

## Towards a better European securitisation market

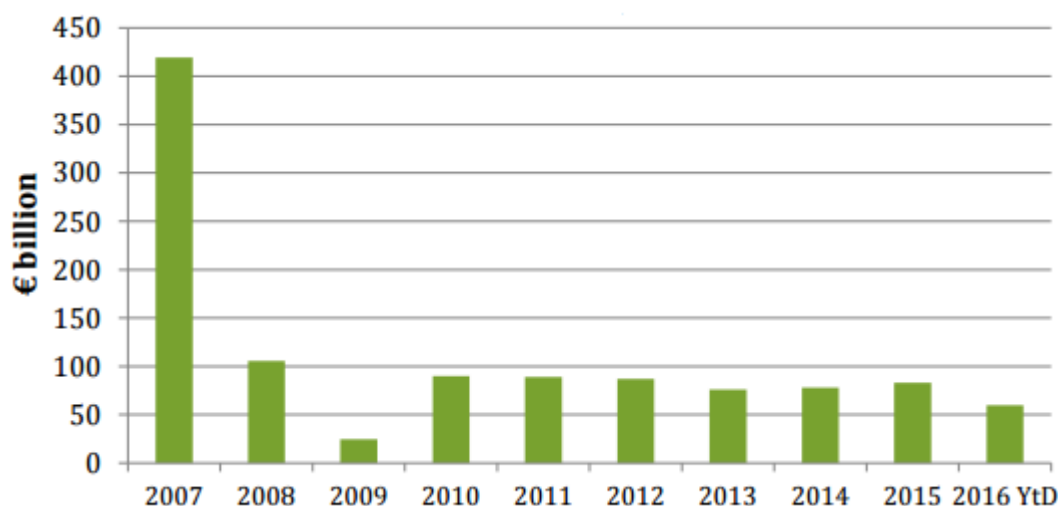
### Apostolos Thomadakis

*While the European securitisation market experienced constant growth for almost a decade prior to the financial crisis, it then plunged precipitously and has never fully recovered. Since 2009, in an effort to revive securitisation and channel funds to the real economy, European authorities have introduced a considerable amount of new regulations/legislation, for example, in the areas of banking (CRD II, CRD III and CRDIV) insurance (Solvency II) asset management (AIFMD, UCITS, MMFs), and credit rating agencies (CRA). These measures, however, have not achieved the expected results in terms of reviving the market and this commentary therefore argues that more needs to be done. In concrete terms, it calls upon Europe to:*

- i) issue securitisation products with transparent and easy-to-understand structures,*
- ii) streamline and consolidate EU financial services legislation and*
- iii) devise smart ways of making cross-border investments easier.*

The European securitisation market has been significantly affected by the financial crisis and current macroeconomic volatility. As shown by the latest data from the Association for Financial Markets in Europe (AFME), the issuance of securitised products has dropped by 46.4% from €75 billion in Q2 2016 to €40.2 billion in Q3 2016. Moreover, new investment in the market has stalled due to uncertainty and negative signals from the new set of regulatory measures.

Figure 1. European placed issuance, 2007-16



Source: AFME data up to Q3 2016.

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As part of its ambition to create a Capital Markets Union (CMU), the European Commission wants to revive the securitisation market in the EU. On 30 September 2015, the Commission adopted the Commission Securitisation (CS) initiative, a package containing two legislative proposals:

- i) A Securitisation Regulation that will apply to all securitisations and include due diligence, risk retention and transparency rules together with the criteria for Simple, Transparent and Standardised (STS) Securitisations.
- ii) A proposal to amend the Capital Requirements Regulation (CRR) to make the capital treatment of securitisations for banks and investments firms more risk-sensitive and able to reflect properly the specific feature of STS securitisations.

Two significant changes to the CRR are worth noting: i) a new hierarchy of risk calculation methods that closely follows the Basel Committee on Banking Supervision (BCBS) framework and ii) a preferential treatment of STS securitisations. The latter provides a more risk-sensitive prudential treatment that generates lower capital charges for positions in transactions qualifying as STS securitisations.

