

Evaluation of the Effects of the G20 Financial Regulatory Reforms on Securitisation: Consultation report

Response to Consultation

International Association of Credit Portfolio Managers

1. Preliminary findings: Does the report draw the appropriate inferences about the extent to which the securitisation reforms have achieved their objectives? Is there other evidence on the effects of the reforms to complement the preliminary findings of the report?

- The International Association of Credit Portfolio Managers (“IACPM”) was disappointed that the FSB chose to reduce the scope of the report to a narrow set of asset classes and products (RMBS and CLOs) and to a narrow set of policies (BCBS prudential and retention rules). This choice excludes from the report major securitisation products which contribute to the financing of the economy (e.g., ABCP and SRT synthetic securitisation), the impact of disclosure and due diligence rules, of structuring requirements other than retention rules, and of regulations applying to (re)insurers as investors or underwriters, and to retail investment funds (e.g., limits in EU UCITS).

The IACPM therefore strongly recommends the FSB to broaden its analysis and provide a more holistic assessment of the effectiveness of the reforms before publishing its final report, recognizing specific areas of over-or under-shooting and recommending concrete targeted improvements or revisions to policy makers.

- In Europe, the securitisation market performed much better than in the US during the GFC. However, prudential rules have become extremely conservative for banks and insurance, which has driven a significant decrease of the EU traditional securitisation market, with low supply by issuers and low demand from investors.
- In the US, retention rules have been implemented, but not BCBS reforms (STC and prudential rules). The market restarted after the GFC, and is now larger than pre GFC levels, without having generated any systemic risk during stresses like COVID, the Russian war in Ukraine, or the recent regional banks failures.

While comparing how the international standards have been implemented across jurisdictions, we would welcome that the FSB encourages Europe to remove some of the gold-plating (e.g., in the definition of STS compared to STC, or in the interpretation of the principle-based notion of “Significant Risk Transfer”).

The securitisation reforms have achieved their primary objective of the recovery of financial stability. However, it is now important to address the effectiveness of their calibration and make both prudential regulation (for banks and insurers) and securitisation regulation (STC criteria, risk retention, due diligence/disclosure, etc.) more risk sensitive and proportionate, so that a securitisation market can safely grow, in particular by risk sharing between banks and non-banks.

- The IACPM will provide feedback on the FSB report specifically in relation to transactions aiming at risk mitigation and capital release by banks (an aspect not covered by the FSB report).

These transactions are classified as:

- SRT, for significant risk transfer of synthetic credit transfer (terminology used in Europe, UK and Canada), or
- CRT, for credit risk transfer or capital release transactions (terminology mainly used in the US).

SRT/CRT securitisations are generally synthetic and are executed on underlying core bank assets with high RWA density (corporate and SME loans, asset-based and specialized finance). They are typically private transactions executed in long-term partnership between banks and investors/insurers, following comprehensive due diligence of the relevant bank's lending origination and risk management practices. Investors - generally acting as or on behalf of long-term investors such as pension funds - favor specific core asset classes, in which they invest on an ongoing basis with the objective of achieving a stable return over time.

Banks typically protect the first loss and the mezzanine tranches of the securitisation and retain the senior tranches which do not attract credit risk.

It should be recognized that inappropriate calibration and disproportionate regulations affect the markets for SRT and senior securitisation tranches differently.

- Currently, the SRT market is supply-driven, i.e. it is primarily driven by its effectiveness for banks' regulatory capital release. Demand side conditions are complied with by structuring transactions privately and in the spirit of a long-term partnership between banks and investors/insurers. Here, a fair Basel 3 regulation is critical.
- By contrast, for retained or acquired senior tranches, addressing only their prudential treatment will not suffice. Even if the required regulatory capital is appropriate, the demand by investors can be completely disincentivised by the disproportionate cost of investment. Here, a fair securitisation regulation is critical, notably for what relates to due diligence and disclosure requirements.

2. Analytical approach: Are the descriptive analyses used to evaluate the effects of the securitisation reforms appropriate? Are there other such analyses to consider? What types of empirical analysis based on available data could inform the evaluation?

