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Securitisation in Europe: which way forward?

25 November 2020

Online Seminar Highlights

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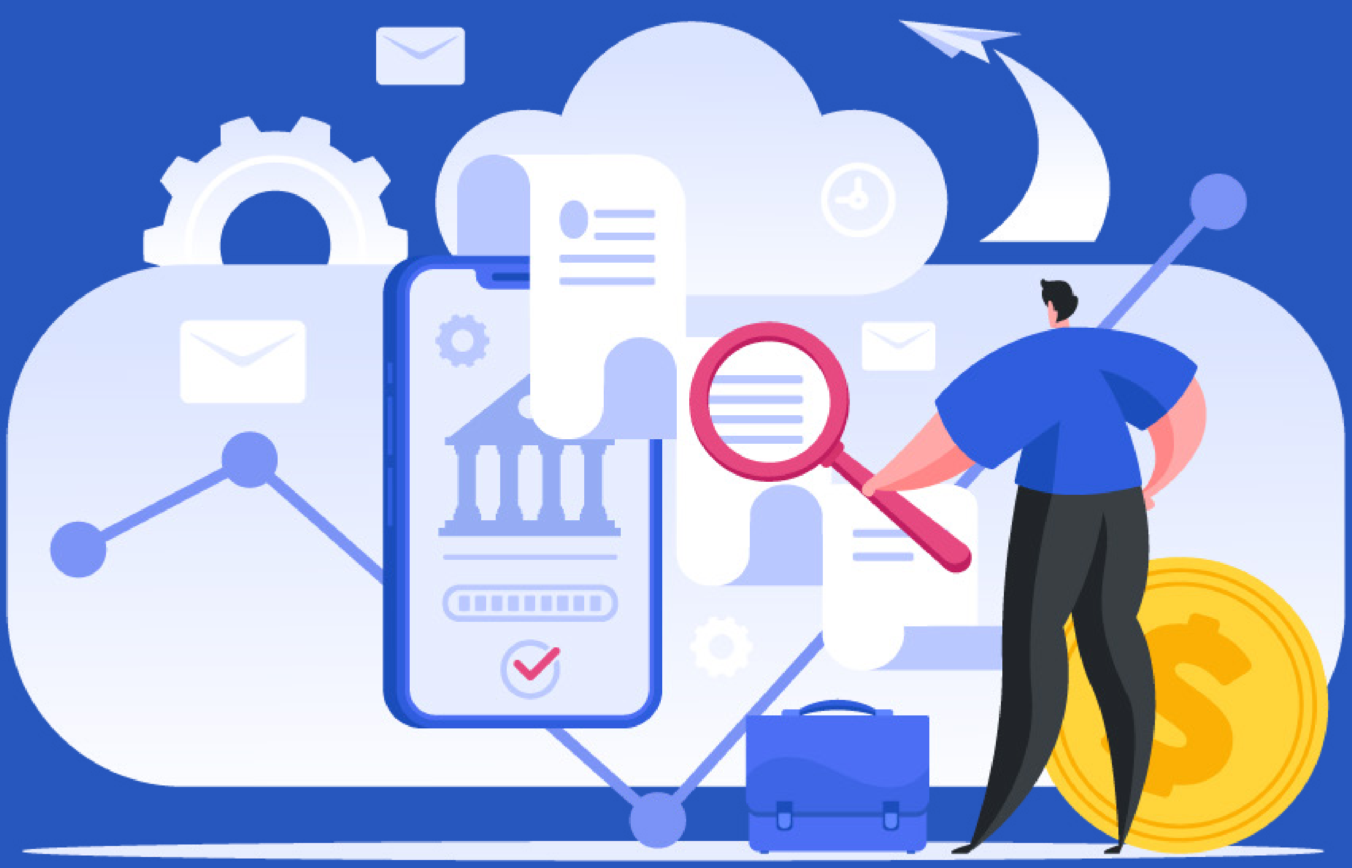


Background

In order to help the recovery from the COVID-19 pandemic, the European Commission proposed urgent amendments to the securitisation regulatory framework ahead of the review initially planned for 2022 with a view to supporting banks maintain their capacity to finance the real economy. In particular, a specific STS ('Simple, Transparent, Standard') framework for on-balance-sheet synthetic securitisation features among the changes under discussion by co-legislators.

The threefold dimension of STS securitisation supposed to encourage the development of the securities market while enabling a more risk-sensitive capital treatment, and soon to be extended to synthetic securitisation, has yet to deliver its full potential. At the moment, transaction numbers remain rather low although one can observe a slight increase of notifications of STS securitisations to the European Securities and Markets Authorities (ESMA) over the last months (from 184 in March 2020 to 396 early November).

The debate focused around the following questions:

- Do current regulatory requirements constitute a barrier or an incentive for market actors?
- How to favour securitisations development and ultimately reach a single market for securitisations in Europe?
- What is the nature of the key underlying exposures in the STS securities market?
- To what extent is the current regime useful for securitising both SME loans and Non-Performing Loans?
- What are the implications of COVID-19 on securitisation in light of the new legislative proposals?

