EUROPEAN BANKING AUTHORITY

EBA discussion paper on simple standard and transparent securitisations

EBA Public Hearing Event – 2 December 2014

Mandate

Mandate behind the EBA work on *qualifying* securitisation:

European Commission Call for Advice (Jan 2014):

*'[…] promoting the development of safe and stable securitisation markets could also contribute to unlocking additional sources of long-term finance. […] EBA is invited to identify which **characteristics would be the most appropriate to designate 'high-quality' transactions**, having particular regard to:*

(a) categories of underlying assets;

(b) structural features;

(c) transparency features.

*'[…] EBA could then assess the appropriateness, from a prudential perspective, of granting **future preferential treatment to certain securitisation transactions qualified as 'high quality'** transactions in order to foster EU securitisation markets'.*

Timeline compatible with global agenda

14 January 2014	EBA Stakeholders consultation closes
March 2015 (expected)	BCBS/IOSCO Task Force provides Final Report to Parent Committees on measures to revive securitisation
Q2 2015 (expected)	EBA plans to submit final advice to the Commission on SST criteria and recalibration of capital requirements

Impediments in the securitisation market

Since the crisis the EU securitisation market is experiencing the following impediments:

a) **post-crisis stigma** attached to the whole market by investors due do defaults/losses and lack of transparency;

b) **macro-economic environment** (lack of assets to be securitised – lack of demand for loans)

c) **availability of alternative funding sources** (central bank operations, covered bonds etc.)

d) external credit **rating agencies** policies tightening

e) **reduced investor base**

f) **regulatory uncertainty**

More risk-sensitive regulation

- The **securitisation market** still suffering from a crisis stigma due to certain specific products' bad performance during the recent turmoil (US sub-prime RMBS and US CDOs in the chart);

- A one-size-fits-all prudential approach calibrated to the crisis (**black line**) does not acknowledge different levels of complexity and risk;

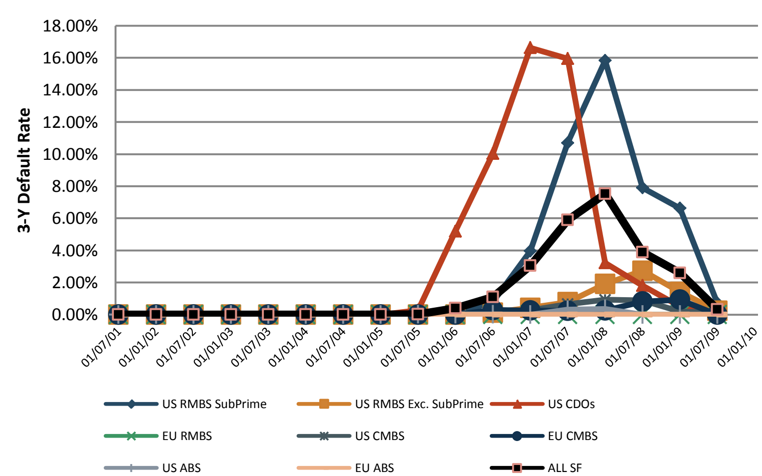
- The EBA proposes criteria defining **Simple Standard and Transparent** securitisations (aligned BCBS/IOSCO work on this) alongside criteria of contained **underlying credit risk** for potential **regulatory recognition**;

→ More risk-sensitive regulation should:

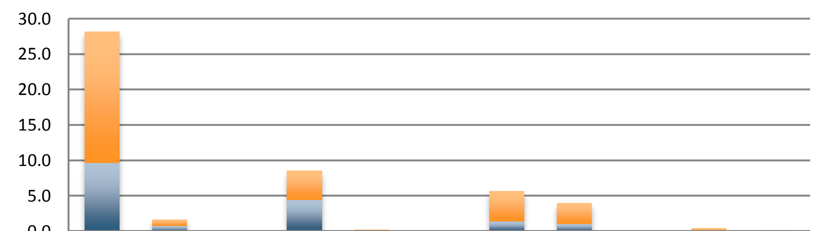
  → Adequately identify the mechanisms that marked the failure of certain securitisation processes;

  → Calibrate capital charges so as to reflect the different riskiness of different products;

Historical Performance: 'AAA' - 3-Years default rates



Losses: EU vs US per asset class (2000-2013 source: Fitch Ratings)



	U.S. SC	EMEA SC		U.S. RMBS	EMEA RMBS		U.S. CMBS	EMEA CMBS		U.S. ABS	EMEA ABS
Loss expected (%)	18.5	0.9		4.1	0.2		4.2	2.9		0.4	0.1
Loss realized (%)	9.7	0.8		4.5	0.0		1.5	1.1		0.1	0.1

2 sources of risk to be addressed

Riskiness of a Securitisation Product

Securitisation Process:
misalignment of incentives - excessive leverage – refinancing - complexity of payment structures - servicing and operational risk - governance and enforceability of rights - lack of transparency (documentation, reporting) etc.

Underlying credit risk:
concentrated portfolios, loose underwriting criteria, etc.

A very simple securitisation transaction can be very risky if the underlying features high credit risk

Two-stage approach to 'qualifying' securitisation

Qualifying Securitisation Framework: [A] + [B]

[A]

PILLAR I: Simple

- No excessive leverage (i.e. re-securitisation)
- No active management
- Legal true sale and no claw-back
- Homogenous assets and full recourse to obligor
- Self-liquidation
- No disputes / defaults / credit impaired borrowers
- No transferable securities
- At least 1 payment

PILLAR II: Standard

- EU Retention rules
- Appropriate hedging
- No complex reference rates
- Early amortisation provisions
- No acceleration or market liquidation triggers
- Procedures on counterparty replacement
- Identified person
- Servicing expertise

PILLAR III: Transparent

- Prospectus Directive
- CRR disclosure to investors (409 CRR) and CRA (8b)
- Underlying documentation
- Documented delinquencies management
- Mandatory external verification
- Historical default data
- Loan by loan data on underlying
- Quarterly investor reporting

Mitigates risks of the securitisation process, e.g. agency/model

[B]

Underlying Credit Risk criteria

- Underwriting standards
- Granularity
- Minimum risk weights

Mitigates underlying risk

‘Differentiated’ regulatory capital treatment

However: what sort of ‘different’ capital treatment?

1. **risk weights for qualifying positions that are lower**, in relative terms, than the risk weights applicable to non-qualifying positions;
2. **a flat risk weight floor** to the most senior tranches of ‘qualifying’ securitisation positions of [15%] at the CQS 1 level.

The calibration of the capital requirements for qualifying transactions should:

a) Take into account the **new BCBS securitisation framework** to be published in December 2014

b) Consider the crucial issue of the **allocation of capital among senior, mezzanines and junior tranches** with respect to the framework currently in force

c) Consider the key role of **external ratings and rating agencies’ policies** in determining the capital cost of securitisation transactions

Exchange with stakeholders

CAVEAT on consultation process: the EBA discussion paper does not cover ABCP transactions stakeholders are invited to provide written feedback on the criteria which could define simple standard and transparent ABCP products during the consultation period

DISCUSSION OF TODAY

General comments & remarks

Do you agree with the identified impediments to the securitisation market?

Do you agree with the creation of a qualifying securitisation framework in regulation?

Do you agree with the 2-stage approach and the proposed SST criteria?

How should capital requirements be calibrated for qualifying securitisations?

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