- The IACPM strongly recommends that the FSB excludes the retained true sale securitisations from its analysis, as they inappropriately flatter the size of the European market (graph 6 on page 21) while neither retention rules nor prudential rules apply, to provide a much more realistic assessment of the subdued European true sale securitisation market and the relative importance of the European CRT/SRT market. The volume of underlying assets securitised in cash securitisations in 2023 by EU banks (94Bn) is actually comparable to the assets securitised in SRT/CRT transactions (100Bn), as highlighted in the attached IACPM paper published after its annual survey on synthetic securitisations (<https://iacpm.org/private-risk-sharing-exceeded-e1-trillion-of-cumulated-volumes-between-2016-and-2023-despite-ongoing-uncertainties-in-final-regulatory-treatment/>).
- The report focuses on RMBS, which is by far the largest securitisation market, and CLOs. However, with € 200 billion issuance in 2023 and € 600 billion outstanding by end 2023, the CRT/SRT market – not covered by the FSB report - is now larger than the CLO market.
- The report does not contain any analysis of the effects of the securitisation reforms and their appropriateness for CRT/SRT transactions, aiming at risk mitigation and regulatory capital release. The effectiveness of CRT/SRT regulatory reforms varies also substantially across the main jurisdiction and asset classes. Such an analysis is important in order to provide the conditions for healthy growth in CRT/SRT securitisation in support of lending by regulated banks.
- This point is particularly relevant now for banks, as the implementation of Basel 3 final regulations will increase capital absorbed by lending, and the demand for lending will grow to support the investments needed by the green transition and the digital transformation in all industries. Here, it is critical that the report identifies the impact of using the same BCBS non-neutrality factors (p factor, RW on senior tranches) for transactions executed on own assets (with no agency and model risk) than for transactions acquired from third parties.

3. Trends: Are the securitisation market trends presented in this report adequate given the scope of the evaluation? Are there other important trends that should be included and, if so, what additional data sources could be used for this purpose?

After excluding retained securitisations, it would also be useful to explain separately the trends for each of the major asset classes and geographies, which would help in understanding the drivers behind the figures, and subsequently exploring potential recommendations.

Some important trends on CRT/SRT transactions are not covered in the report:

- the growing participation of regional/local banks, both in the EU and US in new SRT on mortgages and retail assets, which highlights the importance of appropriate SA regulation.
- the involvement of non-life insurers on the liability side in Europe, and their role in US non-agency RMBS transactions (CRT) – cf. IACPM's paper ["Insurance and Securitisation" (June 2024 - <https://iacpm.org/role-of-insurers-in-securitisation/>)].
- the build-up of differences between the US CRT and the European SRT markets, from both an issuer and an investor perspective, due to fragmentation in the implementation of

prudential regulation applicable to banks and insurers. Differences can be a source of arbitrage or leverage, which can disrupt the market and create new systemic risks.

- the collected information covers a period of weak demand for credit, due to multiple crises. However, the huge investment needed for the digital and environmental transition, combined with the impact of deglobalization, can rapidly change demand for credit and reported behaviours. Non-bank lending is growing, together with banks' need to securitize so that most of the credit market continues to be provided and serviced by regulated entities.

- While CLOs and RMBS have been very positive to the US economy, Europe experienced another trend, due to different regulations and capital market infrastructure. On RMBS and banks' long-term funding:

- o Long term funding of banks is concentrated in covered bonds, because their regulatory treatment is more favorable than RMBS senior bonds (lower risk weights in CRR3 and Solvency II, eligibility in LCR, due diligence/disclosure).

- o Improving the level-playing field between senior RMBS and covered bonds is a prerequisite for RMBS growth in Europe and mitigates the systemic risk arising from concentration in covered bonds, which attract counterparty risk on banks, use only mortgages as collateral, and do not transfer credit risk on the underlying assets.

- o Such an improvement would also be favorable for the development of synthetic SRTs on mortgages, which enable credit risk transfer.

- On CLOs, while CLOs have grown in the US (5 times more than in EU, as indicated by participants in the FSB workshop) and supported the local economy, the same happened in Europe, but through SRTs on corporate/SME loans (for which the volume is also a multiple of the volume of SRTs in the US), no systemic losses have been experienced in the last 20 years, and borrower risk management benefit from banks' broader client relationships.

4. Relevant reforms: Does the report appropriately describe the key aspects of the design and jurisdictional implementation of the BCBS and IOSCO reforms for analysing their impact on securitisation markets? Are there other important aspects of these reforms that should be considered for inclusion?

- The banks' prudential reforms in relation to non-neutrality factors (the p factor and RW floor on senior tranches) did not in our view sufficiently differentiate between the risk retained from on-balance-sheet securitisations – without agency and model risks - and the risk acquired by investing in third party transactions.

