

13th of May 2015

EMF Response to Commission Consultation on High Quality Securitisation

Introduction

The European Mortgage Federation¹ (EMF) is pleased to provide its comments on the European Commission Consultation on High Quality Securitisation. The Mortgage Industry welcomes the European Commission's efforts to re-launch the securitisation market and, as part of this process, to design a robust and sustainable framework to ensure high quality securitisation. This will hopefully serve to provide a viable 'tool box' of funding options for mortgage lenders, according to their needs and market conditions.

As a general comment on this process, the EMF believes that when designing the regulatory treatment of any kind of funding tool, it is vital to ensure that this treatment is determined on the basis of the tool's qualities and risk profile.

Question 1:

A. Do the identification criteria need further refinements to reflect developments taking place at EU and international levels? If so, what adjustments need to be made?

The EMF is supportive of the identification criteria that seek to identify specific characteristics of securitisation in order to secure better regulatory treatment, and is of the view that the heterogeneous nature of the asset class means that a modular approach is optimal.

The EMF would however like to make the following points:

1. With a view to ensuring a level-playing field, it is vital that the criteria for high quality securitisation are globally consistent. This is fundamental to ensure greater consistency and liquidity for the asset class.
2. The exclusion of synthetic securitisation ex ante is harsh and should, in our view, be reconsidered, especially because structurally speaking synthetic securitisation tends to be more simplistic than cash structures. Furthermore, capital relief will become a much more important aspect of securitisation going forward in the light of the discussions around MREL and TLAC. Securitisation can be a very cost effective way of releasing capital for continued lending to the real economy. Some asset classes are more easily securitised using synthetic technology due to difficulties in transferring loans to a vehicle, and the additional cost associated with transfers.
3. Risk criteria should not be part of the foundation criteria. They are already taken into account in the prudential framework and should only be used in the selection of qualifying securitisation which could benefit from a better capital treatment.

B. What criteria should apply for all qualifying securitisations ('foundation criteria')?

The EMF has no objections to the proposals, except the exclusion of synthetic securitisation. Indeed, we think that synthetic securitisations should also be included in the HQS-Initiative.

¹ Established in 1967, the **European Mortgage Federation (EMF)** is the voice of the European mortgage industry, representing the interests of mortgage lenders and covered bond issuers at European level. The EMF provides data and information on European mortgage markets, which were worth over €6.7 trillion at the end of 2013. As of April 2015, the EMF has 18 members across 14 EU Member States as well as a number of observer members. The EMF-ECBC is registered in the EU Transparency Register under ID Number 24967486965-09.

Question 2:

A. To what extent should criteria identifying simple, transparent, and standardised short-term securitisation instruments be developed? What criteria would be relevant?

The exclusion of Asset Backed Commercial Paper (ABCP) and other securitisations of short term assets is inconsistent with regulators' desire to encourage lending to the real economy, especially the SME sector. Trade Receivable securitisation is a very important and attractive funding source for smaller companies. Excluding this type of securitisation from the criteria will only drive up the cost and drive down the supply of this type of financing.

Many banking products of short-term nature, including trade receivables (hence their critical nature for SMEs), are best funded by matched liabilities, for which ABCP in many markets is critical. Without ABCP being appropriately treated, funding costs will need to increase in order to factor in a form of negative carry due to funding of the assets with much longer tenors, leading to reduced lending volumes; the opposite of what we believe the EC seeks to achieve.

While criteria for making short-term securitisations such as ABCPs could take place post the term-securitisation criteria, we would like to point out that initial steps should be taken to ensure that ABCP issuances are not simply bucketed as 'non-qualifying' securitisation which would be unfair and unwarranted, in our view.

B. Are there any additional considerations that should be taken into account for short-term securitisations?

Due to the nature of traditional ABCP financing, which is akin to secured financing, some of the proposed foundation criteria would not be applicable or appropriate, such as the need to list the securities (some transactions are documented as loans for example). Due to competitive sensitivities, some issuers would be sensitive to publicly releasing loan level detail for a commercial trade receivable portfolio. Likewise, most of these transactions are not actively traded due to the short term nature of the ABCP on the one hand, and because issuers wish to restrict the financing to commercial bank relationships with a buy-and-hold intention, so some liquidity criteria would also not be applicable.

Question 3:

A. Are there elements of the current rules on risk retention that should be adjusted for qualifying instruments?

The risk retention rules are reasonable and would be relatively simple for issuers to monitor with a view to ensuring compliance.

B. For qualifying securitisation instruments, should responsibility for verifying risk retention requirements remain with investors (i.e. taking an "indirect approach")? Should the onus only be on originators? If so, how can it be ensured that investors continue to exercise proper due diligence?

Responsibility for verifying on-going risk retention should reside with the Originator, as investors have no power to force an Originator to comply with the retention rules, and should not bear the negative consequences of a default by the Originator. Investors should retain responsibility for verifying the initial risk retention by the Originator.

Question 7:

A. What alternatives to credit ratings could be used, in order to mitigate the impact of the country ceilings employed in rating methodologies and to allow investors to make their own assessments of creditworthiness?