In particular, the Proposed Regulation (PR) first sets a definition of securitisation that is taken from the CRR, which is very broad and built on the concept of tranching. The PR then imposes a set of direct risk retention requirements on originators, sponsors and original lenders. This means that, unlike the current situation, originators would have to satisfy the retention requirements even in cases where all the investors in a securitisation are unregulated or non-EU entities.

In addition, the PR includes due diligence requirements applicable to all types of institutional investors, which would harmonise the rules currently set out across a number of EU directives and regulations. In an effort to improve transparency, the PR sets out certain information which the originator, sponsor or securitisation special purpose entity (SSPE) of any securitisation would have to disclose.

In plain terms, securitisation is a quick and easy way to boost bank lending in Europe. This is especially true when it comes to loans, particularly to small- and medium-sized firms. A securitisation market enables banks to refinance loans by converting them into securities. If it's done correctly, these securities can be attractive to investors both in terms of return and transparency.

In the US, securitisation acquired a bad reputation following the financial crisis and there was a widespread view that the industry has been allowed to develop without proper safeguards. The securitisation of subprime mortgages into mortgage-backed securities (MBS) and collateralised debt obligations (CDOs) was one of the major contributing factors to the subprime mortgage crisis. The imposition of federal conservatorships on 6 September 2008, at the Federal National Mortgage Association and at the Federal Home Loan Mortgage Corporation (the two US government-sponsored enterprise commonly known as Fannie Mae and Freddie Mac) was one of the most dramatic events of the financial crisis. Therefore, the challenge European authorities must tackle is how to persuade the public that the securities market is not as dangerous as it used to be?

### i) **Securitisation products with transparent and easy-to-understand structures**

Since 2008, when €105.5 billion of securitised products had been issued, the European securitisation market has declined by 43% (€59.7 billion in 2016 YtD) and is still suffering from public distrust and a lack of market confidence. The CS initiative aims to develop a differentiation of 'high-quality' securitisation products with transparent and easy-to-understand structures. This is done with a view to possible preferential regulatory treatment across financial sectors, backed by the recommendations of the European Central Bank (ECB) and the Bank of England (BoE). As a result, these securitisations could benefit from being traded on regulated and supervised markets with increased transparency and high levels of risk management systems. This will allow investors to manage risk returns in a more diligent way.

What also needs to be done is the pooling and standardisation of loans, in order to ensure transparency and comparability. This is likely to require the creation of an institutional framework, as well as greater willingness on the part of banks to develop the securitisation markets. Even though the CS initiative is still in its preliminary phase, closer collaboration with international organisations, such as the BCBS and

the International Organisation of Securities Commissions (IOSCO) will be necessary to develop global standards for 'high-quality' structures.

### **ii) Streamline and consolidate of EU financial services legislation**

On the side of financial services legislation, the European Commission has already consulted on possible conflicts or barriers as a consequence of new legislation, which is also part of its work on the CMU. Furthermore, the Commission has established the European Post-Trade Forum (EPTF), which takes steps to create efficient and resilient post-trade infrastructures by removing barriers to cross-border clearing and settlement.

As Europe has reached a junction, it is the time to decide whether or not we have achieved a sufficient level of regulation and whether or not we are now ready to mobilise financial markets to foster economic growth. Regulations that bring us further away from this target should be avoided. For example the Financial Transaction Tax (FTT) is a piece of legislation that runs counter to a growth agenda, given that it will reduce incentives for investments and thus damage economic growth.

### **iii) Smart ways of making cross-border investments easier**

Finally, we also need legal certainty for all cross-border investment activities. Any initiative to harmonise corporate laws in Europe is welcome. The revision of the Prospectus Directive is a step in the right direction. Even though the insolvency laws, taxation and fiscal policy will not be harmonised any time soon, it is essential that we start thinking of smart ways of making cross-border investments easier. For example, to revise some processes like tax reclaims. The creation of one European form for tax reclaims will make life easier for everybody. Why are they different in all member states?

To conclude, a high-quality EU securitisation framework will promote further integration of EU financial markets, help diversify funding sources and unlock capital, thereby making it easier for lenders to lend. Moreover, harmonised criteria and reduced complexity are key for the development of high-quality securitisation, as well as for harmonised transparency in order to restore confidence in securitised products.