- The market reforms (notably due diligence and disclosure requirements) do not differentiate between transactions based on their risk (SRT vs senior), the regulatory oversight of the stakeholders involved, and their experience in similar transactions, asset classes and jurisdictions. The consequence is a disproportionate cost in executing transactions, which constrains the use of securitisation.

- The call made by the EU regulatory authorities to the BCBS for a comprehensive review of the securitisation prudential framework should be echoed explicitly by the FSB in its report, as it is a very important opportunity to reduce the current market fragmentation. This

is particularly important at the current time, given that the Federal Reserve's proposal to implement Basel 3 in the US contains changes that 'goldplate' BCBS rules, for instance by increasing risk weights for residential mortgage exposures above BCBS rule and doubling the 'p factor' (i.e. from $p=0.5$ in the current US capital rules to $p=1$ in the US proposal). A comprehensive review by BCBS is particularly important now because, if rules and regulations become too burdensome, then it is possible that international consensus will be lost and create market fragmentation among jurisdictions. This situation only hurts the market, industry and global regulatory coherence.

5. Other reforms: Does the report accurately identify other G20 and domestic financial reforms that are most relevant for securitisation markets? Are there other reforms that should be considered in terms of their impact on market participants?

- In relation to the prudential reforms applicable to IRB banks, the report does not evaluate the combined impact of the RWA increase on the underlying assets and the output floor introduced by Basel 3 on retained senior tranches of SRT transactions.
- In the European Union, covered bonds are the dominant private secured instrument used by banks and investors, because their regulatory treatment in LCR and Solvency II is more favorable than senior tranches of true sale securitisations
- Securitisation regulations are very fragmented:
 - o In the US, regulations do not prescribe a specific securitisation framework
 - o In Japan, securitisations have no specific disclosure requirements
 - o In Australia, synthetic securitisation is not allowed
 - o etc

6. Conceptual framework: Does the report adequately explain the objectives, transmission channels and expected outcomes of the securitisation reforms? What other metrics to assess the impact of the reforms should be considered?

- The FSB report does not fully acknowledge material differences between the scope of EU and non-EU securitisation regulatory reforms unrelated to prudential requirements.
 - o The definition of "securitisation" in the EU Securitisation Regulation is the same as in the prudential regulations (CRR), covering a very wide scope of transactions for which the Securitisation Regulation was not originally designed, and which are not generally considered by the market as being "securitisations". This has a number of unintended consequences, such as inappropriate due diligence and disclosure requirements, particularly for private transactions where there is typically no asymmetry of information. Outside Europe (e.g. in the US) risk retention, disclosure and transparency reforms apply only to more narrowly defined "asset-backed securities". The scope of the definition of "securitisation" in the European Securitisation Regulation should in our view be adjusted to exclude certain areas from the regulatory perimeter of securitisation, for instance products subject to other regulatory regimes.

o The IACPM recommends that in its final report the FSB should take a holistic approach to securitisation reforms. The securitisation market encompasses a very diverse universe of financial products, and a very prescriptive or “one size fits all” approach to non-prudential regulation can unnecessarily increase the cost of doing a securitisation without benefit to supervisors or the parties involved, and reduce its capacity to support the real economy.

o A holistic approach to securitisation reforms will also enable regulators to assess behavioural changes on the buy-side, and for different types of CRT/SRT structures and jurisdictions.

- Effectiveness metrics are missing in the analysis, i.e. the operational costs of securitisation compliance with due diligence and disclosure requirements, and the cost of capital release (which mainly depends on the amount of capital release).

- The impact assessment of the countries where synthetic securitisations remain prohibited is not considered in the report. The impact should be assessed not only on banks’ lending capacity, but also on the unintended growth of unregulated private lending and private credit.

7. Resilience metrics for the CLO market: Does the report accurately describe the evolution of resilience indicators for the CLO market? To what extent can the evolution of these indicators be attributed to the reforms?

8. Risk retention in CLOs: Does the report accurately describe risk retention practices in the CLO market before and after the reforms? What additional analysis could be included to assess the effectiveness of risk retention in CLOs across FSB jurisdictions, including on how financing of risk retention deals by third party investors impacts effectiveness?

- Both SRTs and CLOs currently have to comply with a 5% retention rule, and the level-playing field here should be maintained to avoid an unintended transfer of loan origination to private credit.

9. Resilience metrics for the non-agency RMBS market: Does the report accurately describe the evolution of resilience indicators for the RMBS market? To what extent can the evolution of these indicators be attributed to the reforms?