The US has carved out the rating-based approach for assigning capital requirements completely using either an internal approach or modified supervisory formulae. In Europe, it is likely that the majority of investors do not have sufficient data/capability to use an internal model, and thus are most likely to need to rely on ratings at least for certain analysis/opinions provided. Some agencies already explicitly mention where the ratings are capped by the sovereign and one possibility would be to amend the CRA regulation in order to force agencies to provide such information for each of their ratings for structured finance instruments.

B. Would the publication by credit rating agencies of uncapped ratings (for securitisation instruments subject to sovereign ceilings) improve clarity for investors?

An 'AAA' rated security which is rated 'A' due to a sovereign cap is a very different risk profile to an 'A' rated security from the same jurisdiction; the ratings for both instruments are the same, but arguably the credit risk on the former is much lower. Where this is not apparent, providing the uncapped information as well would improve clarity. These types of additional ratings should therefore be encouraged, since they can help investors understand if a transaction has all the requirements of a target rating, without the sovereign cap.

Question 8:

A. For qualifying securitisations, is there a need to further develop market infrastructure?

Standardised reporting and documentation requirements for SMEs are important prerequisites for building up a pan-European market for qualifying securitisations. Accessibility of loan level details on harmonised data basis will provide investors and other market participants with the necessary information for credit risk assessments and comparative analysis.

B. What should be done to support ancillary services? Should the swaps collateralisation requirements be adjusted for securitisation vehicles issuing qualifying securitisation instruments?

Legislative and regulatory initiatives would be helpful given that they would assist in lowering the cost of using securitisation vehicles, and ultimately, enable higher capital recycling and onward lending to the real economy.

For example the French securitisation law provides for so-called "Specially Designated Accounts" that protect investors from commingling risks, thereby reducing or eliminating the need for commingling reserves. Any legal or regulatory initiative that can insulate or reduce the risks associated, for example, with the bankruptcy of a counterparty can reduce the need for onerous collateral requirements. For example, a regulation would be helpful specifically carving out swaps or account bank arrangements from cancellation in case a financial institution goes into resolution without liquidation would give more confidence to investors and agencies.

C. What else could be done to support the functioning of the secondary market?

Lower capital charges for ABS trading positions.

Question 13:

Are there wider structural barriers preventing long-term institutional investors from participating in this market? If so, how should these be tackled?

The most obvious and onerous barrier to entry are the capital charges imposed on ABS investments. Prudential treatment of securitisation for institutional investors (banks, insurance companies) should be much improved compared to the current situation. Insurers for example are very often better off holding the underlying asset directly than holding the most senior tranche of a securitisation of those assets. By reducing capital charges, it would be possible to create a more competitive broader investor based and potentially reduce the cost of securitisations.

Furthermore, the higher due diligence requirements imposed on ABS investors create barriers to entry for new investors that might otherwise want to invest in ABS. Investor uncertainty and disparity among jurisdictions as to the interpretation of due diligence requirements also scares new investors away.

Question 15 Part A:

A. How could the institutional investor base for EU securitisation be expanded?

In addition to addressing the problems outlined under question 3 above, for the institutional investor base to develop, the market must be of a certain size, and issuers also need to be incentivised to increase supply compared to current levels. One way to do this for HQS that have achieved SRT, and as suggested in recital 11 of the Commission's delegated act on the leverage ratio, is to allow issuers to remove the securitized assets from the ratio's denominator.

Question 16:

A. What additional steps could be taken to specifically develop SME securitisation?

As pointed out above, we think that synthetic securitisations should not be excluded from qualifying securitisation, especially as this technique was and still is regularly used in SME securitisation markets.

We furthermore advise a reduction in capital charges for high quality securitisations. HQS risk weights should reflect the true risk profile of the underlying assets. High quality SME assets would justify a better regulatory treatment and lower capital allocation in relation to the present ABS risk weights.

B. Have there been unaddressed market failures surrounding SME securitisation, and how best could these be tackled?

Other than the answer given in section A, there is arguably a case to have more standardised and comparable information for SME assets.

C. How can further standardisation of underlying assets/loans and securitisation structures be achieved, in order to reduce the costs of issuance and investment?

Efforts along the lines of the Banque de France SME rating scale for SMEs can help investors by providing more reliable and comparative data on SME loan performance. Creating a checklist label for qualifying SME loans that meet certain standardisation features may be helpful.

D. Would more standardisation of loan level information, collection and dissemination of comparable credit information on SMEs promote further investment in these instruments?

Yes, under the prerequisite that such collection and dissemination of credit information is in line with the EU Data Protection regime.

Question 17:

To what extent would a single EU securitisation instrument applicable to all financial sectors (insurance, asset management, banks) contribute to the development of the EU's securitisation markets? Which issues should be covered in such an instrument?

Harmonisation of rules is essential and accelerated publication of technical regulations and interpretations of rules will reduce uncertainty among investors and issuers. A Q&A tool providing rapid feedback to originators and investors on questions of interpretation or uncertain application of the rules would be useful. The new securitisation regime must provide certainty for investors that a particular securitisation meets the qualifying rules, since the consequences of investing in a securitisation that later proves to be ineligible as a qualifying securitisation would restrain investors to engaging in this new market segment.