



Call for advice to the Joint Committee of the ESAs for the purposes of the securitisation prudential framework review

Context

Capital framework

Banks and insurance companies are actively involved in the business of investing in securitisations and, hence, it is important that these firms hold sufficient capital to absorb unexpected losses from such exposures and have a sufficient understanding of the risks attached.

As regards banks, on 11 December 2014, the Basel Committee on Banking Supervision (BCBS) published its revisions to the securitisation framework (the “Revised Basel Framework”). The Revised Basel Framework was intended to strengthen the capital standards for securitisation exposures held in the banking book and address the Basel II securitisation framework’s shortcomings, namely:

- (a) an undue mechanistic reliance on external ratings, which was the preeminent driver to assign capital charges under the previous framework;
- (b) an excessive procyclicality of the capital requirements, as tranches downgrades led to a rapid and sudden increase in capital requirements for banks holding downgraded mezzanine and senior tranches (“cliff effect”);
- (c) an insufficient risk sensitivity of the framework, which led to excessively high capital requirements on senior tranches and unduly low capital requirements on junior tranches.

On 11 July 2016, the BCBS published an updated standard for the regulatory capital treatment of securitisation exposures, which includes the regulatory capital treatment for simple, transparent, and comparable securitisations (“STC securitisations”).

The Revised Basel Framework was implemented in the Union law through Regulation (EU) 2017/2401¹, which amended the securitisation capital framework set out in Regulation (EU) No 575/2013² (the “Capital Requirements Regulation” or “CRR”).

¹ Regulation (EU) 2017/2401 of the European Parliament and of the Council of 12 December 2017 amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms

² Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013. on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012

In parallel, the BCBS standard on STC securitisations was implemented in Union law through Regulation (EU) 2017/2402³ (the “Securitisation Regulation”) laying down a general framework for securitisations and creating a specific framework for simple, transparent and standardised securitisation (“STS securitisations”).

Both the above elements of the new EU securitisation capital framework became applicable on 1 January 2019.

As regards insurance companies, the calibration of capital requirements for investments in securitisation tranches by insurance and reinsurance firms was revised to reflect the new securitisation framework with the adoption of Commission Delegated Regulation (EU) 2018/1221.

Banks’ liquidity framework (LCR)

The Liquidity Coverage Ratio (LCR) for banks is another of the key set of reforms introduced as part of the Basel III framework. The LCR promotes the short-term resilience of a bank’s liquidity risk profile by ensuring that it has sufficient high-quality liquid assets (HQLA) to survive a significant stress scenario lasting for one month.

Under Basel III’s LCR, only the senior tranches of residential mortgage backed securities (“RMBS”) with an external rating AA or higher qualify as level 2B HQLA, subject to a 25% haircut. The Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 (the “LCR DA”) expanded level 2B eligibility beyond RMBSs to the senior tranches of securitisations backed by SME loans, auto loans and leases and consumer loans, subject to certain specific conditions. The LCR DA justified the broader scope of LCR-eligible securitisations compared to the Basel III standard on the basis of:

- (a) market data showing that securitisations backed by high quality assets with short weighted-average life and high prepayments had exhibited a robust performance as a safe source of liquidity for investors during the financial crisis, similarly to other liquid assets such as covered bonds;
- (b) the convenience of diversifying the LCR buffer with assets that had shown a low correlation with other liquid assets such as government bonds as a means to weaken the bank-sovereign nexus and the fragmentation in the internal market, as well as to facilitate the financing of the real economy.

The LCR DA was subsequently amended by the Commission Delegated Regulation (EU) 2018/1620 of 13 July 2018 to restrict the eligibility of securitisations as level 2B HQLA to transactions backed by the same asset classes, provided that they qualify as STS securitisations.

Securitisation prudential framework review

Considering that the securitisation capital and liquidity legislative frameworks have been in force for a sufficiently long period of time now and through challenging market conditions, it seems appropriate to conduct a thorough review of how they have performed relative to their stated prudential purpose and the objective of reviving the EU securitisation markets on a prudent basis.