The IACPM wishes to put forward a general comment on FSB resilience analysis.

As indicated in the report (p 56), “the period immediately prior to the GFC was characterised by 1) excessive risk taking and 2) the unsustainable build-up of leverage by the private sector”. The GFC was actually triggered by banks developing a large non-prime mortgage business that did not exist before, for the sole purpose of satisfying the demand of a new community of leveraged traders and investors relying on market prices and liquidity.

Market resilience requires therefore:

1) at issuer level, stability in issuance of regular volumes of securitisations on assets originated from banks’ core lending book, and not assets which exceed their risk appetite

2) at investor level, stability in investment strategies, enabling to develop through-the-cycle experience of credit losses per asset class and region.

Therefore, we believe that the final report would be enhanced by analysing vintages of issuance on all asset classes to identify changes in issuers and investors strategies per (sub)asset class, and to understand the nature of the relationship between issuers and investors. This can be achieved by establishing transparency on the risk transfer chain between lenders and ultimate owners of risk, which can be either bilateral and based on long-term partnership, or separated by several steps of risk transformation and leverage sensitive to changes in market prices and liquidity, but enabling scalability in a non-stress financial context.

10. Risk retention in RMBS: Does the report accurately describe risk retention practices in the RMBS market before and after the reforms? What additional analyses could be included to assess the effectiveness of risk retention in RMBS across FSB jurisdictions?

11. Effectiveness of BCBS securitisation reforms: Does the report accurately describe the changes in bank behaviour following the implementation of the BCBS securitisation framework reforms? To what extent can the effects of these reforms be disentangled from the broader Basel III framework, other reforms and confounding factors?

The report does not cover:

- the combined – probably unintended - negative effect of the output floor on retained tranches, of the increased RWA on underlying assets, and of the non-neutrality factors (p, senior floor)
- the related differences per jurisdiction and for banks using the SA and the A-IRB approach, making that different asset classes are economically relevant for capital release by CRT/SRT.

12. Simple, transparent and comparable (STC) securitisations: Does the report accurately describe the impact of the introduction of the STC framework on the securitisation market? To what extent has the reform met its objectives?

The report does not cover the impact of:

- The absence – at BCBS level - of STC regulation specific to synthetic securitisations (cf. the STS for synthetics in the EU).
- The differences across jurisdictions in eligibility and prudential treatment of unfunded protection provided by regulated insurers (e.g., non-eligibility of insurers as qualified providers of credit risk mitigation in US, non-eligibility of unfunded protections provided by multi-line insurers in EU STS securitisation regulation, etc).
- The lack of proportionality in due diligence and disclosure in EU STS regulations between professional investors in private SRT and investors in senior tranches of public transactions,

between regular issuers/investors and new entrants, and between regulated and non-regulated entities.

- The lack of differentiation between non-neutrality risk (agency and model risks) for tranches retained on securitisations executed on a bank's own assets vs on tranches acquired by the bank from securitisations backed by third party assets.

13. Effects on financing the economy: Does the report accurately describe the main effects of the reforms on financing the economy? Is there additional analysis that could be undertaken to estimate the benefits and costs of these reforms and to assess their impact on securitisation as a financing tool?

- Through securitisation of loans originated by banks, both banks and non-banks jointly contribute to financing the economy. The relationship between banks and the various types of non-banks (Insurers, investment funds, pension funds, MDBs, etc) is not analyzed, nor its benefit and resilience in a stress situation.

The analysis does not include an estimate of the volume of missed "good" securitisations (i.e. safe and good for the economy and society) which were not carried out because of excessive conservatism in prudential or in market regulation. The riskiest portion of this volume was either pushed towards non-bank lenders, or just not financed at all.

14. Effects on financial system structure and resilience: Does the report accurately describe the extent to which there has been a redistribution of risk from the banking to the non-bank financial intermediation sector? What role did the reforms play in this process and what are the main benefits and risks from a system-wide perspective? How have the reforms impacted the demand and supply of liquidity in securitisation markets?

