent situation. It depends on the number of potential institutions that are willing to buy a security at a given time, which has an impact on the bid-ask spread. Increasing that number increases an asset’s liquidity and helps reduce the drop in liquidity during a period of stress. The opposite applies, as stated in the 2024 paper by Papadogiannis-Varouchakis entitled “*The European Securitization Market: Effects of an Uneven Regulatory Playing Field*”<sup>12</sup>:

*“Focusing on the shortcomings of the current calibration, it is important to note at the outset that the introduction of the STS regime in the context of the LCR resulted in an exclusion of (previously eligible) non-STs tranches from all levels of the liquidity ratio, and the replacement of those tranches by senior STS tranches at the same LCR level (Level 2B).”*

All securitisation senior tranches, subject to specific liquidity-related criteria, were eligible as HQLA assets at the beginning of the LCR implementation. They were an important tool in the toolbox of bank treasurers for diversification and quality. The introduction of the STS label was supposed to improve the situation for such treasurers. As initially envisaged by the Commission, the now STS label should have provided ‘upside’ in terms of LCR recognition, rather than create a ‘downside’ for the Non-STs market segment.

Moreover, CQS 1 category used to be mapped from AAA to AA-. When CQS 1 was split into a new CQS 1 of AAA only, and a new CQS 2 from AA+ to AA- in the 2017/2401 text that modifies regulation 575/2013 (and also the commission implementing regulation 2016/1801), no amendment was made to the eligibility LCR criteria, meaning that suddenly, only AAA-rated tranches were deemed liquid for the LCR.

As many European countries (such as Italy and several Central and Eastern Europe countries) cannot generate a senior tranche rated AAA due to the sovereign rating ceiling methodology, the CQS 1-only rating criteria is fundamentally against the spirit of the Capital Markets Union and raises question as to the governance of decision making on financial stability issues. There are no such restrictions on Covered Bonds (CBs), and the haircuts for CBs are also much more favourable.

To level the playing field, the first step would consist in allowing highly rated CQS 1 and CQS 2 tranches of Non-STs securitisations to the Level 2B, with a haircut of 25%. Derogation would be made for EU countries whose sovereign rating ceiling means that CQS 1 and CQS 2 could not be achieved, to be aligned with the CQS 3 of the country (still investment grade). This could also include Non-STs ABCP issued through multiseller conduits supported by well-rated banks.

<sup>12</sup> *Journal of Financial Regulation*, 2024, 00, 1–31 (<https://doi.org/10.1093/jfr/fjae002>)

Second step, appropriately rated, senior STS tranches should be eligible to Level 2A, with a haircut of 15%.

In addition, securitisation is the only product to feature a maturity cap for HQLA, which clearly affects RMBS (to be eligible the senior notes need to be callable after 5 years, while underlying assets are longer, which reduces the appeal of the securitisation product as matched funding). This maturity cap clearly restricts issuance volumes for RMBS. It should be removed for securities with floating rates.

LCR eligibility is an important investment criterion for banks but also for non-bank investors (including insurance companies) that take liquidity aspects into account in their investment decision. Investors need to know that banks will be able to buy a senior tranche at a fair price, which itself is highly dependent on the LCR classification, haircut, and potential ECB eligibility and repo-ability.

The current inappropriate LCR treatment affects investors' perception of the European securitisation market. For example, insurers are interested in knowing banks' liquidity treatment of a senior tranche, as in the event it needs to liquefy a senior tranche, its price will depend on whether banks can buy it at a fair price, which itself depends on the banks' LCR classification and haircut for that instrument, and potential ECB eligibility and repo-ability.

**The above proposal would send a strong positive signal, encourage further investment, and help the dynamic of the secondary market. Such a treatment would remain prudent compared with the ECB collateral eligibility rules, which apply a mere 5% haircut on the best ABS categories.**

**Question 9.44:**

With a change in the CQSs, haircuts and other relevant eligibility conditions to the Level 2B liquidity buffer, by how much would the volume of securitisations that you invest in, change?

Looking at the size of the bucket Level 2B and 2A, moving from the level 2B to level 2A with the corresponding change in haircuts we propose, and based on the AFME survey on bank treasury functions (4 June 2024), it should have the potential to increase significantly the HQLA portfolio.

In the AFME survey, 80% of responding banks' treasuries invest in securitisation of which 80% for HQLA purposes. The main limitations mentioned with respect to securitisation are the limited market size, the LCR haircuts and the LCR eligibility criteria. Of course, considerations related to the risk of security (in RWA term but also linked to the interest rate risk) and its profitability come just after.

In this survey around half of respondents expressed an interest in investing on ABS from non-eligible sectors, such as Buy to let RMBS and CLO and to a smaller extent CMBS. Therefore, a widening of the LCR buffer should contribute to an increase of the HQLA portfolio invested on ABS, since it will be a welcomed opportunity to diversify its liquidity risk.

Obviously, an increase of securitisation in the HQLA portfolio, it is not completely independent from the change in risk weight on senior tranches that is proposed in Paris Europlace's answer to question 9.23, due to its impact on profitability measures.

Combining both LCR reforms and RW Floor reforms would make banks' treasury portfolios be able to fill in the function of liquidity provider that is mainly taken by central banks; this function is core to bring in other investors to the European securitisation market.

To answer specifically the question, it is difficult to quantify an isolated reform on the market which needs a series of changes to occur together, as a package.

**Question 9.45:**

Have the senior tranches of the STS traditional securitisations reached a sufficient level of market liquidity and stress resilience based on historical data covering a full economic cycle, including crisis conditions, and are there any additional solid arguments that could justify their potential upgrade from the Level 2B to Level 2A HQLA?

- Yes
- No
- No opinion

Please explain your answer.

Answer to multiple choice:

- **Yes**

Explanation / justification / answer:

The inclusion of an asset in a liquidity buffer (or the upgrade to an upper buffer) should have a positive effect on its liquidity. So, the real question is whether a bank would have an interest in investing in such asset for liquidity purpose from a risk/return point of view.

Considering senior tranches of securitisations with ratings AAA or AA, STS or not, those assets are quite safe and provide a proper diversification in the liquidity portfolio. They also have a higher yield than sovereign of similar rating and can thus be of some interest. They also offer more frequently a variable rate remuneration, which reduces the interest rate risk or valuation risk for the bank. The inclusion or the upgrade of such assets in the LCR buffer will thus have a positive impact on the management of risks linked to HQLA portfolio, especially the various risks of concentration (in credit, sectors, or with regard to interest rate risk).

The inclusion of covered bonds at a higher LCR level than ABS is not justified by research studies, such as the ones by Risk Control in 2014 and 2022. Specific attention was made to analyse the Global Financial Crisis period and the Euro Sovereign Crisis period, and the Covid Crisis. The 2022 Risk Control report<sup>13</sup> covered the Euro Sovereign Crisis and the Covid Crisis periods, and the following assessment was made (with the emphasis added).

*This study examines the relative liquidity of senior Asset Backed Securities (ABS) and Covered Bonds (CBs). The analysis is based on bid-ask spread data on all securities in the two asset classes for which information is available on Bloomberg for the period 2010 to 2021.*

*Key findings are that while CB were generally more liquid in the early 2010s, since 2016, senior ABS have been consistently and generally more liquid even in the 2020 Covid-19 crisis.*

*The study builds on an earlier Risk Control analysis of ABS and CB liquidity, Perraudin (2014). Like that earlier analysis, we find that even in the European sovereign debt crisis period of 2011-14, the more liquid ABS were comparable in liquidity to the more liquid CB.*

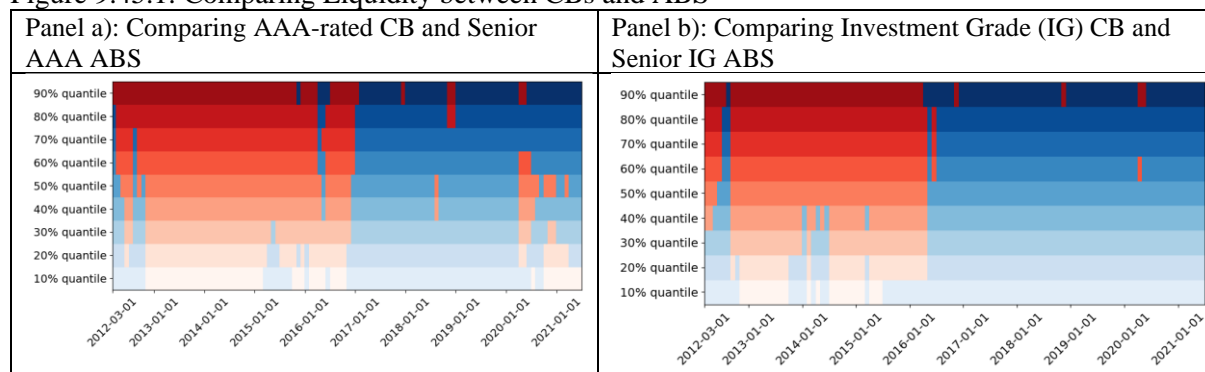
*The significance of these findings is that ABS and CB are treated very differently in the current regulatory rules on bank liquidity, specifically the eligibility criteria for inclusion in bank Liquidity Coverage Ratios. The evidence provided here suggests that senior ABS should be included within higher LCR categories than is currently the case.*

In Figure 9.45.1, two graphs are reproduced from the study that represent the entire data set used, with regards to which asset type (Covered Bonds in red, and ABS in blue) has the lowest transaction costs (a liquidity indicator), with three different filters. Panel a) shows AAA-rated CBs and Senior ABS; Panel b) Investment Grade (IG) CB and Senior IG ABS; CB and Senior ABS (all ratings).

