BUSINESSEUROPE

POSITION PAPER

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CAPITAL MARKETS UNION: SECURITISATION

Introduction

BusinessEurope would like to confirm its long-standing support for the completion of the Capital Markets Union project. In this regard, we believe that the legislative proposals to revive securitisation are an important contribution to addressing the issues of access to finance as companies take forward their investment projects. The creation of a European framework for simple, transparent and standardized (STS) securitisation will play an important role in allowing banks to free up their balance sheets and extend lending, in particular, for VSEs and SMEs which largely rely on banks for access to finance. In addition, securitisation will allow for the transfer risk of trade and leasing receivables to the capital markets which also benefits the real economy.

Considering the intended contribution of a European STS securitisation regulation to growth, investment and employment, BusinessEurope, is concerned about some of the latest proposals that are under discussions within the context of the trialogue negotiations as these would harm the revitalization of the securitisation market in Europe. Also, the current proposals lack proper provisions for accommodating exiting and legacy transactions as well as grandfathering rules.

Prudential rules

BusinessEurope believes that the proposed capital treatment for STS securitisations will not do enough to encourage banks, non-financial companies and lease companies to issue STS securitisations or encourage important investors, such as pension funds, insurance companies, and banks, to invest in these products. The new capital charges for STS, while lower than for non-STS, will still be much higher than today and will discourage banks from investing in STS securitisations or issuing securitisations which achieve significant risk transfer. The lack of clarity about how proxy data can be used in Internal Rating Models, and today's harsh LCR treatment (level 2b) will also continue to hold back securitisation investment. The standard approach in Solvency 2 basically prevents insurers from investing in securitisations; indeed many insurers have already left the market due to punitive charges even though STS securitisation would provide them with a safe and needed diversification alternative. Amendments must be implemented urgently in order for these entities to start investing again in STS securitisation.

The current rules do not ensure a level playing field between different types of fixed income instruments: securitisation transactions are disadvantaged to other investments or funding and capital relief tools. We would like to emphasise that capital requirements for STS securitisation, as discussed in trialogue, will be higher for most transactions than capital requirements under the current regime, and are therefore unlikely to help the market. Further work is needed to make sure that issuers and sponsors can indeed structure STS-eligible transactions.

If the capital requirements are not lowered, at least for STS-securitisations, then it will discourage banks to issue STS securitisations. Also, the securitisation of trade and leasing receivables will not only be penalised by higher capital charges, the (real

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economy) sellers of such receivables will be discouraged by harsh sanctions and overly restrictive – and yet unclear – rules in order to comply with the STS requirements. This will make securitisation especially unviable for small and medium-sized businesses.

Exclusions and limitations

ABCP STS criteria

BusinessEurope is also concerned about proposals to limit recognition of STS for Asset Backed Commercial Paper (ABCP) to certain underlying assets with longer maturities as drafted in the Commission proposal. In order to prevent any negative consequences on specific sectors like the automotive industry, the Council and European Parliament extended the remaining weighted average life and the residual maturity on pools of auto loans, auto leases and equipment lease transactions. This extension should also cover other underlying assets such as trade receivables, consumer loans and credit cards.

Limitations on issuers

It is important that real economy companies and leasing companies should continue to be able to securitise as they currently do. If Article 2a para 2, as proposed by the European Parliament, were to be maintained, leasing companies whose main business is operating leasing, would be excluded from the term securitisation market and lose an important refinancing instrument. This could have a significant impact in some industries or sectors, such as, for example, the automotive industry, as assets deriving from businesses other than lending or financing leasing (e.g. operating leasing or hire-purchase) could not be securitised by such entities.

We also suggest removing legal barriers that prevent asset managers from supplying funding to EU businesses (especially through collateralised loan obligations) by including them in the sponsor definition.

Constraints on investors

BusinessEurope believes that the securitisation market has to be open to all willing professional investors such as professional clients under MiFID II. In any case, it should still be possible that an undertaking belonging to the same group as the originator can hold a securitisation position such as the mezzanine securitisation position even if such undertaking is not deemed to be an institutional investor because there is typically a high level of transparency between the group undertakings. The new constraints introduced by the European Parliament on investors are a key concern for the funding of originators as significant numbers of investors are based outside the EU in particular in regard to risk transfer transactions that are critical for enabling European banks to manage their balance sheets (e.g. European based ABCP programs rated by Moody's are funded up to 56% in USCP, as per 30 June 2016).