The report does not cover:

- the diversification benefit of the redistribution of risk to unfunded credit insurance offered by multi-line non-life insurers.
- the risk of long-term funding concentration in cheaper competitive products (e.g., covered bonds vs senior ABS tranches).
- the risk of excessive thickness of junior tranches to release capital, largely exceeding the economic level of expected and unexpected losses on the underlying portfolios (e.g. in the US, where CLNs on corporate loans must cover 12,5% of the underlying assets); unless transactions are tranching to fit the risk/return profile of various classes of investors, investors have to leverage by repo or NAV lending to comply with their risk appetite and target return, with the result that some of the SRT risk is returning to the banking sector.
- the need to have fair treatment for banks for both SRT (for capital release) and senior tranches (for investment in LCR), in synthetic and true sale transactions, especially since the final implementation of Basel 3 will incentivize capital release on retail assets (generally securitized on a true sale basis).

15. Other issues: Are there any other issues or relevant factors that should be considered as part of the evaluation?

Other relevant factors that could be considered in the final report are:

- the conditions to grow SRT risk sharing in both true sale and synthetic securitisations (see below)
- the difference between capital and operational challenges faced by smaller vs. larger institutions.
- the need to review prudential and market regulations also for institutional investors (Insurers' spread risk on ABS and CLN in Solvency II standardized approach, limits in acquisition amount per issuer in UCITS/AIMFD funds) in order to incentivise securitisation investments.
- The application of principles-based diligence and disclosure to seasoned investors in private SRT.
- The effect of Basel 3 final implementation in the US, triggering a rapid increase in the issuance of – often large – synthetic securitisations, purchased by a different profile of investment firms.

IACPM recommends that FSB analysis is also grounded on the below principles and objectives:

- To achieve scalability, both true sale and synthetic securitisations must grow
- Loans originated by banks and credit insurance contracts underwritten by (re)insurers should be handled differently than capital markets transactions
- In Basel3 and in the Securitisation Regulation, whatever the type of securitisation, requirements appropriate to private SRT tranches are different from requirements appropriate to public senior tranches
- In Securitisation Regulations, proportionate due diligence and disclosure should be enforced based on criteria like seniority of investment, experience of the issuer/investor, and type of oversight of market participants.

1. Objective 1 : Increase SRT transactions effectiveness from a capital perspective, by improving the prudential treatment of risk sharing transactions

- For banks:
 - o A permanent solution for the capital treatment in Basel 3 of SRT transactions is crucial for the existence of the SRT market
 - o The applicable Securitisation Regulations and Basel 3 regulations should be also amended by:

- Allowing to use a reduced p factor level in all transactions using the Standardized approach

- Eligibility in STS of Solvency II or equivalent regulated insurers rated CQS 1 or CQS 2

- Introducing a risk-sensitive senior RW floor in CRR3

- o The treatment of unfunded credit protections provided by regulated insurers should be applied consistently across all types of unfunded protections provided by insurers, including on SRT transactions.

- For insurers as investors in funded SRT tranches of securitizations

- o Insurers are currently not investing in credit linked notes (CLNs) from SRT transactions. Would the treatment of securitization be reviewed in Solvency II-equivalent regulations and become more risk-sensitive, policy makers should ensure that CLNs issued from on balance-sheet transactions are also in-scope, to enable insurers' investment.

2. Objective 2 : Increase competitiveness of EU participants in the SRT market, by reducing the operational costs of compliance with regulations, and accelerating market access.

For the benefit of all participants, we recommend to:

- Streamline the SRT notification and approval process by supervisors
- Rapidly amend the disclosure for private SRT transactions
- Introduce principles-based due diligence requirements for investors
- Where applicable, improve the STS criteria for on-balance-sheet securitisations

3. Objective 3 : Ensure resilience of the risk sharing market, by pro-active and shared monitoring of changes in the securitisation market

- Set up a joint platform between regulators and associations' representatives of banks and non-banks to monitor, educate, discuss opportunities for real economy finance, as well as anticipate and prevent potential systemic risks arising from securitisation and risk sharing growth between banks and non-banks across all jurisdictions.

Finally, we want also to anticipate the changes in the SRT market that might be triggered by the implementation of Basel 3 and the normalisation of monetary policies, and might create a relationship between growth in SRT synthetic market and growth in traditional true sale transactions, currently disconnected.

Up to now, SRT securitisations have mostly been executed in a synthetic format and on assets with high RW density, like loans to SMEs, corporates, project and asset-based finance. However, as we can already see for banks regulated under the standardised approach, the economics of capital release will improve on other asset classes, like e.g., residential mortgages, consumer or car loans, traditionally securitised in a true sale format and for long term funding.

Unlocking the burdens which currently refrain investors' investment in senior true sale transactions will then become a prerequisite for growth of the SRT true sale market.