<sup>13</sup> Perraudin, William and Yixin Qiu (2022), "Comparing ABS and Covered Bond Liquidity", Risk Control / AFME, February. [https://www.afme.eu/Portals/0/DispatchFeaturedImages/Comparing%20ABS%20and%20Covered%20Bond%20Liquidity%2021-134a%2030-10-2021%20v22%20\(003\).pdf](https://www.afme.eu/Portals/0/DispatchFeaturedImages/Comparing%20ABS%20and%20Covered%20Bond%20Liquidity%2021-134a%2030-10-2021%20v22%20(003).pdf)



Figure 9.45.1: Comparing Liquidity between CBs and ABS



The Risk Control study also contains evidence that the criteria for a WAL of less than 5 years is not needed for RMBS, and if it is maintained then such short-dated RMBS should have definitively a better treatment than CBs.

A basic observation can be made from the Risk Control study: if the LCR were to be recalibrated with data that includes the Covid crisis and adjusting for the active support of the ECB for CBs during the Euro Sovereign Crisis, the ABS treatment in the LCR should be better than for CBs. As European authorities want to maintain regulatory privileges to the European instrument that is CBs (even though it is only a funding instrument, not a financing instrument), politically it would not be acceptable to calibrate solely on data. Political judgement is needed when setting the categories and the haircuts.

**If the LCR were to categorise appropriately ABS with relevant liquidity buckets and appropriate haircuts, one should expect European bank treasuries to start using securitisation instruments to manage their liquidity, and this will help the financing of countries with financing requirements to access funding from countries with excess resources, in the true spirit of the a functioning European Capital Markets Union / Savings and Investment Union.**

**Question 9.46:**

**If you answered yes to question 9.45.,** please provide arguments and data, that could justify the potential upgrade from Level 2B to Level 2A HQLA.

If we come back to the definition provided by the Basel Committee (Annex 1 Summary description of the LCR, 2013)<sup>14</sup>:

*“Level 1 assets generally include cash, central bank reserves, and certain marketable securities backed by sovereigns and central banks, among others. These assets are typically of the highest quality and the most liquid, and there is no limit on the extent to which a bank can hold these assets to meet the LCR.*

*Level 2 assets are comprised of Level 2A and Level 2B assets. Level 2A assets include, for example, certain government securities, covered bonds and corporate debt securities. Level 2B assets include lower rated corporate bonds, residential mortgage backed securities and equities that meet certain conditions. Level 2 assets may not in aggregate account for more than 40% of a bank’s stock of HQLA. Level 2B assets may not account for more than 15% of a bank’s total stock of HQLA.”*

While level 1 assets can be considered as near-cash assets that are accepted at central bank facilities, Level 2A is composed of assets of similar credit quality less likely to be eligible to central banks. Level 2B assets seems focused on the immediately lower quality.

Therefore, the highest bucket of rating (AAA to AA-) for STS senior tranche of securitisation should at least be in the Level 2A, as is the case for some covered bonds (the biggest and best rated CB being Level 1). The inclusion of those ABS assets in the Level 2B bucket is not justified, it is merely a consequence of the distrust caused by the US subprime crisis.

<sup>14</sup> <https://www.bis.org/press/p130106a.pdf>

AAA senior securitisations that exhibit a risk profile which is very similar to Level 1 assets should fall in the Level 2A category. European AAA RMBS, like AAA covered bonds, have experienced a low default rate as measured by rating agency (for S&P, the average cumulative defaults over 10-year horizon for AAA European RMBS from 1983 to 2022 is 0.12%) quite comparable to some Sovereign risk in the EU.

Moreover, it should be noticed that European residential mortgage assets exhibit a much lower default rate than US assets even before being securitised into RMBS or covered bonds, and EU RMBS have not suffered the kind of losses that were seen in the US during the subprime crisis.

The Level 2B bucket seems to focus on slightly less liquid bonds, hence it could be fit for bonds having no STS validation and similar credit quality (AAA to AA-).

An additional argument is that the presence of securitisation offers more diversification to the LCR buckets. Having mainly covered bonds, whose primary risk is on banks, concentrate the risk in the LCR buckets. The diversification aspect is important, and despite not being treated appropriately in the LCR, may explain the results obtained by the research studies of Risk Control, that the liquidity of ABS is better than CBs since 2016.

**Question 9.47:**

**Considering your answer to 9.46**, with an upgrade of securitisations from Level 2B to Level 2A HQLA, by how much would the volume of securitisations that you invest in, change?

The most important impact from Level 2A is the lower haircut (15%) compared to the non-economic haircut of Level 2B (30%). This aspect of the LCR classification would have more impact than the limit on Level 2A (40%) which is higher than Level 2B (15%). Together, the haircut and the increased limit would act to generate significant volumes.

The main focus of the LCR reform should be on haircuts and minimum ratings. Such measures will increase traditional securitisation volumes.

Other reforms such, as due diligence (for bank investors) and reporting (for bank originators) are needed as part of a package of measures to make the European securitisation market an efficient market to finance the European economy.

**Question 9.48:**

Are there any impediments in the current liquidity framework that prevent or discourage banks from making a better use of their liquidity buffer capacity and from increasing their investments in securitisation exposures?

- Yes
- No
- No opinion

Answer to multiple choice:

- **Yes**

**Question 9.49:**

**If you answered yes to question 9.48**, please specify what are the impediments and provide suggestions for targeted amendments to make the liquidity treatment more proportionate, without endangering financial stability.

Provide estimates of the potential additional volumes of securitisations that could be included in banks' liquidity buffers.

Examples of targeted amendments have been proposed in the September 2024 Paris Europlace Securitisation Report (Recommendation 6).

Currently securitisation can be part of the bucket Level 2B, which is the smallest bucket. It is very restrictive, a heritage from the US Subprime crisis and how it influenced the Basel regulation. This has led to a strong reduction of the use of securitisation by banks compared to before the introduction of this limit.

In the US, AAA RMBS are accepted as repo to the central banks, they are therefore assumed very liquid, and the same assumption was made on EU RMBS before the regulation became even more restrictive since EU AAA securitisation was very liquid in interbanking repo.

Eligibility to central bank facility is without doubt the most important factor of liquidity, even if haircuts applied by the ECB are overly punitive. The Eurosystem could be expanded to all performing asset classes and haircuts should be decreased which would also be beneficial to the liquidity of ABS.

Another impediment is linked to the level of due diligence that banks should put in place (even in the case of a repo transaction). Simplifications should be granted for senior tranches of high quality. It is doubtful that a short-term repo with an ABS senior tranche that is protected by an important non-senior layer would require any due diligence at all.

Some renowned major actors, such as some European regional central banks, have expressed their inability to dispense all the due diligence that would be required under the current regulation because it is simply not feasible in the required timeframe. In such kind of situation, a strong simplification is needed, especially for senior tranches, even more so for retained senior tranches.

From an operational perspective, the investment by banks in securitisation senior tranches will not be unlocked only thanks to a better treatment of senior STS and Non-STS in the HQLA. The simplification of the due diligence requirements and the improvement of the capital prudential treatment of the securitisation tranches bought will also be decisive.

It should also be noted that improving the LCR treatment would also have a benefit for market makers, removing the disincentive to step up when an investor wants to sell an ABS instrument. Today when a market maker buy 100M€ in ABS, it needs to finance it with 130M€ of funding, due to the haircut...!

Encouraging market making would also benefit indirectly the investors. Indeed, when deciding whether to engage in a given asset class, and even if the strategy is mainly buy-and-hold, investors have to consider in which conditions they would be able to sell, if needed, at a later point in time. Having clear evidence that there is no regulatory disincentive for market makers to buy, would greatly improve their willingness to engage.

## 10. Prudential treatment of securitisation for insurers

Insurance companies allocate 0.33% of their investment assets to securitisation positions<sup>29</sup>. The Commission would like to know whether Solvency II standard formula capital requirements as currently applicable, also taking into account the forthcoming amendments to the [Solvency II Directive](#) that were approved by co-legislators, or other factors cause limited demand by insurance companies.

<sup>29</sup> See [Joint Committee advice on the review of the securitisation prudential framework \(Insurance\) - JC-2022/67](#)

Questions to stakeholders:

### Question 10.1:

Is there an interest from (re)insurance undertakings to increase their investments in securitisation (whether a senior tranche, mezzanine tranche, or a junior tranche)?

- Yes
- No
- No opinion

Answer to multiple choice:

- Yes

### Question 10.2:

**If you answered yes to question 10.1.**, please specify the segments of securitisations in which (re)insurers would be willing to invest more (in terms of seniority, true sale or synthetic nature, type of underlying assets, etc.) and describe the potential for increase in the share of securitisation investments in (re)insurers' balance sheet.

The September 2024 Paris Europlace Securitisation Report discussed this issue. European (re)insurers (the “insurers”) can play two complementary roles in securitisation via the asset or liability side of their balance sheets, and are the only “non-banks” which are in the scope of prudential regulations (Solvency II) and supervisory oversight dedicated to their investments/risk taking in securitisation transactions.

As **funded investors on the asset side**, their appetite for securitisation investments has reduced and remained low since the announcement of Solvency II. To note, insurers have barely invested in senior securitisation exposures from EU issuers since the introduction of Solvency II. Even five years post the regulatory change for STS, traditional securitisations are an immaterial asset class (0.33%) for the average European insurer. This is to be compared with, on one hand, the portfolio allocation by European insurers before the announcement of Solvency II, on the other hand, with the share of securitisation in insurers' portfolios in other jurisdictions.