Against this background, it is worth recalling that the High Level Forum on Capital Markets Union addressed a report to the Commission on 10 June 2020

³Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012

(the “HLF Report”)⁴ with a set of recommendations aimed at “removing the biggest barriers in the development of the EU’s capital markets” and that the HLF Report included specific recommendations on amendments to the securitisation prudential framework, both for banks and insurers. The HLF Report noted that the completion of the Capital Markets Union would be particularly important at this time to speed up the EU’s recovery from the COVID-19 pandemic. Furthermore, the Commission is obliged to submit a report to the Co-Legislators under Article 519a of the CRR on the application of certain selected provisions in the securitisation part of that Regulation “in light of developments in securitisation markets, including from a macroprudential and economic perspectives” and the Commission may submit a legislative proposal jointly with the report.

The Commission services, thus, seek input and technical assistance from the Joint Committee of the European Supervisory Authorities (“JC”) to carry out the review of the securitisation prudential framework in accordance with the terms laid out in the following sections.

Assessment of the securitisation capital framework

Scope of the JC’s work

Banks

The scope of the JC’s advice on the regulatory capital part of the securitisation framework should be tailored to the matters referred to in Article 519a of the CRR.

As per this Article, the Commission is required to prepare a report for the European Parliament and the Council assessing the “*application of Chapter 5 of Title II of Part Three*” of that Regulation “*in the light of developments in securitisation markets, including from a macroprudential and economic perspectives*” (see annex for more details).

The Commission services seek advice primarily on the application and impact of the following provisions which set out the key parameters for the calculation of risk-weighted exposure amounts for positions in a securitisation:

- the “hierarchy of methods” laid out in Article 254 of the CRR;
- the determination of the securitisation tranches’ attachment (A) and detachment (D) points (Article 256 of the CRR) and their maturity (Article 257 of the CRR);
- the non-neutrality correction factors designed to capture the agency and modelling risks prevalent in securitisations, specifically:
 - (i) the (p) factor embedded in the formulae of the SEC-IRBA (Article 259(1) of the CRR) and the SEC-SA (Article 261(1) of the CRR) as a capital surcharge on the securitisation tranches’ capital requirements; and
 - (ii) the capital floors setting the minimum risk weight on the senior securitisation positions at 15% (Articles 259, 261 and 263 of the CRR) and 10% for STS securitisations (Articles 260, 262 and 264 of the CRR);
- the caps for securitisations that include a “look-through approach” for the most senior securitisation position (Article 267 of the CRR) and an overall cap on capital requirements for all tranches (Article 268 of the CRR).

These provisions are central to the securitisation capital framework’s purpose to address the shortcomings identified in Basel II, and the impact of their application should be

⁴ [200610-cmu-high-level-forum-final-report_en.pdf \(europa.eu\)](#)

carefully assessed against the background of prevailing market trends and other relevant factors. In particular, the analysis should consider:

- origination and issuance volumes in EU securitisation markets in recent years, with relevant comparisons of volumes for significant periods (pre- and post-financial crisis and pre- and post- 1 January 2019 and March 2020). For these purposes, the analysis should include a breakdown by Member State and asset class, and the latter be further broken down to show data on:
 - (i) non-performing exposure (NPE) securitisations;
 - (ii) STS and. non-STs securitisations;
 - (iii) cash and synthetic securitisations;
 - (iv) ABCP and non-ABCP securitisations ;
 - (v) volumes of securitisation issuances retained by originators vs. volumes transferred in the market;
- origination and issuance volumes in major third country securitisation markets, in particular the US, showing relevant comparisons with both EU and pre-financial crisis volumes;
- relevant credit performance of securitisations during the immediately preceding 5 years (including rating downgrades), in particular in the period following March 2020, with a breakdown by asset class and comparison with the performance of similar asset portfolios retained by originator banks, where available;
- the effective change in the capital requirements on banks in relation to securitisation positions held after 1 January 2019 in comparison to the requirements that applied or would have applied to those positions before that date;
- major economic trends that have impacted EU securitisation markets' performance in recent years, namely after 1 January 2019, including the COVID-19 pandemic, and the policy and legislative responses implemented to deal with such trends (in particular the monetary policies of central banks).

Insurance and reinsurance undertakings

The Commission services seek advice primarily on the impact of the following provisions on the investment behaviour of insurance and reinsurance undertakings which set out the key parameters for the calculation of capital requirements on spread risk for securitisation positions

- the determination of risk factor stress for senior STS securitisation positions in Article 178(3) and 178(5) of Commission Delegated Regulation (EU) 2015/35;
- the determination of risk factor stress for non-senior STS securitisation positions in Article 178(4) and 178(6) of Commission Delegated Regulation 2015/35;
- The determination of risk factor stress for non- STS securitisation positions in Article 178(8) and 178(9) of Commission Delegated Regulation (EU) 2015/35;

The analysis should consider the information gathered under the previous section as well as the evolution of the share of investments in tranches of STS and non-STs securitisation positions on the balance sheet of insurance and reinsurance undertakings in recent years. It should also take into account the capital requirements on spread risk for comparable instruments, such as corporate and covered bonds.

