SECURITISATION: WILL THE EUROPEAN COMMISSION'S RECENT ATTEMPT TO RELAUNCH BE THE RIGHT ONE ?

Faced with the need to find the necessary funding for the massive investments required for the energy and technological transitions identified by Mario Draghi in his report, and for Europe's defence remobilisation (Readiness 2030), on 19 March, the European Commission unveiled its strategy for a "Savings and Investments Union"(SIEU), of which securitisation is an essential part. On 17 June, the Commission also proposed new measures to boost securitisation activity in the EU while preserving financial stability. These measures are a good basis for relaunching the securitisation market. However, certain aspects could benefit from improvement. Above all, in order not to slow down investors and relaunch this market, it is crucial to align the capital requirements imposed on securitisations with those relating to other assets of comparable risk.

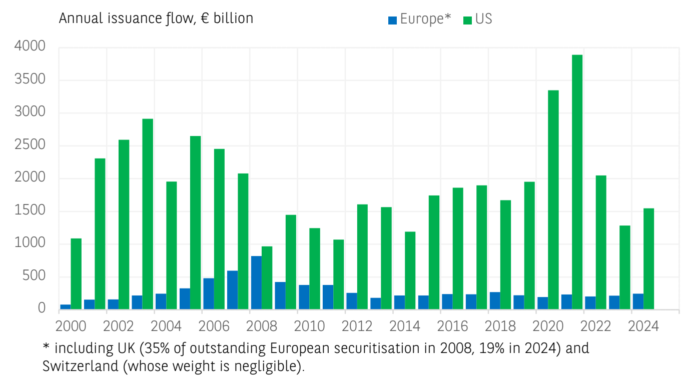
As a reminder, securitisation, in its so-called "cash version", is a mechanism that consists of banks grouping loans into relatively homogenous «packages», then transferring them to a special purpose vehicle (SPV), which in turn transforms them into more liquid securities (the units issued by the said vehicle)[1]. Some of these securities are kept on the balance sheet of the originating bank, while others are placed on the market with institutional investors and acquired by other banks. The bank equity freed up on the balance sheet of the originating bank as a result of the sale of transferred loans can thus be reallocated to financing new projects. Today, in the European Union, a large proportion of securitisations are synthetic, meaning that the risk is transferred, but the underlying asset remains on the balance sheet of the originating bank.

THE WHEAT WITHOUT THE CHAFF

Securitisation has a number of other merits: diversification and a better spread of risk, increased liquidity that facilitates the exchange and valuation of previously illiquid assets, and the ability to adapt the risk/return trade-off to investors' preferences (who benefit from more opportunities as a result). These characteristics make securitisation a powerful tool for improving market efficiency, savings allocation and the potential for financing the economy. However, securitisation needs to be regulated in order to avoid the moral hazard that can lead some originators to dispose of "bad risks" or to "originate" certain loans with the sole aim of placing them with investors. In order to avoid this pitfall and align the interests of originators with those of investors, after the 2008 crisis, the Basel Committee recommended that the originating bank be required to retain at least 5% of securitised exposures on its balance sheet. This recommendation was translated into European law in 2011[2].

More broadly, since 2019, securitisation in the European Union has benefitted from a radically overhauled framework aimed at promoting sound securitisation that is not a potential source of financial instability. Despite several attempts by the European Commission to revive securitisation[3], the issuance histogram issuance has remained hopelessly flat.

SECURITIZATION ISSUANCE COMPARED BETWEEN EUROPE AND THE UNITED STATES



* including UK (35% of outstanding European securitisation in 2008, 19% in 2024) and Switzerland (whose weight is negligible).

CHART 1 SOURCE: AFME, BNP PARIBAS

NECESSARY BUT INSUFFICIENT MEASURES

With this in mind, on 17 June, the Commission unveiled its reform of the legislative and regulatory framework for securitisation in the European Union.