Paris Europlace concurs with a position paper from Insurance Europe (2022)<sup>15</sup> that has addressed this topic: *“European insurers are Europe’s largest institutional investors, with over €10 trn of assets under management. In their role as investors, insurers need a wide range of appropriate assets in which to invest to achieve good returns, portfolio diversification and appropriate liability matching to benefit their policyholders. These include investments in securitisation. [...] While insurers are willing to invest in this asset class, the high capital requirements placed on securitisations in Solvency II have clearly been one of the key obstacles to investing”*.

Some European insurers wound down their specialised teams because of the shrinking of the European securitisation market, and, caught in a vicious circle, are now no longer able to assess the market and create

<sup>15</sup> Insurance Europe (2022), “Response to EIOPA consultation paper on the advice on the review of the securitisation prudential framework in Solvency II”, July, <https://www.insuranceeurope.eu/publications/2677/response-to-eiopa-consultation-paper-on-the-advice-on-the-review-of-the-securitisation-prudential-framework-in-solvency-ii/>

demand. Some will come back to this market once regulatory obstacles are removed. Others that are still present in the market will increase their allocations to this market. In the report on insurance by the ESAs Joint Committee (Dec 2022), 37% of respondents expressed an intention to increase securitisation investments in the next 3 years if regulation is adapted.

The rebuilding of investment capacity will happen in a progressive and sustainable way, i.e., not overnight. Their initial focus will be on senior tranches backed by senior loans and mortgages. On a medium term basis, potential increase on the balance sheet could be around 5% (with less than 0.5% each year), but only if impediments are addressed (including capital charges for STS and Non-STS, reflecting the absolute and relative risk for each rating category, simplification of STS criteria and due diligence requirements, regulation in favour of strong and liquid market).

**Question 10.3:**

Is there anything which in your view prevents an increase in investments in securitisation by (re)insurance undertakings?

- Yes
- No
- No opinion

Please explain your answer. If you mention prudential rules as part of your answer, please provide an estimate of the impact on the level of investments in securitisation, of the reduction of capital requirements for securitisation investments by a given percentage, e.g. 5% or 10%.

Answer to multiple choice:

- **Yes**

Explanation / justification / answer:

In March 2024, the Eurogroup in inclusive format stated: “*the adequacy of our toolbox, including **the prudential treatment of securitisation for banks and insurance companies** and the reporting and due diligence requirements*” and to “*should consider coming forward with corresponding proposals*” (emphasis is ours). Therefore, the fact that the prudential treatment of securitisation of insurance companies is a major impediment to investments should not come as a surprise.

Several factors prevents an increase in investments in securitisation by (re)insurance undertakings, especially the prudential treatment, under the Standard Approach, which has:

- unjustified gap between STS senior securitisation tranches with bonds & loans;
- unjustified gap between STS non-senior securitisation tranches with bonds & loans;
- no sensitivity to seniority in non-STS;
- unjustified gap between STS and non-STS securitisation tranches;
- higher shocks (proxy for capital charges) than for equity (for instance, a non-STS AAA securitisation tranche with a 5 year duration will have a 62.5% shock versus a Type 2 equity with a 49% shock; an STS non-senior BBB securitisation tranche with a 5 year duration will have a 39.5% shock, which is as much as a standard equity shock (39%).

One of the most critical outcomes of securitisation treatment under Solvency II is that it is more capital efficient to hold a whole pool of loans rather than a senior securitisation tranche of those same assets. For example, a 5-year AAA-rated STS RMBS will incur a capital charge of around 5% for the senior tranche, and 14% for a non-senior tranche. This compares to a spread charge of ca. 3% for instance for a pool of 30-year mortgages with an 80% loan-to-value (LTV), where the investor is exposed to far greater risk of loss.

Comments on the miscalibration itself will be addressed as answers to questions 10.5 to 10.9. Misaligning risks with capital requirements leads to either undesirable regulatory arbitrage or the disappearance of activities. Solvency II spread shocks for securitisation is a case study for the latter. The question 10.3 implies that a reduction in percentage (5%, 10%) of something that is miscalibrated can lead to a percentage increase in the

market. That is not case. To increase securitisation in European insurers' balance sheet, the entire table needs to be recalibrated in absolute values for STS, and in absolute and relative values for Non-STS, in relative terms between STS and Non-STS.

Furthermore, as explained by Insurance Europe (2017)<sup>16</sup> (emphasis added), “Solvency II remains a key regulatory challenge for insurers, **as it wrongly assumes that insurers act like traders** and are fully exposed to market volatility, thus forcing them to hold unnecessarily high capital. The Commission should address a set of straightforward and key questions, including:

- i. To what extent does Solvency II recognise that insurers are often not exposed to short-term volatility in market movements?
- ii. Is the current Solvency II assumption that insurers would be forced to sell their entire portfolio at a huge loss in a time of stress reasonable and backed by evidence? Answering such questions would make perfect sense in the context of assessing the barriers to and risks facing long-term investment in Europe.”

Other impediments affects insurers' appetite, such as the onerous due diligence requirements under Article 5 of the Securitisation Regulation. They are disproportionate and excessive. This has been addressed in Section 4 of this consultation.

Concerning to STS securitisation, numerous criteria need to be respected and those need some simplification to increase their share of the market.

A transparent reporting (similar to Ampere Files with the funds) could help to estimate the risk of the underlying assets.

Last but not least, human resources, securitisation required a related high degree of investor specialisation and investment management commitment to securitisation. Those can be fostered with a positive prudential and supervisory environment towards the activity.

**Question 10.4:**

Is Solvency II providing disincentives to investments in securitisation for insurers which use an internal model?

- Yes
- No
- No opinion

Please explain your answer, being specific in your reply.

Answer to multiple choice:

- **Yes**

Explanation / justification / answer:

Insurers using internal models are subject to the same non-prudential impediments are insurers using the standard formula.

In terms of prudential treatment, supervisory attitudes to variance between the output of the standardised formula and internal models (and/or insurer's own calibration of internal models to ensure that they do not depart materially from the Solvency II standard formula) can mean that the Solvency II capital framework impacts insurers using internal models indirectly.

Internal models on the asset side will usually be based on critical past historical data. For securitisation, this is

<sup>16</sup> Insurance Europe (2017) “Response to European Commission consultation on Capital Markets Union mid-term review”, Position Paper, March. <https://www.insuranceurope.eu/publications/1888/response-to-european-commission-consultation-on-capital-markets-union-mid-term-review/>

heavily dominated by spread volatility, rating migration, and defaults, stemming from the Global Financial Crisis.

A key lesson regarding securitisation positions was that rating agencies had been underjudging accumulation risks stemming from structures specifically correlation risks, especially for US subprime mortgages and resecuritisations.

During the peak of the GFC, there was little differences in prices, and the default performance of European securitisation vs. US securitisation could be assessed clearly ex-ante (see EBA Report on Qualifying Securitisations 2014). Needless to say, it was much better in Europe than in the US.

Furthermore, rating agencies have changed since the GFC. The type of rating downgrade waves experienced during the GFC, or the European Sovereign Crisis (downgrade waves followed by upgrade waves) are unlikely to reoccur, as they are now regulated by ESMA, and their rating methodology and models and calibration of stresses have changed. Thus, using rating migration data influenced by the GFC results, without adjusting for the way rating agencies have evolved and the new European regulatory environment in which they operate, leads to negative biases in today's internal models.

To conclude, using historical raw price performance from the GFC in model building, including the data associated with no banned products (such as resecuritisations) or segments influenced or weighted by the US subprime activity, or with raw rating agency rating migration data that are not adjusted, leads to miscalibration and overstating risks for today's European securitisation market.

Addressing those issues would require a deep introspection as to whether calibration methodologies and outputs are fit-for-purpose for the objectives of European economic growth and financial stability policy objectives of the European Union.

**Question 10.5:**

Is the current calculation for standard formula capital requirements for spread risk on securitisation positions in Solvency II for the **senior** tranches of **STS** securitisations proportionate and commensurate with their risk?

- Yes
- No
- No opinion

Please explain your answer, being specific in your reply, and, where relevant, provide a comparison, including, where appropriate, with internal models and their relative impact on the share of securitisation investments.

If you consider calibrations inappropriate, please indicate what you would consider as 'appropriate' calibrations, as well as any data/evidence of historical spread behaviours that would justify your proposal.

Answer to multiple choice:

- **No**

Explanation / justification / answer:

The calibration of capital requirements for Senior STS tranches in the Standard Formula is least deviating from appropriate calibrations compared to Non-senior STS, Senior Non-STS and Non-Senior Non-STS tranches. Nevertheless, it is usually seen as a calibration anchor and thus should also be based closely to empirical evidence, and to a certain extent be fit-for-purpose for what the policy objectives of the European Union are.

The last publicly available calibration exercise has been performed by a study from Risk Control / AFME in 2022 by William Perraudin and Yixin Qiu (2022), "ABS and Covered Bond Risk and Solvency II Capital Charges" (Risk Control). The results imply that the Senior STS ratio to Covered Bonds (CBs) should x1.3.

A 5-year AAA Senior STS has a capital charge requirement of 5.0%, whereas for a 5-Year AAA CB the value is

3.5%. This implies a Senior STS/CB ratio of x1.43. A 5-year AAA corporate bond or loan has a capital charge of 4.5% (according to the Bonds & Loans table). This implies a Bonds & Loans/CB ratio of x1.29.

**Therefore, by aligning the Senior STS calibration to the Bonds & Loans capital charges, the Senior STS capital charges would match the empirical ratio of x1.3.**

This would be a step forward for the anchor calibration of Senior STS, and for the recalibration of Non-Senior STS, Senior Non-STS, and Non-Senior Non-STS. It is noted, however, that this anchorage embeds the historical data from a past European securitisation market that has suffered and is still suffering from many impediments compared to the CB market who has benefited from regulatory privileges since the Global Financial Crisis.