Assessment of the banking regulatory capital treatment of securitisations

Taking into account the scope of the assessment and any relevant findings from the market analysis exercise referred to above, the Commission services would welcome the JC's assessment in particular on the matters referred to in Article 519a, point (a) of the CRR. The JCs' views are requested as to whether:

- (a) the securitisation capital framework has been the main or, at a minimum, a very significant driver for banks' origination and investment activity in EU securitisation markets in recent years and which other factors should be regarded as having had major impact and why. For the purposes of assessing the relative impact of the securitisation capital framework in the market, the Commission services invite the JC to consider, in particular, whether:
 - (i) the current levels of the (p) factor in the SEC-IRBA and SEC-SA formulae and the LGD input floors in the former are proportionate, having regard to the relative riskiness of each of the tranches in the waterfall, and adequate to capture securitisations' agency and modelling risks;
 - (ii) the current capital floor levels for the most senior tranches of STS and non-STs securitisations should be regarded as proportionate and adequate, taking into account the capital requirements of comparable capital instruments;
 - (iii) the inversion of the hierarchy of methods that allows banks to apply the SEC-ERBA as per paragraphs (2) and (3) of Article 254 of the CRR has met its purpose to mitigate the conservatism of the SEC-SA in certain cases;
 - (iv) the securitisation caps have operated as an effective backstop to the conservatism of the hierarchy of methods;
 - (v) the current determination of tranche maturity is adequate to assign the respective capital charges to each of the tranches under the hierarchy of methods relative to their seniority and riskiness, in particular having regard to the impact of the maturity determination in the calculation of the (p) factor in SEC-IRBA, the look-up table of SEC-ERBA and, indirectly, in the calibration of the (p) factor in SEC-SA;
- (b) taking into account the assessment of the matters referred to in the preceding point, the impact of the securitisation capital framework on banks' origination and investment activity should be regarded either as:
 - (i) insufficient and failing to meet the framework's purpose of correcting the shortcomings of the previous framework and strengthening securitisation capital standards;
 - (ii) sufficient and proportionate, thus meeting the framework's purpose and having no significant detrimental knock-on effects on the securitisation market's performance and function;
 - (iii) overly conservative and disproportionate, thus creating major obstacles to the market's ability to perform effectively its function as a source of funding that EU banks can channel as lending to the real economy and as a means of risk transfer and diversification.

Assessment of the capital calibration of securitisation tranches held by insurance and reinsurance undertakings

Despite the revisions to the capital treatment of securitisation positions implemented in the Solvency II framework following the entry into force of the STS regime, insurance and reinsurance undertakings' participation in the EU securitisation market remains low. As previously explained, the Commission services request the JCs' advice:

- (a) as to whether the Solvency II capital framework has been a significant driver for insurance and reinsurance companies' investment activity in EU securitisation markets in recent years, and whether other factors, including regulatory rules other than capital requirements, should be regarded as having had major impact;
- (b) whether the current calculation for capital requirements for spread risk on (i) securitisation positions in Solvency 2 for the senior tranches of STS, (ii) non-senior tranches of STS and (iii) non-STS securitisations are proportionate and commensurate with their risk. The JC should take into account the capital requirements for non-securitised assets with similar risk characteristics, comparing the capital requirements for such assets with senior and non-senior tranches of securitisations;
- (c) whether the risk sensitivity of the capital calibration framework could be improved in order to increase investor demand and, in particular, whether Solvency II capital requirements for spread risk should differentiate between (i) mezzanine and junior tranches of STS securitisations, and (ii) senior and non-senior tranches of non-STS securitisations.

In addition, the Commission requests the JC to assess whether the existing calibration method of Solvency 2 could be elaborated in a manner coherent with the overall Solvency 2 framework providing for more consistency with the CRR's securitisation framework. This alternative method should, in particular, provide for the following:

- (i) differentiated treatments for STS vs. non-STS securitisations,
- (ii) a link between capital requirements for securitisations and the capital requirements for the underlying exposures, including a cap based on the capital requirements of the underlying portfolio of assets as a backstop to the capital requirements on the securitisation positions,
- (iii) the granularity of the treatment of tranches as characterised by their attachment and detachment points; and
- (iv) a hierarchy of approaches similar to that currently set out in the CRR (SEC-IRBA (Internal Ratings Based Approach), SEC-SA (Standardised Approach) and SEC-ERBA (External Ratings Based Approach).