Transparency requirements on ABCP and other private transactions

Transparency requirements regarding private transactions should be carefully reconsidered. Originators in private transaction agree to provide detailed information to investors (including sponsor banks in ABCP transactions), but under strict confidentiality agreements. This does especially apply to ABCP transactions of trade receivables where a corporate originator has to describe in detail his credit granting process, his terms of trade and other business secrets. Should such confidential information compulsorily be made public (for example by way of disclosing transaction documentation), originators would have to turn to alternative, less efficient sources of funding.

Furthermore, the proposal to disclose investor positions will have a strong negative impact on investor's willingness as it would seriously limit the secondary market. If a regulatory body should collect data on investor position, such data must only be disclosed in anonymised and aggregated form. Investor positions in exposures held within a trading book or in instruments with maturities below one year (e.g. ABCP) should not be reported as its information content would not justify the administrative burden to collect and refurbish such data.

Constraints on non-EU originated securitisations

BusinessEurope is also concerned about the new final sentence of Article 6 of the Council text which states that: "The originator, sponsor and SSPE involved in a securitisation considered STS shall be established within the Union". This is an unhelpful proposal which will prevent any non-EU originated securitisations from getting STS status. The proposal is problematic for a wide range of securitisations, for example for ABCP conduits. The key component in the case of STS ABCP should be the localisation of sponsors. The need for an efficient control of the STS designation is fair, but in the case of ABCP programmes, the localisation of sponsors - which provide a full guarantee - within the EU should be a sufficient condition in order to allow the STS qualification.

It will also likely have an indirect negative impact as an implication of restricting STS status to EU originated securitisations is that other jurisdictions may reciprocate with similar geographical restrictions, for example, such as the treatment of Central Counterparty Clearing Houses (CCPs) between the EU and the US. This may lead to fragmentation of the global securitisation market along regional lines so that effectively only EU investors will be willing to invest in EU securitisations, and only US investors to invest in US securitisations, with no cross border investing taking place. This will significantly limit the investor base for any given STS securitisation and undermine market liquidity in an already relatively illiquid market. It is vital that Europe has access to a diverse funding and investor base outside of the EU provided those entities can comply with the criteria set out within the STS regulation. Minimising access to STS would thus not be appropriate if the EU is truly trying to create a Capital Markets Union and open Europe up to a wider and more diverse funding and investment base.

Credit Guarantee Transactions

We believe that the de facto exclusion of "synthetic securitisations" is not justified, at least to the extent to which this term is used for simple credit guarantees. These guarantees are employed by banks to transfer credit risk from their traditional loan business financing real economy customers. They are vital for banks to free up their lending capacity to real economy borrowers and have little to do with other "synthetic securitisations" such as arbitrage and derivative transactions.

Credit guarantees are traditional risk management tools which are treated as securitisations only because guarantees, like any type of insurance, usually provide for a deductible and a cap, which technically makes the guaranteed credit risk "tranched" under the CRR. Certain types of loan guarantee transactions can be simpler, more transparent and standardized and present fewer risks to investors than traditional securitisations. This is true regardless of whether the guarantee undertaking is secured by collateral or embedded in a note issued by the bank.

Credit guarantees are particularly important to free up lending capacity when true-sale transactions (traditional securitisations) cannot be employed because bank customers do not want the bank to sell their loans (transfer clause limitations). Moreover, credit guarantee transactions are often the only way to manage risk arising from certain off-balance-sheet credit exposures, e.g. letters of credits or avals provided to a bank's customers. This also applies to certain on-balance-sheet exposures, such as until-further-notice overdraft facilities.

Also, in Article 270 of the proposed STS legislation, there is currently a carve out in place which allows synthetic securitisations related to SME exposures to be classified as standardised, but only if protection has been purchased by the bank from the EIF or any other "supranational" organisation. However, this carve out does not currently include private investors who fully fund the notional of protection they write with cash. From a credit risk perspective, a collateralized guarantee such as this would be at least equivalent to purchasing protection from a supranational organisation. As such it would be reasonable to extend this treatment to contracts where banks have the benefit of fully funded cash protection, mitigating counterparty risk. BusinessEurope suggests proposing this extension and considering it during the trialogue process.