As a CB instrument can be seen technically as a “Securitisation-Given-Default” instrument (i.e., upon a default of the bank issuer, the instrument becomes a senior position on a static ‘securitised’ pool of assets, with a credit enhancement that is less than what would have been obtained with a Senior STS securitisation). Thus, there is a strong technical argument to align the AAA (CQS 0 on the insurance scale) and AA (CQS 1 on the insurance scale) Senior STS with that of the CQS 0 and CQS 1 CB capital charges, respectively. (Note that the CQS scale for AAA and AA is different in the insurance regulation compared to the bank regulation).

Furthermore, in situation of economic stress, a AAA and AA senior securitisation position backed by a granular pool of senior loans will have a higher recovery rate (around 95%) compared to corporate bond or loan (around 55%). And STS pools have a granularity requirement (with granularity N being greater than 50). Therefore, according to financial logic, one would expect to have Senior STS capital charges numerically better than the Bonds & Loans ones. There is no financial logic to have Senior STS capital charges equal or worse than Bonds & Loans ones. The historical data in the Risk Control indicating that they are not on par is simply a reflection of the many impediments against the instrument that have been priced in.

There is also a long-term political argument for lawmakers interested in implementing legislation fostering economic growth in the EU. This is because CBs are an instrument that brings funding to the banking system, whereas Securitisation is an instrument that brings financing. The first one is unable to generate capital velocity, whereas the second one does. Therefore, there could even be a political argument to have Senior STS capital charges better than CBs.

The calibration of Senior STS that is expected for 2026 will be a reflection of what lawmakers really want for the financing instruments of Europe’ economic growth, and Europe’s strategic autonomy.

**Question 10.6:**

Is the current calculation for standard formula capital requirements for spread risk on securitisation positions in Solvency II for the **non-senior** tranches of **STS** securitisations proportionate and commensurate with their risk?

- Yes
- No
- No opinion

Please explain your answer, being specific in your reply, and, where relevant, provide a comparison, including, where appropriate, internal models and their relative impact on the share of securitisation investments.

If you consider calibrations inappropriate, please indicate what you would consider as ‘appropriate’ calibrations, as well as any data/evidence of historical spread behaviours that would justify your proposal.

Answer to multiple choice:

- No

Explanation / justification / answer:

The Non-Senior STS capital charges are excessive with regards to their absolute values. They were set in 2018



by the European Commission for the Delegated Act introducing STS, and corrected many anomalies embedded in the 2015 Delegated Act for the Type 1 securitisation (a sort of STS ancestor), by giving logic to their relative values.<sup>17</sup> Now, the European Commission should address the absolute values, and make the calibration of Senior STS and Non-senior STS coherent, in both the absolute and relative values of the capital charges.

An unjustified gap exists between the calibration used for a corporate bond or loan and those designed for Non-senior STS products. For instance, for a modified duration of five years and a rating of AAA, a Non-senior STS tranche has a capital charge of 14%. For a corporate bond or loan, this is 4.5%. Thus, the ratio of Non-senior STS to Bonds and Loans is x3.1.

Is it justified theoretically to have a higher level of capital charges than for Bonds and Loans? The answer is 'Yes', as in a situation of economic stress, the recovery rate of usually not-thick non-senior tranches, with the same rating, will be lower (around 30%) compared to a corporate bond or loan recovery rate (55%). The Loss-Given Default ratio between both instruments is thus an order of magnitude of 70% / 45%, or an order of magnitude of x1.55. This recovery rate issue matters, as when the probability of default increases (as implied by market spreads), the market-implied embedded loss-given-default overwhelms the price composition.

Based on historical data, as per the Perraudin and Qiu (Risk Control (2022)) study, the ratio of Non-senior STS to Senior STS risk-based capital charges is lower at x1.3 (with some greater differentiation according to ratings).

Therefore, by taking an overall conservative approach, and by setting the calibration ratio of Non-senior STS to Senior STS at the higher value of x1.5, one can obtain a calibration for the capital requirement of Non-Senior STS tranches. In that case a 5-year AAA Non-senior STS capital charge would be  $4.5\% * 1.5 = 6.75\%$ .

If instead, a historical ratio value of x1.3 was chosen, a 5-year AAA Non-senior STS capital charge would be  $4.5\% * 1.3 = 5.85\%$ . What matters is that the Bonds & Loans table should be considered as a theoretical ceiling for Non-senior securitisations.

**Question 10.7:**

Is it desirable that Solvency II standard formula capital requirements for spread risk differentiate between **mezzanine** and **junior** tranches of STS securitisations?

- Yes
- No
- No opinion

Please explain your answer.

Answer to multiple choice:

- **No opinion**

Explanation / justification / answer:

The question refers to whether the Non-Senior STS calibration should be split into 2 separate calibrations, which would address tranche thickness issues / rating shopping issues (as a highly rated junior tranche is likely to be very thick and rated only by Moody's that has an Expected Loss-based rating methodology rather than a Probability of Default-based rating methodology like most other rating agencies).

This would be a refinement to make in table that has higher order issues to fix.

In any case, there is not be enough trading data to calibrate based on historical prices.

Some Paris Europlace members would find it beneficial. Others consider that it would add unnecessary complexity for Standard Formula (re)insurers.

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<sup>17</sup> In 2015, a 1-Year BBB Type 1 securitisation had a 3% capital charge, and if downgraded to BB a 'financial guillotine' fell on the unfortunate investor with an 82% capital charge, i.e., a 2633% increase.

This said, if the underlying idea behind question 10.7 is to maintain the existing Non-Senior STS table in the Delegated Act for a future table of Junior Non-STS, and at the same time, create a new table in the Delegated Act for Mezzanine STS that would be calibrated on a coherent Non-Senior STS as per the proposal in Question 10.5, then this would be an elegant way to modify the rules. But it would be imperative that a similar split is done for the Non-STS table (Senior / Mezzanine / Junior) to keep an overall coherence.  
, as explained in the answer to question 10.3.

We note that this idea would be in the spirit of what Insurance Europe (2022)<sup>18</sup> had mentioned two years ago when it states to a similar question: “*In principle, regulation should avoid being too complex but in the case of mezzanine versus junior tranches, a differentiated treatment could be justified. To be however noted that for equivalent rating levels, the differences between capital charges of same segmentations should be consistent (i.e., not too different).*”

**Question 10.8:**

**If you answered yes to question 10.7.**, please provide suggestions for calibrations of capital requirements for such mezzanine and junior tranches, including the data/evidence of historical spread behaviours backing such suggestions.

Please indicate how you would define the mezzanine tranche as well as the assumption (e.g. of thickness of the tranche) underlying your proposed calibration.

Please also indicate whether and why such introduction of a mezzanine calibration would be needed in Solvency II, even if no dedicated treatment for mezzanine tranches is introduced in EU banking regulation (CRR).

N/A

**Question 10.9:**

Is the current calculation for standard formula capital requirements for spread risk on securitisation positions in Solvency II for **non-STS** securitisations proportionate and commensurate with their risk, taking into account?

- Yes
- No
- No opinion

Please explain your answer, being specific in your reply, and, where relevant, provide a comparison, including where appropriate with internal models and their relative impact on the share of securitisation investments.

Answer to multiple choice:

- **No**

Explanation / justification / answer:

There is no appropriate data or theoretical justification for the capital charges in the ‘Other securitisation’ table (which is referred to here as the Non-STS table). The Appendix 1 of the new 2024 Risk Control paper entitled “How to calibrate securitisation capital and liquidity risk” explains how this table was constructed and how it ended up disconnected from reality, being the disparate assembly of a 2010 methodology (using a theoretical framework and AAA S&P stress factor of 6 applied to pool defaults in a base scenario) and a 2013 VaR methodology on historical prices.

<sup>18</sup> Insurance Europe (2022), “Response to EIOPA consultation paper on the advice on the review of the securitisation prudential framework in Solvency II”, July, <https://www.insuranceeurope.eu/publications/2677/response-to-eiopa-consultation-paper-on-the-advice-on-the-review-of-the-securitisation-prudential-framework-in-solvency-ii/>

In a nutshell, the non-investment grade component of the current table was calibrated in 2011 based on the 2010 methodology. It is not based on price data.

The investment grade component of the current table was calibrated in 2014 with the 2013 methodology, based on data from the Global Financial Crisis. It assumes that insurers would sell 100% of their portfolio of securitisation positions at the worst possible point in time under duress, irrespective of their liability obligations, something that would be clearly illegal and forbidden by their supervisors, given the liability matching obligations. The calibration itself makes no difference between the most basic financial concepts of seniority. Furthermore, it has not been updated since 2014 and ignores all the work of the European authorities to make the securitisation sector safer in Europe, especially on Non-STS where SECR applies.

To have an idea of where risk-based capital charges would end up, the study by Perraudin and Qiu (2022) is used. Unfortunately, the AFME mandate for this study was to calculate an 'Other securitisation' table to fit within the existing legal text of the Delegated Act. The financial ratio of Non-STS to STS in the study is x1.3.

Therefore, to maintain financial logic, and to combine it with financial mass, this ratio of Non-STS to STS is applied to both ratios of Senior STS to Senior Non-STS, and to Non-senior Non-STS to Non-senior STS.

As per the answer to question 10.5, in essence, a 5-year Senior Non-STS would have a capital charge of  $4.5\% * 1.3 = 5.85\%$  (compared to today's 62.5% value).

As per the answer to question 10.6, in essence, a 5-year Non-senior Non-STS would have a capital charge of  $4.5\% * 1.3 * 1.5 = 8.78\%$  (compared to today's 62.5% value).

**Question 10.10:**

Is there a specific sub-segment of non-STS securitisation for which evidence would justify lower capital requirements than what is currently applicable?