Finally, the Commission services will welcome additional suggestions that the JC may want to make on any other alternative methods (other than the one mentioned above) to the calculation of risk factor stress that can capture in a more adequate and proportionate manner the risk of securitisations. In its advice, the JC is particularly invited to reflect about agency and modelling risk and how they differ between STS and non-STS securitisations.

Follow-up recommendations

Should the JC conclude that the securitisation regulatory capital framework could be improved, the Commission services would welcome recommendations from the JC on appropriate amendments to the framework. The JC is, in particular, invited to consider for these purposes the recommendations laid out in the HLF Report for recalibrating capital

charges applied to senior tranches under the CRR and for recalibrating the capital treatment of securitisation tranches under Solvency II (see pages 61-62 of the HLF Report).

In addition to the above, the Commission Services welcome recommendations from the JC on any other technical amendments that may be appropriate or desirable to improve the prudential capital treatment of securitisations, as well as on desirable mechanisms to enhance consistency in the interpretation of the framework.

Assessment of the securitisation liquidity framework (LCR)

Scope of JC's work

For the purposes of assessing the securitisation liquidity framework, the JC is hereby requested to consider the following:

- (a) the scope of eligible asset classes and the requirements on securitisations to qualify as Level 2B liquid assets as currently laid out in Article 13 of the LCR DA;
- (b) the liquidity performance of senior tranches of securitisations in EU markets in recent years, for which the analysis should:
 - (i) cover the period following the entry into force of the new securitisation framework on 1 January 2019, with a particular focus on the impact on liquidity of the COVID 19 pandemic starting in February of 2020;
 - (ii) assess the liquidity of the most significant securitisation asset classes, namely those currently qualifying as STS securitisations and ABCPs, and include relevant comparisons between securitisations and covered bonds;
 - (iii) use the same methodology employed for preparing the “Report on appropriate uniform definitions of extremely high quality liquid assets and high quality liquid assets” of 20 December 2013. The JC is, however, requested to use multiple datasets and give more weight in their analysis to trading cost measures, such as spreads, and less weight to frequency on trading and turnover.

Follow up recommendations

Having regard to the market analysis and the matters referred to in the previous section, the Commission services would welcome recommendations on appropriate amendments to the LCR DA as regards securitisations. The JC is, in particular, invited to consider for these purposes the recommendations laid out in the HLF Report (see pages 54 and 63) on the LCR eligibility of securitisations.

Final considerations

The Commission services are aware that time and resource constraints may restrict the range of analysis to be conducted by the JC in certain aspects of this call for advice. If that will be the case, the JC should highlight these limitations in its final report.

The JC's assessment as per the response to this call for advice will not prejudice the Commission's final report under Article 519a of the CRR.

Please note that the Commission Services would need to receive the JC's advice no later than by 1 September 2022.

ANNEX

Article 519a

Reporting and review

By 1 January 2022, the Commission shall report to the European Parliament and the Council on the application of the provisions in Chapter 5 of Title II of Part Three in the light of developments in securitisation markets, including from a macroprudential and economic perspective.

That report shall, if appropriate, be accompanied by a legislative proposal and shall, in particular, assess the following points:

- a) the impact of the hierarchy of methods set out in Article 254 and of the calculation of the risk-weighted exposure amounts of securitisation positions set out in Articles 258 to 266 on issuance and investment activity by institutions in securitisation markets in the Union;
- b) the effects on the financial stability of the Union and Member States, with a particular focus on potential immovable property market speculation and increased interconnection between financial institutions;
- c) what measures would be warranted to reduce and counter any negative effects of securitisation on financial stability while preserving its positive effect on financing, including the possible introduction of a maximum limit on exposure to securitisations;
- d) the effects on the ability of financial institutions to provide a sustainable and stable funding channel to the real economy, with particular attention to SMEs;
- e) how environmental sustainability criteria could be integrated into the securitisation framework, including for exposures to NPE securitisations

The report shall also take into account regulatory developments in international fora, in particular those relating to international standards on securitisation.’