Retention rate

BusinessEurope would like to reiterate that in order to effectively revive securitisation markets and free up banks' balance sheets, retention rules should not discourage institutions to issue securitisations. We therefore fully support the views of the Council and Commission that the retention risk should be maintained at 5 %. If some of the Parliament's proposals to enhance the retention rate to 10 % were to be adopted, it would be contradictory to the goal to foster and promote simple, transparent and standardized securitisation in Europe. In our view, a retention rate of 5% strikes the right balance between allowing for prudent alignment of interests of securitisations and maintaining appropriate "skin in game".

In addition, the European Parliament introduced Article 4 (1a) where it is stated that „losses on the securitised assets, measured over one year, shall not be significantly higher than losses over the same period on homogenous assets, pursuant to Article 8 (4), which are randomly selected from the balance sheet of the originator or the original lender of a securitisation. Where this condition is not met, the competent authority shall investigate potential improper selection of assets by the originator, sponsor or the original lender of a securitisation, at a risk of a fine in accordance with Article 17." BusinessEurope suggests deleting this new article, since it can happen simply by chance that a randomly selected sample performs better than assets kept on the balance of the originator. Targeting specific assets is already inhibited within the process of taking a random sample. Therefore, it is not necessary to create this additional layer of bureaucracy and stress for the originator.

Compliance and certification

BusinessEurope agrees that investors should take full responsibility for the relevant credit analysis of their holding positions and that issuers are fully responsible for the facts that they disclose. However, in our view, a third party certification regime should be in place in order to provide assistance with the compliance process.

Uncertainty over the STS status will erode trust in the market and would disincentive originators or sponsors to notify a transaction or ABCP programme as STS. Therefore, originators or sponsors should have the right to request a legally binding confirmation of conformity from a competent authority. Such a confirmation should not exempt the originator (or the sponsor in case of ABCP) from its obligations; it is merely a safeguard for originators, sponsors and investors of sudden changes or incoherencies in the supervisory interpretation after the securitisation has been placed. This is important if the interpretation depends on the special circumstances of the single case because it might be difficult, if not impossible, to provide interpretation on all relevant cases. Without this, securitisations may be re-qualified to being non-STS at a later stage which will be extremely harmful for the market. The same goes for lengthy and undefined procedures that may arise from competent authorities interpreting the STS criteria in different ways.

In addition to this, and again, without exempting originators, sponsors and issuers from their obligations, we consider it is key to recognise third party agencies, independent certification agents under the supervision of a competent authority, that would be entitled to perform the certification of compliance with the STS requirements. This would help to create a “common language”, necessary for the revival of the market.

Lastly, sanctions should only apply in the cases of negligence or deliberate misconduct. It should also be made clear than any sanction only applies to the party in charge. This is especially relevant in ABCP programmes where multiple originators provide information which is subsequently aggregated and complemented by the sponsor.

The role of ESMA

The European Parliament authorizes in Art. 7 para 1b and Art. 8 para 9b, ESMA to specify guidelines and recommendations on the harmonised interpretation and application of requirements in general and for homogeneous assets in particular. Such delegation of the determination of definitions is problematic as it causes problems after a regulation has come already into effect. The legislator should specify clearly the regulatory provisions regarding which ESMA is allowed to act.

Accounting problems

Double accounting of specific provisions and purchase price discounts will substantially increase the originator's capital requirements (*Art. 244 par. 1 (b) CRR, Commission, Council, Parliament*). In transactions where a significant risk transfer has been recognised but where the SSPE has still to be included in commercial consolidation according to IFRS 10, the specific provisions from the underlying securitised exposures cannot be released and are still available on the group level to absorb the losses. The same would apply for discounts on the purchase price of securitised exposures that are frequently made to provide additional credit enhancement to investors. If in addition a risk weight of 1,250% would be allocated to retain securitisation positions (e.g. to comply with retention rules under Art. 405 CRR) this would result in a double-counting of the specific provisions and purchase price discounts and thereby substantially increase the originator's capital requirements unintentionally.

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