- Yes
- No
- No opinion

Answer to multiple choice:

- **Yes**

**Question 10.11:**

**If you answered yes to question 10.10.**, please specify the sub-segment of non-STS securitisations that you have in mind as well as its related capital requirement, including any evidence/data of historical spreads supporting your proposal.

The question 10.10 is not correctly phrased. The current calibration for Non-STS has not been done in a rigorous fashion, with the sub-investment grade portion of the table not based on data, and the investment grade portion of the table based on questionable choice of historical data range and scope. This is explained in the answer to question 10.9.

A more appropriate question for 10.10 and 10.11 would have been: “If a risk-based calibration is based on a stressed price estimation of ABS indices (as per the answer to question 10.5, 10.6 and 10.9, is there a sub-segment for which such calibration is not prudent enough?” The answer to this question would be yes.

And it is not linked to the credit quality of the underlying pool, but to the level of granularity N in a tranching pool. This is because the ABS trading indices refer to transactions with an implied granularity, transactions falling outside those boundaries could have a higher set of capital charges. The technical reason is because the correlation risk increases for low granularity pools (N below 100) and the LGD volatility risk increases with very low granularity pool (N below 10). The effect is demonstrated for credit losses in Duponchee et al. (2013).<sup>19</sup>

The Basel regulation for SEC-IRBA (based on stressed credit losses rather than stressed prices) makes a granularity distinction, with different levels of calibration with a granularity threshold N set at 25. To keep a certain coherence in the market, this threshold could be adopted for the insurance regulation.

As Solvency II is based on distressed market spreads, the LGD component becomes prevalent. Which explains why the Non-Senior calibration is higher than for the Senior calibration (for both STS and Non-STS). There is thus a theoretical foundation to make a distinction based on granularity.

But such distinction would assume that the Senior capital charges are already lower than the ones for Bonds & Loans, to reflect their lower LGD, and converge for low granularity towards Bonds & Loans, to reflect the equality in LGD.

However, the choice made in the answer to Question 10.5 is that there is an alignment of Senior STS with Bonds & Loans (based on prices that are embedding the current and past securitisation impediments). Therefore, the convergence towards Bonds & Loans cannot occur, since it is already set at the point of convergence.

Unless there is a complete overhaul of the calibration based on financial theory on impediment-free market prices, rather than on historical prices with embedded impediments, there is no need to calibrate for very low granularity (which converge for the senior position towards the Bond & Loans capital charge).

**Question 10.12:**

Is it desirable that Solvency II standard formula capital requirements for spread risk differentiate between **senior** and **non-senior** tranches of **non-STS** securitisations?

- Yes
- No
- No opinion

Please explain your answer, being specific in your reply.

<sup>19</sup> Duponchee, Georges, William Perraudin, Alastair Pickett and Daniel Totouom-Tangho (2013d) “Granularity, Heterogeneity and Securitisation Capital,” BNP Paribas mimeo / Risk Control report, September, available at: [http://www.riskcontrolimited.com/public/Granularity\\_Heterogeneity\\_and\\_Securitisation\\_Capital.pdf](http://www.riskcontrolimited.com/public/Granularity_Heterogeneity_and_Securitisation_Capital.pdf)

Answer to multiple choice:

- Yes

Explanation / justification / answer:

Paris Europlace believes that it is highly desirable that Solvency II Standard Formula capital requirements for spread risk differentiate between Senior and Non-senior tranches of Non-STS securitisations.

Indeed, the recovery rate is not the same between a Senior and a Non-senior tranche, and that influences prices, price composition, price volatility and thus capital requirements with the spread risk module.

At the same as differentiating on seniority, the Non-STS calibration itself needs to be reviewed. There is currently a factor of x12.5 (a whole order of magnitude, something incomprehensible) between a Senior STS and a Senior Non-STS. This is the equivalent of a ‘financial guillotine’ on any portfolio manager that invests in a portfolio of STS securitisations in good faith. A sudden reinterpretation of the rules (without any grandfathering, a European specialty) could well put in danger the STS label on any given transaction, at any time. The fact that the loss of the STS label has not occurred yet is no guarantee that it will not in the future.

For example, a 5-year Senior STS capital charge is currently 5.5% (although it should be aligned with 4.5% of Bonds & Loans (embedding historical impediments), or better with the 3.5% of Covered Bonds (without embedding the historical impediments)). But a Senior Non-STS capital charge for the same modified duration is an extraordinarily high 62.5%. The loss of the ‘STS’ label is thus an astronomical increase in capital requirement of 1150%. In comparison, for banks, the loss of the ‘STS’ label is only 50% (based on the current fixed value risk weight floors). For an insurer, the calibration of Non-STS makes investing in STS potentially toxic.

This is why, to grow the STS market in Europe, and to ensure a take up among insurers, the most important component is to address the miscalibration of Non-STS. In other words, to abolish the ‘financial guillotine’.

In this regard, the European Commission already abolished in 2018 the 2015 Delegated Act ‘financial guillotine’ for investors investing in short-dated BBB Type 1 securitisations who would see a sudden capital increase of 2633% if that position were downgraded by a rating agency to BB. This made investing in short-dated BBB Type 1 securitisation super-toxic for a portfolio manager. No wonder there was little taken up of this paper among prudent insurers.

Let us visualise with a heatmap the various calibrations. The current calibration in the 2018 Delegated Act is provided in Figure 10.12.1. The proposed coherent calibration in the answers to question 10.5, 10.6 and 10.9 are provided in Figure 10.12.2. Those figures are extracted from the September 2024 Paris Europlace Securitisation Report. The heatmaps are self-explanatory, both in terms of the problems of the current calibration, and in terms of the possible solutions.

**Question 10.13:**

**If you answered no to question 10.12.,** please provide suggestions for calibrations of capital requirements for such senior and non-senior tranches, including the data/evidence backing such suggestions. Please also indicate whether you target a specific segment of non-STS securitisation.

The answer to question 10.12 was ‘Yes’. Explanation of calibration is provided in question 10.12.



## **11. Prudential framework for institutions for occupational retirement provision (IORPs) and other pension funds**

This section aims to gather information on both IORPs and ‘non-IORPs’ (i.e. nationally regulated pension funds that are not regulated by the [IORP II Directive](#)). Information on non-IORPs is particularly encouraged for Member States with limited or no IORPs activity. When providing information also on non-IORPs, please clearly indicate whether the information provided refers to IORPs, non-IORPs, or both.

Questions to stakeholders:

### **Question 11.1:**

For the purpose of this section, please indicate whether you are an IORP, a non-IORP or another type of stakeholder.

- IORP
- Nationally regulated pension fund not regulated by IORP II
- Other

Please elaborate in case you are not an IORP.

Answer to multiple choice:

- **Other**

### **Question 11.2:**

Is there an interest from IORPs and/or non-IORPs to increase their investments in securitisation (whether a senior tranche, mezzanine tranche, or a junior tranche)?

- Yes
- No
- No opinion

Answer to multiple choice:

- **Yes**

### **Question 11.3:**

Please clarify whether your answer to question 11.2. concerns your own situation, or whether it is an assessment of a given national market (in which you operate for instance).

**If you answered yes to question 11.2.**, please specify the segments of securitisations in which IORPs and/or non-IORPs would be willing to invest more (in terms of seniority, type of underlying assets, etc.) and describe the potential for increase in the share of securitisation investments in their balance sheet.

In addition, if your reply concerns or encompasses non-IORPs, please indicate i/ the number of non-IORP in your jurisdiction, ii/ the amount of assets under management and iii/ the type of pension business concerned, for which investment in securitisation would be interesting.

IORPs tend to have long-term investment horizons and prefer stable markets of high-quality, robust transactions with sound standards.

IORP will be willing to invest more in securitisation for diversification of portfolio and the search for interesting performance versus risk profile. A deeper and more liquid market, with high quality securitisations, would entail further investment opportunities and render securitisations more attractive for these investors.

It should also be noted that, in countries such as France where there are no pension funds, long term / retirement savings are managed through different format, in particular life insurance and employee retirement schemes. For the former, the amendments needed are described in Section 10 of this consultation.

For employee retirement schemes, they often give mandates to asset managers to invest their funds. The resolution of the single name limit in UCITs needs to be addressed to allow securitisation to find its way in these portfolios.

**Question 11.4:**

Does the IORP II Directive contain provisions which in your view restrict IORPs' ability to invest in securitisation?

- Yes
- No
- No opinion

Please explain your answer.

Answer to multiple choice:

- **No opinion**

**Question 11.5:**

Are there national legislations or supervisory practices which in your view unduly restrict IORPs' and non-IORPs' ability to invest in securitisation?

- Yes
- No
- No opinion

Please explain your answer, as well as whether it applies to IORPs, non-IORPs, or both. Please be specific in particular where you refer to non-IORPs.

Answer to multiple choice:

- **No opinion**

Explanation / justification / answer:

A stocktake of existing practices should be engaged as part of the broader Savings and Investment Union (SIU) roadmap, which should also approach the subject of pension funds more broadly, as a way to develop long-term savings. Securitisation is only one of the instruments within the toolbox for pension funds.



**Question 11.6:**

Are there wider structural barriers preventing IORPs and non-IORPs from participating in this market?

- Yes
- No
- No opinion

Please explain your answer, as well as whether it applies to IORPs, non-IORPs, or both.

Please be specific in particular where you refer to non-IORPs.

Answer to multiple choice:

- **No opinion**

**Question 11.7:**

**If you answered yes to question 11.6.,** please explain how these barriers should be tackled?

Please explain your answer, as well as whether it applies to IORPs, non-IORPs, or both.

Please be specific in particular where you refer to non-IORPs.

N/A

## 12. Additional questions

This section includes some general questions on the functioning of the securitisation market and on wider aspects that may affect the securitisation activity and various segments of the securitisation market in the EU.