The panel featured

Patrizia Canziani
(Structured Finance Professional)

Bertrand Chavasse
(BNP Paribas)

Bart Joosen
(VU Amsterdam)

Pablo Portugal
(Association for Financial Markets in Europe – AFME)

and has been chaired and moderated by

Jean-Jacques van Helten
(Florence School of Banking and Finance, European University Institute)

Key highlights

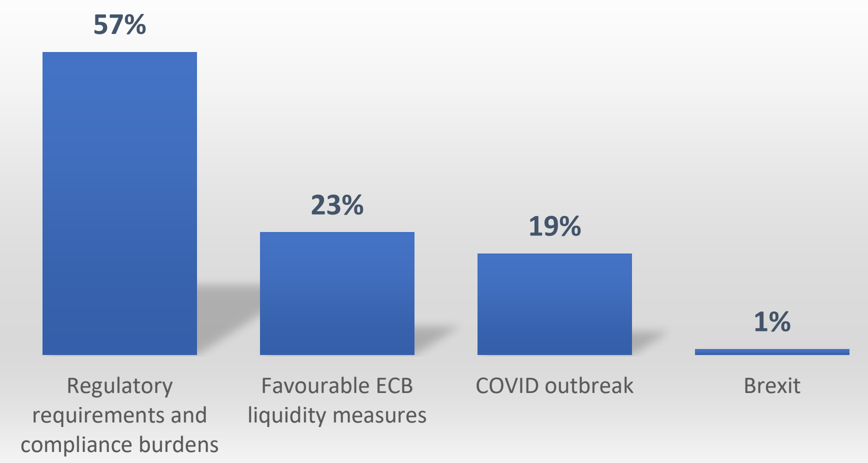
Speakers identified the following regulatory obstacles:

1.
Prudential requirements applicable to securitisation need to be recalibrated.

The requirements applicable to credit institutions laid down in the Capital Requirements Regulation (CRR) and calibrations for securitisation investments by insurance and reinsurance undertakings under the Solvency II directive arguably have punitive effect, and ought to be recalibrated to provide incentives for market actors to invest in securitisation. At present, "over calibration" of prudential requirements *(Chavasse)* constitutes a "significant impediment" *(Portugal)* to the development of a single market for securitisations in Europe. According to the polls the audience largely shared the view expressed by the panellists.

What explains the current state of the European securitisation market?

Poll results from the participants
Number of respondents: 70



2.
Significant risk transfer (SRT) process and requirements raise a number of obstacles for the market functioning. The current procedure under CRR leads to a lengthy review process by national authorities, creating uncertainty and impeding planning for issuing institutions.

This constitutes a "huge regulatory burden"*(Chavasse)* for the industry. The existing requirements for STS securitisations should be even further simplified and reduced to provide more incentives both for issuing credit institutions, insurers as well as investors.

3.
Synthetic securitisations and non-performing exposures securitisations face a number of regulatory obstacles. Initially not intended to be included under the framework, the Capital Markets Recovery Package envisages an extension of the STS framework to enable this credit risk management tools for credit institutions.

It is crucial that the appropriate framework for small and medium-sized enterprise (SME) loans is "to be finalised swiftly" *(Joosen)*, including the introduction of proportionate capital requirements to provide incentives for both issuers and investors.

Impact of Covid-19 on European securitisation and non-performing loans (NPLs)

4.

"European securitisation market remains subdued" *(Portugal)*, reflecting the drop in issuance level further affected by the Covid-19 pandemic. In Q3 2020, a decrease of 19.1% from Q2 2020 has been reported (from EUR 49.2 bn to EUR 39.8 bn of securitised product). This constitutes a further 1.5% decrease from Q3 2019 (EUR 40.4 bn) of the products issued in Europe.

5.

ECB's pandemic emergency purchase programme (PEPP) has provided support to the fixed-income securities market but according to Pablo Portugal, there has been a noticeable lack of support for the asset-backed securitization transactions (ABS). The long-term effects of the pandemic on the ABS market is not yet entirely clear.

6.
NPLs to increase medium term and long term.

NPL increase in the short term is unlikely because of the government measures, incl. payment holidays and release of state guarantees. However, decrease in revenues and worsening financial state of many companies is likely to lead to reclassification to default of many borrowers. Rigorous valuation of the credit quality of banking portfolios post-crisis will lead to reclassification of exposures.

7.

NPL growth "will not be homogenous" *(Canziani)*, as some sectors are more vulnerable than others. Sectors particularly vulnerable to the economic shock of the Covid-19 include hospitality, food, arts and entertainment, retail sales, manufacturing, transportation, construction and real estate. Moreover, as reiterated by Patrizia Canziani, the impact of the Covid-19 shock will be felt in different times. E.g. immediate impact on tourism and transportation, slower impact on real estate and construction. Similarly, the length of the recovery will vary across sectors. Credit institutions with higher exposure to SME loans are likely to experience a stronger increase of defaults as SMEs are expected to be hit harder by the crisis than larger companies.