On the securitisation supply side, the Commission's proposal is improving prudential calibration. Firstly, it is reducing current capital charges (by lowering p-factors and risk weighting floors). Secondly, it is introducing risk sensitivity (calculation of the risk weight floor in proportion to the risk weight of the portfolio of underlying assets) on the securitisation tranches retained by banks. In theory, this makes it possible to lower the weighted average cost of the banking resources allocated to these exposures and to extend the volume of viable securitisations (i.e. whose return makes it possible to remunerate the resources) to assets that were previously difficult to qualify for (loans to large companies and SMEs, etc.). The effect on the volume of securitisation transactions issued by banks should be positive.

1 In the case of traditional securitisation. Synthetic securitisation, on the other hand, authorises the transfer of risk while retaining the underlying asset on the balance sheet.
2 The requirement to retain 5% of the value of securitised exposures was introduced in the EU for the first time on 1January 2011 by Directive 2009/111/EC on securitisation.
3 The Securitisation Regulation introduced common rules on due diligence, risk retention and transparency for all securitisations. It also created a new label for simple, transparent and standardised securitisations (STS). At the same time, the 2017 Regulation amending the Regulation on prudential requirements for credit institutions and investment firms (Capital Requirements Regulation, CRR) made bank capital requirements more risk-sensitive and introduced specific preferential treatment for STS securitisations. Finally, in 2021, the scope of the STS label has been extended to on-balance sheet synthetic securitisations through an amendment to the Securitisations Regulation and regulatory impediments to the securitisation of non-performing exposures have been removed through an amendment to the CRR.

In practice, however, the scope of the reduction in weightings would be limited by weighting floors, the level of which would depend on the intersection of two criteria. The first would be the STS or non-STS nature of the securitisation; the second, a new criterion, would be "resilience", which meets certain conditions for the exposure to be guaranteed by a third party (credit enhancement). The floors proposed range from 5%, in the best case (resilient STS exposure), to 12% in the least favourable (when neither of the two criteria is met).

On the demand side, the Commission does not wish to significantly improve the current treatment of exposures of banks acting as investors, even for senior tranches, in order to avoid risks being re-injected into the banking system. It only proposes to align the risks between originators and investors for the senior tranches of resilient STS transactions. Furthermore, while the Commission's intention to simplify due diligence requirements for investors is commendable[4], these simplification efforts risk being undermined by the introduction of disproportionate penalties, notably in the form of fines as a percentage of global turnover. Not only will this measure would discourage potential investors from entering the market, but it could also reduce the scope of existing investors, which is already limited. In parallel with its legislative proposal, the European Commission has launched a public consultation with a view to amending the delegated regulation on the liquidity coverage ratio (LCR). The aim is to make securitisation exposures eligible, under certain conditions, for the numerator of the LCR.

While the economic impact of the new measures proposed by the Commission remains difficult to assess, bringing capital requirements more into line with risk could broaden the scope of securitisable loans, particularly for relatively risky loans (large corporates and SMEs). This would lead to an increase in issuance volumes in these segments. The text proposed by the Commission is therefore a step in the right direction. However, the choice of a relatively high weighting floor could cancel out the favourable effects of lower weightings for the least risky exposures (housing loans). Similarly, the new sanctions regime, to which investors would be subject, could act as a deterrent and run counter to the desired objective. In the discussions that will take place over the coming weeks, this text would benefit from evolving towards a better balance between the safeguards needed to reassure investors and guarantee financial stability, and a degree of complexity that, if it were to remain excessive, could give rise to mistrust that is no longer justified.

Above all, these measures do not call into question the disadvantageous prudential treatment of securitisation compared with asset classes with a similar risk profile. It is to be hoped that, as part of the draft amendment to the Solvency II delegated regulation, which aims to "take better account of the real risks of securitisation and eliminate the unnecessary prudential costs borne by insurers when they invest in securitisations", the Commission will make decisive proposals to reduce this disparity in treatment and effectively relaunch this market.

Laurent Quignon
laurent.quignon@bnpparibas.com

4 For example, the removal of the requirement for EU investors to verify that selling parties comply with the obligations set out in Regulation (EU) 2017/2402 of 12 December 2017 (Securitisation Regulation, SECR) when established in the EU.