### Question 12.1:

What segments of the securitisation market have the strongest potential to contribute to the CMU objectives, and that should be the focus of any potential regulatory review? You may select more than one option.

- Traditional placed securitisation
- Synthetic securitisation
- SRT securitisation
- ABCP securitisation
- STS securitisation
- Non-STS securitisation
- Securitisation of SME and corporate exposures
- Securitisation of mortgages
- Securitisation of other asset classes
- Other

Please explain your answer.

Answer to multiple choice:

- **Traditional placed securitisation**
- **Synthetic securitisation**
- **SRT securitisation**
- **ABCP securitisation**
- **STS securitisation**
- **Non-STS securitisation**
- **Securitisation of SME and corporate exposures**
- **Securitisation of mortgages**
- **Securitisation of other asset classes**

Explanation / justification / answer:

Whether the dry up of the securitisation market in Europe<sup>20</sup> is driven by lack of offer or lack of demand is often debated in policy circles, to focus potential regulatory adjustments on the most binding constraints. **Paris Europlace considers that the securitisation market must be looked at as an ecosystem, and that the instrument must make economic sense both for the issuers and the investors.**

To have a properly functioning CMU, Paris Europlace considers that the rules should serve the needs of, at least:

- all EU countries:
  - in the Eurozone and outside (for outside the Eurozone, wider collateral options and uncollateralised ('unfunded') STS is key as current collateral options are restrictive);
  - large, medium and small (for small countries, homogeneity blocking cross-border trades needs reviewing, or small deals should be made viable by reducing administrative burden and capital costs);
  - for the few Members States (mentioned in question 12.6) and other Members States (especially the CEE ones as the latter having mainly SA banks, a SEC-SA that is workable is key, which can be achieved with a scaling factor (see question 9.28).
- all types of banks such as:
  - banks using SEC-IRBA (where the 'p'-factor needs to be winsorized (see question 9.23) and

<sup>20</sup> See September 2024 Paris Europlace Securitisation report - Appendix 3 - Securitisation market trends

- for which the SA Output Floor calculation is key);
  - banks using SEC-SA (for which a scaling factor in the capital formula needs to be introduced);
  - banks using SEC-ERBA (for which the RW Floor needs to be aligned with SEC-IRBA and SEC-SA);
  - banks using IAA (which depends on SEC-ERBA calibration).
- all types of assets, all of them having an economic role:
  - from low credit quality, high risk-weight corporate assets (the only asset class benefiting from the current fixed value risk weight floor) to high quality, low risk-weight prime consumer assets (for which the latter requires a proportional RW Floor);
  - from long-term assets such as residential mortgages (for which a cap to the ‘p’-factor in SEC-IRBA is required (see question 9.23)) to short-term assets like trade receivables (for which the STS granularity threshold needs to be changed).
- all types of roles:
  - originators: Banks and Non-banks;
  - sponsors: ABCP and Non-ABCP;
  - risk-takers: collateralised (‘funded’) investors and uncollateralised (‘unfunded’) credit protection providers (for the latter, the STS collateralisation requirement stops them from investing in Europe (see questions 7.4-7.8)).
- all types of risk appetite:
  - from low-yield senior tranches (pension funds, non-life insurers, etc., for which due diligence requirements are not commensurate with the risk) to high yield non-senior tranches;
  - with low liquidity requirements (for which the LCR rules is a proxy indicator for liquidity in times of needs) or high liquidity requirements (for which the heavy due diligence requirements more appropriate for the primary market reduces the activities of the secondary market).
- all types of issuances:
  - from ‘retained’ for collateral purpose for central bank/repo activities to ‘placed’ with investors;
  - from ‘traditional’ (for which the LCR classification and haircut needs reviewing for senior tranches of STS and Non-STS, and for which the RW Floor needs to be made proportional to the underlying risk) to ‘synthetic with SRT’ (for which the RW Floor needs to be made proportional to the underlying risk, and for which the STS collateral requirements stop insurers from participating in Europe);
  - STS (for which there too many constraints) or Non-STS (for which the Solvency II calibration needs an in-depth review to be made fit for purpose).

There are many combinations of the above, with some additional dimensions (such as public or private) not listed above.

Securitisation is a tool for banks and non-banks issuers to access long term and stable funding (and in the case of ABCP, short term, but recurrent, funding). It is a means for traditional investors and unfunded credit protection providers to access asset classes not available in capital markets, tranced in levels of risk that fit their risk-adjusted investment objectives. Moreover, risk-taking investors in traditional or synthetic SRT tranches provide capital velocity to the banking system, thereby strengthening the banking sector and reducing the bailout probabilities.

If the European Commission pays attention to the diversity of the ecosystem, then the European securitisation market will thrive (in size, liquidity, and diversity), benefiting the economy, across the EU (including the CEE countries) while ensuring financial stability.

**There are eight key blockage points that need to be tackled to allow the European securitisation market ecosystem to thrive**, and the solutions have been described in the September 2024 Paris Europlace Securitisation Report.

**Question 12.2:**

What are the principal reasons for the slow growth of the placed traditional securitisation (where the senior tranche is not retained, but placed with the market)?

Why do banks choose not to issue traditional securitisation for both funding and capital relief? You may select more than one option.

- Interest rate environment
- Low returns
- Operational costs
- High capital charges
- Difficulty in placing senior tranches
- Significant Risk Transfer process
- Preference for alternative instruments for funding
- Prefer to retain to keep the client relationships
- Prefer to retain to keep the revenue from the underlying assets
- Prefer to retain to access central bank liquidity
- Other

Please explain.

**Answer to multiple choice:**

- **Low returns**
- **Operational costs**
- **High capital charges**
- **Difficulty in placing senior tranches**
- **Other**

**Explanation / justification / answer:**

As a one-liner, the prudential cost is the main factor behind the current shrunken market, a new version of Balzac's "Peau de chagrin".

**Preamble:**

Banks need to have eligible collateral for their liquidity operations with central banks and repo counterparties; senior tranches of retained securitisations serve this purpose. Banks will always need to transform illiquid portfolio into eligible collateral, even if this does not create any room for new lending. It would be misplaced to assume that the retained transactions could be sold to grow the securitisation market. The latter's development needs to be on top of the retained transactions (which do not provide capital velocity).

The post-GFC regulatory agenda implemented an ultra conservative framework aiming at disincentivising the use of securitisation. It worked: the outcome discouraged both regulated issuers and regulated investors.

Should the set of regulatory measures currently in force needs to remain unchanged? If yes, it will lead to the same outcome. Or should it be marginally amended to tackle the eight blockage points (see the September 2024 Paris Europlace Securitisation Report eight recommendations).

**Supply side dynamics:**

From an issuer perspective, **the decision to securitise a portfolio must be value-creating**, i.e., the cost of securitisation must be compensated by a commensurate capital saving, otherwise the transaction is value-destroying, and just does not happen.

In the EU, banks are the main source of funding to the economy; they should be recognised as the natural and main source of, or transmission channel for, assets to be securitised. However, the excessive 'capital non-neutrality' acts as a strong disincentive to issue. This is driven by:

- the 'half-pipe' design with a 'table' of 1250% risk weight that is too thick, and a 'transition' driven by the 'p'-factor that is miscalibrated; and
- the risk weight floor that is disconnected from the risk of the pool.

Moreover, non-banks financing the economy rely on securitisation for funding purposes, given that they have no access to deposits or central bank funding. While not subject to bank prudential rules, they are affected by the burdensome due diligence and reporting framework, which impacts both issuers and investors, as well as overall lack of liquidity and depth of this market.

The regulatory framework should be calibrated closer to neutrality and allow for evolutions in structuring trends.

**Demand side dynamics:**

Investors on publicly placed senior tranches of traditional securitisations are evidently not enough in both number and volume, even in the current low level of issuance. Essentially, it is limited to 20-30 bank investors, asset managers and public institutions, a number that has significantly reduced over the years. Also order sizes (especially with asset managers) can be quite small (while much larger for covered bonds), placing reliance on a handful of anchor investors.

In fact, **bank investors** were partially crowded out of the market as potential buyers of senior securitisation tranches. **Even STS tranches are penalised in the LCR with a significant haircut which makes them too onerous to play a role in the management of the liquidity buffer.** The LCR mis-categorisation and mis-calibration is the key missing point from the list in question 12.2.

Should the issuance volume take off on the supply side, without making changes on the demand side, the lack of investment capacity in senior tranches could worsen, putting pressure on costs, market execution and consequently reducing viability of the product.

**Solvency 2** prudential regulation has discouraged **(re)insurers** to invest cash in securitisation tranches in their investment portfolios by setting capital charges at a higher level for a senior securitisation tranche than for a bond or a loan of the same rating. This is not financially sound as the senior securitisation tranche of a granular pool has a much better recovery rate in a distressed situation. It also produces unappealing low risk-adjusted returns.

**UCITS Directive** has also discouraged investment in senior tranches of traditional STS securitisation, by non-differentiation of covered bonds and ABS issued by the same bank in the 10% acquisition limit. Money market funds cannot invest due to the strong limitations (eg. on legal maturities) restricting appetite of real money investors.

In addition, due diligence requirements on these senior tranches are also highly prescriptive, slowing time to market and increasing costs, and directly impacting the capacity of high-grade institutional investors to act in the primary market efficiently, and indirectly as they might want to sell those assets.

Improving the prudential and non-prudential rules applicable to traditional senior securitisation would not only enable to relaunch the ABS traditional market, but it is also a prerequisite for the development of the emerging “full stack SRT” true sale transactions, for both funding and capital relief.

**Question 12.3:**

Please specify which regulatory and non-regulatory measures have the strongest potential to stimulate the issuance of placed traditional securitisation.