8.

NPL absorption by banks is linked to their asset quality.

The asset quality of credit institutions in Europe has improved significantly since the 2008-2009 global financial crisis. Generally, European banks have larger capital buffers and liquidity positions than in 2009. However, discrepancies remain across the region with higher NPL rations in Southern European banks before Covid-19 compared to the banks in Northern Europe.

Recommendations

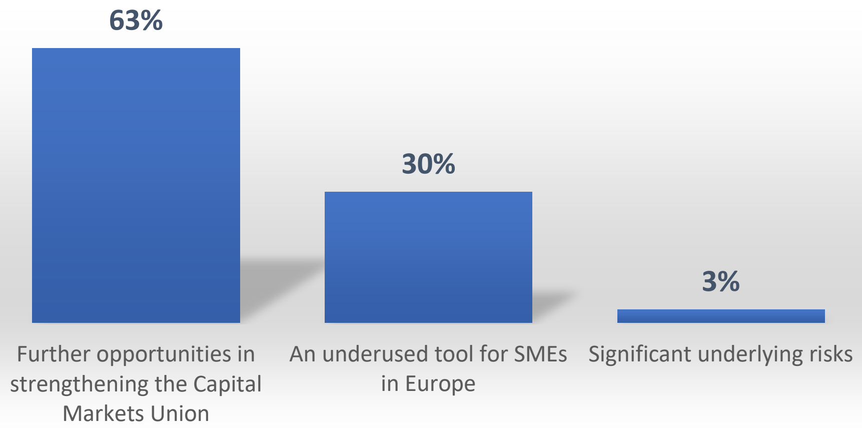
9.

Securitisation represents an opportunity to strengthen European capital markets. A number of regulatory barriers need to be eliminated to provide better incentives for market actors, both issuers and investors, to participate in European securitisation market. From recalibration of capital requirements to simplification of procedural aspects, STS framework should be further adjusted to the changing market reality.

Covid-19 pandemic has proven to be a catalyst, and should be used to expand and adapt the framework to synthetic securitisations. The majority of the participants in the audience shared the positive outlook of the panel with respect to the future development and the role of the STS securitisation in strengthening the Capital Markets Union.

After this debate, would you say that securitisation represents...

Poll results from the participants
Number of respondents: 40



10.

More dialogue between public sector regulators and private sector practitioners is needed to reduce mistrust, to increase incentives, and to ensure the STS framework is advanced to realise its full potential. STS framework is functioning and provides a solid foundation for the further development of the European securitisation market.

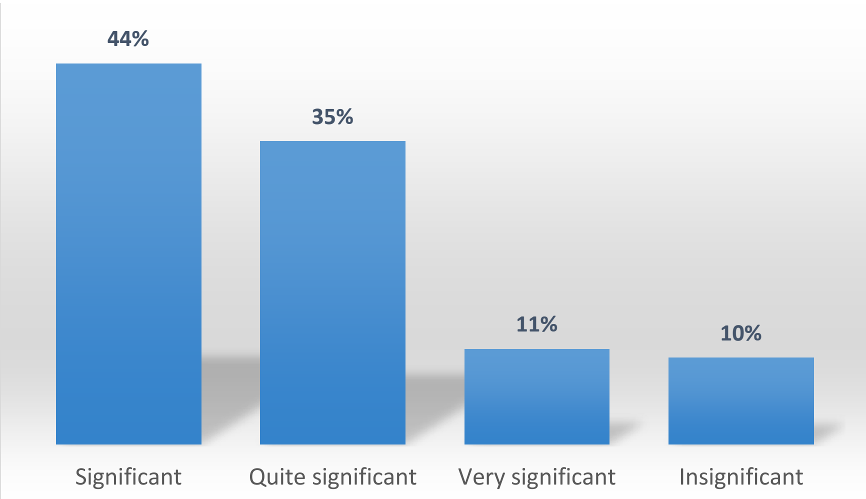
Reactions from the audience

The online debate was attended by 164 participants representing public sector, regulators, private sector actors, and academia. A number of questions have been raised following the debate with regard to the adequacy of the capital requirements, including specific requirements to different tranches of securitisation, and the effects of the requirements on the market incentives. According to the polls, the audience appeared to support the views expressed by the panellists about the review of the calibration of capital requirements and procedural aspects of the STS securitisation framework, currently discussed by the co-legislators.

Despite the emphasised effects of regulatory and compliance burdens on the development of the European securitisation market, a significant number of the participants agreed on the major impact of the Covid-19 pandemic on the current state and further development of securitisation. In particular, the effects of the pandemic on NPL levels and on the supply of NPL securitisations were considered as significant.

What has been the impact of the pandemic on NPL levels and NPL securitisation supply in your opinion?

Poll results from the participants
Number of respondents: 66



You can watch the recording of the Online Seminar on the FBF website and Youtube Channel.

Save the date!
Do not miss
FBF Securitisation: Regulation and Practice online Academy starting on 11 January 2021.
Register by 21 December 2020!

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