Regulatory measures to stimulate the issuance of placed traditional securitisation need to address the blockage points of senior and non-senior tranches.

- A better prudential treatment of the very low risk senior tranches of securitisation.
  - For banks, this involves:
    - Reviewing the risk weight floor, to make it a fraction of the underlying risk weight of the pool. Paris Europlace recommends 12% of the risk weight of the pool for Non-STS senior tranches, and 7% of the risk weight of the pool for STS senior tranches.
    - Providing an appropriate LCR classification to STS and Non-STS senior tranches and ensuring that the haircuts are sized to take into account the expected recovery rates on such tranches.

- For (re)insurance companies, this involves:
  - An adjustment of the Solvency II capital charges for Senior STS tranches. Senior tranches of granular pools have a higher recovery rate than Bonds & Loans of equivalent rating; this obvious financial fact is currently not reflected in the Solvency II capital charges of the Standard Formula.
  - A complete review of the calibration of the unreasonable capital charge levels for Senior Non-STS tranches. Senior Non-STS capital charges should be 30% higher than STS capital charges (not 1150% higher as currently – this is not a typo).
- A better prudential treatment encompassing the non-senior tranches of securitisation.
  - For banks, this involves:
    - For SEC-IRBA, winsorizing the p-factor (by setting a minimum and a maximum).
    - For IRB banks, extending the Amendment Boyer halving the p-factor under SEC-SA, beyond the SA Output Floor.
    - Reducing the unreasonable Basel 1 requirement to maintain 1250% risk weight at all mezzanine level with attachment point below x1 pool capital, irrespective of the actual level of risk.
    - For SEC-SA, for Non-STS, introducing a scaling factor SF of 0.65 to the capital input as it enters SEC-SA, and 0.575 for STS, while maintaining a p-factor at 1.0. This has the effect of generating a capital surcharge of only 30% for Non-STS and 15% for STS, while avoiding the undercapitalisation of mezzanine tranches.
  - For (re)insurance companies, this involves:
    - Reviewing Non-Senior STS capital charges so that they do not exceed a value that is 50% higher than the value for Senior STS capital charges.
    - Reviewing Non-Senior Non-STS capital charges so that they do not exceed a value that is 50% higher than the value for Senior Non-STS capital charges.
  - For funds, the removal of 10% acquisition limit in the UCITS Directive should be removed. It was designed for other purpose, and it is not fit-for-purpose for a securitisation tranche investment.

For all transactions, including traditional securitisations, there should be a proportionate due diligence and disclosure/reporting requirement under SECR Article 7 and 5, respectively.

There are other technical measures, such as deletion of Article 243, decrease of the credit conversion factor for undrawn liquidity / credit lines.

There should also be a simplification of the STS framework (see question 7.13).

With regards to non-regulatory measures, the idea of the platform as described in Section 8 of the consultation is not a solution to increase securitisation volume in Europe. If created it will serve a different purpose.

**Question 12.4:**

What are the main obstacles for cross-border securitisations (i.e. securitisations where the underlying exposures, or the entities involved in the securitisation, come from various EU Member States)?

There exist too many divergences regarding the transfer of property of loans, receivables, or other debt portfolio between jurisdiction and so a too high risk of resources and associated legal costs. The market requires a simplification of enforceability of such transfer of property. Similarly, there is too many disparities between legislations regarding Insolvency regime. Moreover, fiscal risks is also important because of fragmented legislation and regulatory burden linked to DAC 6 legislation.

From a policy point of view, traditional cross-border securitisations should not be regarded as a key objective on a stand-alone basis.

- Cross-border securitisations of retail assets are not appealing for capital market investors. Indeed, in consumer securitisations (residential mortgages, auto loans/leases, unsecured consumer, credit cards), the

main risk drivers are principally domestic (GDP, unemployment rates) and investors prefer to do country risk allocation themselves and consequently, they prefer domestic pools rather than blended, pan-European pools.

- Cross-border securitisations are costly for originators. They require long implementation periods from an IT, accounting and other operational perspectives. They are costly to structure for legal and tax reasons. They are priced by investors on the basis of the ‘worst jurisdiction’, which taints the overall economics.

Synthetic securitisations work well with cross-border pools. However, it is not possible to reach the STS status when securitising granular pools of SME and Large Corporate loans from different jurisdictions. Although, there is no risk-related reason this should not be possible, it would no longer be ‘simple’ (see question 7.12).

Overall, improving the regulation should lead to reducing costs for transactions and making smaller transactions sizes possible. This will be beneficial also for domestic banks without a network across several countries.

**However, the focus should not be on cross-border transactions from the point of views of the assets, but rather on how to have cross-border investors**, i.e., investors from one country (EU and Non-EU) investing into the economy of another EU country. This is about making the EU attractive for investors (see question 7.3). It would also reinforce the resilience of the EU thanks to private risk sharing and be a factor of integration of the Single Market.

**Question 12.5:**

What measures could be taken to stimulate cross-border securitisation in the EU?

Please substantiate your answer for traditional and synthetic securitisation respectively.

Two types of measures should be envisaged (see answer to question 12.4):

- Facilitating the securitisation of cross border asset pools by reviewing homogeneity and granularity requirements.
- Facilitating the development of cross border investors, by making securitisation more attractive.

**Question 12.6:**

Securitisation activity is heavily concentrated in a few Member States – primarily Italy, France, Germany, Netherlands and Spain.

What are the main obstacles to increasing securitisation activity in other Member States? What measures could make securitisation more attractive in those Member States?

The main obstacle for a primo originator is the barrier to entry; and the main obstacle for a primo investor is the overall high cost (regulatory complexity and skills/expertise to acquire) and low return on capital (due to high prudential cost). This one-liner is developed below.

The first issue is that for a securitisation to be cost effective a minimum size is required. Below EUR 500 million, the market costs increase materially. Not all banks have sufficient assets to ensure that a securitisation represents a small percentage of its balance sheet.

There are also barriers to entry created by the prescriptive regulatory framework. Setting up a first transaction and preparing IT systems to meet the regulatory requirements is a costly process, especially for smaller banks.

Both the size issue, and the first issuance costs issue, means that for “smaller” EU countries, costs for banks to join the securitisation market are simply too high.

Furthermore, most banks outside the large countries are under the Standardised Approach. As a result, often investors demand higher quality transactions to invest in these banks, i.e. these banks find it harder to use high risk and capital-intensive assets for traditional or synthetic projects with SRT.

Additionally, the STS status is more difficult to obtain due to the homogeneity criteria. The introduction of STS has caused all Non-STS senior tranches to lose their access to the LCR buffer, making the securitisation instrument even less appealing. The rating requirement in the LCR do not consider the sovereign ceiling issues. This leads some CEE countries to see securitisation as the preserve of large IRB banks in the five countries mentioned above.

This view is compounded by the fact that the SEC-SA currently generates a 100% capital surcharge. This is to be compared by IRB banks where the capital surcharge can be as low as 30% (a scaling factor of 0.65 to the capital input as it enters the SEC-SA formula, if introduced, would reduce the capital surcharge to 30%).

When the STS label can be obtained, the capital surcharge in SEC-SA is halved to 50%, and the risk weight floor is reduced by a third, to a fixed value of 10% from a fixed value of 15%. This makes an STS securitisation appealing if it can be achieved, especially for synthetic SRT.

Banks often struggle with STS requirement of Article 26e for one of the following reasons:

- The bank is domiciled in a country with CQS 3 rating or lower which limits their own rating due to country rating cap. This means that such banks cannot use simple structures but need to set up more complex structures with involvement of SPVs and third-party banks which often is difficult for them to manage or implement due to resource limitations.
- The bank is domiciled in a European country that is not part of euro currency and so cash collateral is more costly. The bank could alternatively denominate the SRT contract in euros, but this would be costly as well due to currency mismatch haircuts. Either way, this can make the realisation of an SRT project very difficult.

For these banks the most viable solution is the most simple and cheapest execution of all, i.e. an unfunded guarantee contract. However, Article 26e is limiting them to multilateral institutions with 0% risk weight (such as EBRD, EIF and IFC) and hence is cutting them off a large part of the investor market.

**Question 12.7:**

Does the EU securitisation framework impact the international competitiveness of EU issuers, sponsors and investors?

- Yes
- No
- No opinion

Please explain your answer and where possible elaborate on the difference in regulatory costs stemming from the prudential, due diligence and transparency requirements in non-EU jurisdictions, in comparison to the EU securitisation framework.

Answer to multiple choice:

- **Yes**

Explanation / justification / answer:

The core issues of competitiveness are revenues (return on capital, diversification, risk/return) and costs (labour, infrastructure, delays, issuer costs, investors costs). Those have been addressed in earlier questions. Here are additional points.

There are two separate points to make on the **international competitiveness of EU issuers**.

- 1) Expenses for non-EU investors into EU transactions are higher than for investing in non-EU transactions. Hence, the EU is crowding out international investors. This raises the costs for EU issuers, which on the other hand are restrained in their capacity to invest abroad, given the disclosure requirements that non-EU issuers are not subject to.
- 2) Article 18 of SECR states: *“The originator, sponsor and SSPE involved in a securitisation considered STS*



*shall be established in the Union.*” This limits the possibility to structure EU STS transactions when one of these three entities is not based in the Union. The introduction of some flexibility on the location of one of these entities would allow additional operations to be STS compliant under SECR and so a better efficiency for such transactions.

There are four separate points to make on the **international competitiveness of EU investors**.

- 1) The current framework impact the international competitiveness of EU investors and impedes the EU from being the location of global investment centres in securitisation products. Many investment opportunities offered to Non-EU investors, but not to EU investors, are caused by the reporting obligations imposed on Non-EU issuers. Paris Europlace is aware of several situations in which Non-EU issuers in G7 countries have refused to spend time and money on ESMA reporting obligations (Article 5 of SECR) to satisfy the due diligence requirements of EU investors (Article 7 of SECR). They consider that such reporting obligations increases unnecessarily their transactions costs, to access a dwindling investor base in the EU. Non-EU investors only require targeted information to assess the risk based on their risk appetite (Senior tranche investors require less information than Non-senior tranche investors).
- 2) Entities without jurisdictions, such as Multilateral Development Banks (that are actively supported by the EU itself and by EU member countries as shareholders) do not produce the ESMA template when acting as originators. Therefore, SDG-compliant securitisation transactions cannot be invested in by EU investors. It is Non-EU investors that generate capital velocity to EMDE countries through MDBs.
- 3) SECR could introduce rules of equivalence for transactions respecting the STS criteria (or STC criteria) in other jurisdictions (for example in the UK) and for which such transactions are publicly notified as STS (or STC) to the relevant regulatory body similarly to the EU securitisation framework. It would allow for example Non-EU affiliate of EU entities involved in such Non-EU STS compliant transactions to benefit from an EU preferential regulatory framework for STS. The example of how the UK jurisdiction handles the reporting and due diligence situation is described in the IACPM response to question 12.7.
- 4) Real money investors could play a bigger role in financing the European economy with traditional securitisation. For example, the 10% acquisition limit for debt securities in a single issuing body that applies under Article 56 of the UCITS Directive is too restrictive and disproportionately hinders the ability of UCITS to invest more in securitisations thus driving more UCITS investments towards unsecured corporate credit with higher risk of defaults, less protections and lower rates of return compared to securitisation.

Currently, EU investors are unable to build diversified portfolio that meet their investment criteria for diversification. They also miss on investment opportunities to improve their risk-adjusted returns.

Some of the issues mentioned above were raised in the Noyer report of March 2024 which states “...*the current rules do not distinguish between transactions with EU and non-EU originators. Originators outside the EU should not be required to produce ESMA reports*”.

More broadly, as regards the competitiveness of the EU economy at large, developing the EU securitisation market would offer to EU investors a new incentive to invest in Europe, supporting EU investments, and potentially reducing the share of non-EU investments (estimated at 300bn€ per year in the Draghi report).

**Question 12.8:**

How could securitisation for green transition financing be further improved?

What initiative could be taken in the industry or in the regulatory field?

To paraphrase the French mathematician and chemist Antoine de Lavoisier — a sceptic of alchemy: securitisation transforms the credit risk of the underlying pool, it does not make it disappear, it does not create it. There is no alchemy in the securitisation technique; there should not be capital requirement created spontaneously.

The same applies to the Green issue. Securitisation will ultimately be as green as the projects and investments will be. Should it be limited to target predefined pools of financing needs, it will not produce the expected benefits. Securitisation should first develop across the board with no restrictive underlying or use of proceeds criteria.

The 'EU Green Bond Standard' label (EuGBS), which can also be granted to securitisation transactions when the proceeds raised by the securitisation are invested in activities that meet the requirements of the EU Taxonomy, will probably attract little volumes.

Because it is strictly linked to the EU Taxonomy whose criteria are in practice excessively difficult to fulfil, and because the universe of Taxonomy eligible assets is for the time being quite narrow, while the EU economy is at the beginning of its path to transition. The issue with the EU GBS is not a securitisation issue but an issue that cuts across all types of green bonds, namely the complexity of the Taxonomy, the enormous data requirements to show that an activity is compliant and the risks of sanction in cases a complex and opaque set of standards are not met.

Moreover the EuGBS label does not currently accommodate synthetic securitisations and it will be some years before the feasibility report is prepared on this by the ESAs and the European Commission makes a decision as to whether to amend the EuGBS regime to accommodate synthetic securitisations (EuGBS provides that the European Commission may submit a report on this to the European Parliament and the Council of the European Union by 21 December 2029).

For traditional securitisation, ELTIF should be able to increase the cap on securitisation from 20% to 50%+ when the invested tranches meet the green criteria; this could be taken into consideration when the EU will review its green regulation. (The existing regulation EU 2023/2631 considers in its Title II chapter 3 "Conditions for the use of the designation 'European Green Bond' or 'EuGB' in respect of securitisation bonds" shall be taken in consideration to allow creation of equivalent of typology article 8 or article 9 under EU SFDR Regulation but for securitisation SSPE.) However, the combination of a complex Taxonomy, and recent ESMA Fund naming guidelines may paradoxically reduce the capacity of ELTIFs to buy green bonds, including securitisation.

**The most effective contribution that the European Commission, the Council of the European Union and the European Parliament, is to tackle the eight obstacles presented in the September 2024 Paris Europlace Securitisation Report, and to unlock both traditional and synthetic securitisations to finance the massive investments required for green transition.**

There is also a technical point worth revisiting, as significant amount of investments required for the green (and digital) transition are financed in the form of infrastructure loans, one of the areas where European banks are global leaders. Article 243(2)(b)(iv) requires that in order for a bank to benefit from the preferential treatment for STS transactions, the standardised risk weight at the time of inclusion should be maximum 100%. From 1 January 2025 onwards, the standardised risk weight for pre-operational (construction) phase project finance assets will increase to 130%, making it ineffective to include these assets in a project finance STS transaction. As the green (and digital) transitions the EU want to stimulate via the CMU will require a vast amount of project financing by banks, including for the construction phase in which banks are typically active, those assets cannot be 'temporarily' STS. This is either an unintended consequence of the way many rules interact.

Nevertheless, this is another perfect example where a proportional risk weight floor would solve the problem. There would be no need for a minimum risk weight per asset, since the proportional floor would be sensitive to the increased risk.

**Question 12.9:**

Are there any other relevant issues (outside of those addressed in the specific sections of the consultation paper above) that affect securitisation issuance and investments that you consider should be addressed?

- Yes
- No
- No opinion

Answer to multiple choice:

- Yes

**Question 12.10:**

**If you answered yes to question 12.9., please explain your answer.**

The question of **unlevel playing field** caused by regulation has not been addressed in this consultation. It is mentioned in the context of divergence in supervisory practices (i.e., Level 4 of the Lamfalussy architecture), but not in terms of regulatory rules (Level 1, Level 2 and Level 3 of the Lamfalussy architecture). Paris Europlace recommend reading the 2024 paper by the academic Papadogiannis-Varouchakis entitled “*The European Securitization Market: Effects of an Uneven Regulatory Playing Field*”<sup>21</sup>.

Questions on governance should also be tackled at some stage, from a horizontal policy perspective. Paris Europlace recommends reading Section 5 of the 2024 Risk Control paper entitled “*European Competitiveness and Securitisation Regulations*” on the Governance of Regulatory Reforms. In no particular order:

- Of special importance is the need to empower various authorities to mitigate quickly unintended consequences such as:
  - The unintended banning of European (re)insurers to participate in the unfunded STS market), without having to wait for a full legislative cycle.
  - Level 4 supervisors not having the power to suspend sometimes unworkable text (such as specific points on SRT recommendations); this should be granted.
  - The case of the ‘interim’ LGD payment in STS that appeared in Level 1 text is a classic example of how overreach of technicalities may raise anti-European sentiments among mortgages holders (see Appendix 2 – When Level 1 Text Departs from Principles). This is because a concept for corporate recoveries (interim LGD payment) is absolutely not adapted to private individuals restructuring their residential mortgages to better their personal situation. Those little details are significant and have the potential to snowball politically.
- Securitisation and Covered Bonds are the two highways to finance the European economy: positioning one against the other constantly (the story of the last decade) is partly due to the way the ESAs are organised. And partly because securitisation has been seen as the prerogative of a few banks and a few countries. These needs changing. If the EU succeeds in implementing new rules and regulation for the securitisation instrument, allowing for the function and not just the form of the instrument, increased investment, of the kind advocated by the ECB Governing Council or the Mario Draghi report advocates, will result.
- Unlike other European agencies where technical and industry expertise sits clearly outside the agencies, there is little recognition by the ESAs that technical and industry expertise sits outside too. To move forward, there is a need for the ESAs to work with, not against, capital markets participants.

The September 2024 Paris Europlace Securitisation Report also contains specific points on governance.

- First, **the Joint Committee of the ESAs on Securitisation should be empowered to drive the process of implementing securitisation reforms as a package, in close liaison with DG-FISMA.** Securitisation is a technical, and multifaceted topic, as there are multiple legal and regulatory texts addressing various aspects or types of regulated entities. Therefore, the capacity to ensure consistency, in both substance and timeline, across the various regulatory bodies involved is key to ensure a proper

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<sup>21</sup> *Journal of Financial Regulation*, 2024, 00, 1–31 (<https://doi.org/10.1093/jfr/fjae002>)

implementation and achieve the targeted outcome. An evolution of the role and governance of the Joint Committees could be envisaged as part of the upcoming ESAs review.

- Second, dialogue with practitioners is essential. This dialogue must be permanent, transparent, and constructive. It needs to include the whole ecosystem, from investors to issuers, but also rating agencies, label providers, law firms, accountants... Such a variety of expert profiles do not exist in the existing ESAs Stakeholder Groups. **A dedicated Securitisation Experts Group should be created to institutionalise the existing dialogue across various types of players, the Joint Committee and involved regulators.**

To conclude the last sentence of the answer to the last question, Paris Europlace views the depth and breadth of this consultation as the first evidence that for the European securitisation market, the European Commission is not just hearing the industry, but is actively listening; and this explains why Paris Europlace has decided to provide answers to all the 167 questions, thanks to the active participation and diversity of its members, proving that securitisation is a true ecosystem.