Event report

Description

In the context of the capital markets union plan, the European Commission proposed an initiative to re-launch securitisation, with harmonised rules across the EU for a subset of standardised offerings, and with CRR amendments to adjust capital charges to provide for a more risk-sensitive treatment for such instruments. Securitisation is key to reduce balance sheets of banks and to make individual loans liquid. However, securitisation still raises eyebrows with many policy makers and users, and the question emerges whether the distinction can easily be made between standardised and transparent on the one hand, and complex, opaque and bespoke securitisations on the other. The intention of this debate is to discuss the feasibility of STS, and its potential.

Panellists

- ***Almoro Rubin de Cervin***, *Head of Unit, Financial Services Policy and International Affairs, DG FISMA, European Commission*
- ***Steve Gandy***, *Managing Director and Head of DCM Solutions, Santander Global Banking and Markets*
- ***Stefan Rolf***, *Head of Asset Backed Securitisation and Treasury Coordination Asia-Pacific Region, Volkswagen Financial Services AG*
- ***Menno van den Elsaker***, *Head of European ABS at APG Asset Management*
- ***Nicholas Dorn***, *Associate Research Fellow, Institute of Advanced Legal Studies (IALS), University of London*
- ***Paul Tang***, *Member of the European Parliament, ECON Committee*

Moderated by: **Karel Lannoo**, CEO, CEPS

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Almoro Rubin de Cervin indicated that the Commission's proposal is in line with the work in international fora and represents the outcome of a collaborative effort by supervisors and regulators across Europe. On top of the new elements (e.g. STS label, the notification system), the proposal is also consolidating the already existing patchwork of securitisation rules (skin in the game – risk retention, disclosure and transparency, prudential requirements). He indicated that the eligibility criteria for STS securitisation were drafted based on the features of the products that recorded very low default and loss rates. STS aims to be a platform for the development of standardised products rather than for individual issuances. The category should be wide enough to capture this alternative funding channel/asset class provided that it still allows distinguishing between toxic and non-toxic products. This should also be reflected in the risk weights to the securitisation exposures, .i.e. the capital to put aside. For the market to develop further and contribute fairly to the real economy and a more resilient financial sector, it is of utmost important to have in place the right incentives for both issuers and investors. Finally, he stressed that one should look at securitisation as one of the many other market instruments.

Note: This report was drafted by Cosmina Amariei and Roberto Musmeci (European Capital Markets Institute). The content of this event report is not a transcript of the speakers' interventions and should instead be understood as the interpretation of their views by the authors.

Steve Gandy explained that securitisation allows banks to avoid risk concentration on the assets side and prudently diversify funding sources on the liabilities side. During the sovereign debt crisis, many banks were shut out from the covered and senior unsecured bonds markets. Nonetheless, Santander UK was able to raise over £15bn in independent funding through the securitisation of its mortgages portfolio. When compared to other capital markets instruments, securitisation has the unique benefit that banks can share the risk with the institutional investors and then recycle the capital to fund the real economy. He further explained that while almost all deals are sold on a cross-border basis, the underlying assets remain national primarily because the investors prefer a homogenous type of risk. Two cases were presented: i) an actual sales deal through an special purpose vehicle (SPV) between Santander Consumer Germany unit (auto and consumer loans) and APG buying class A shares as an investor and ii) the use of synthetic securitisation to buy credit protection (CDS) from PGGM for a pool of SMEs originated by Santander Spain.

Stefan Rolf stressed the importance of securitisation for the car industry in Europe. The two most important segments of securitised products are residential mortgage-backed securities (RMBS) and asset-backed securities (ABS). The largest subsector in the ABS market is represented by auto loans (around 70%). This sub-segment is characterised by constantly high volumes, the smallest credit spreads in the market, highly granular and homogenous pools of assets and no single default to date. In his view, a STS label/segment where auto ABS would be missing is not possible. Furthermore, a number of pitfalls need to be addressed in Commission's proposal. While fully supportive of an STS label as such (i.e. it will allow to correct the information asymmetry in the market), the criteria are too vague. In order to avoid legal uncertainty, these criteria should very clear from the outset and allow to run a conformity test (e.g. 3rd party certification). Moreover, he argued that the capital charges are too high, especially when comparing the risk weights for securitised products with those for covered bonds.

Menno van den Elsaker emphasised that by adding securitised products to their portfolios institutional investors achieve better diversification and risk-adjusted returns. Most importantly, it enables them to gain exposure to the consumer related part of the real economy and the corporate sector without having to develop in-house origination and servicing capabilities. Buying the portfolios directly from the banks would be a very cumbersome process, i.e. making sure that each loan has been transferred in a correct manner, duty of care, administrative problems etc. This would lead to significant decrease in the number of deals, e.g. from 45-50 deals/year to max 3-5 deals/years. He further explained that in a true sale securitisation the assets are transferred to the investor while the synthetic securitisation transactions (risk sharing transaction) do not involve legal transfers. Moreover, these two types of securitisation serve different purposes. Synthetic securitisation is primarily for credit risk hedging and capital management purposes; and not for funding purposes and capital relief.

Nicholas Dorn characterised securitisation as a legacy design that is not helpful for the future. He summarised an open letter from academics to MEPs: rather than creating diversity and contributing to financial stability and the real economy, the STS legislative proposal would increase interconnectedness, pro-cyclicality and leverage. Turning to the rationale for re-starting securitisation in Europe, he said that this was not a case of capture, as initially the industry was highly cautious. Public institutions were responsible – notably ECB to facilitate transmission of policy (via ABSPP), EIB because of its funding model, and EBA in support – feeding ideas to BCBS, IOSCO and the Commission. The LCR & Solvency II delegated acts then provided a template which the STS proposals generalise, fine-tune and widen. There is pressure to squeeze everything into STS, including synthetics, bringing it closer to old-style securitisation. Calling for a radical re-think, he said that STS illustrates cognitive closure by public institutions, re-working familiar thinking and practices.

Paul Tang indicated that that transparency, accountability, financial stability, contribution to the real economy are all very appealing objectives in theory. Nonetheless, several conditions to be met in practice before an increased use of securitisation. It's important to learn the lessons from the past (e.g. highly leveraged deals that lead to forced sales) and then to undertake constructive but cautionary efforts to revive the market. Furthermore, to make sure that market participants are well-regulated and the general public trust is restored. He also cited the necessity to have a market that is not only there in good times, but also there in bad times. He also urged the industry to justify in better terms why a STS label is needed in the first place and warned against focusing only on the related capital charge reductions. Finally, the MEP noted that the STS is indeed a technical and complex dossier. While the Council had quickly reached a common position about the proposal, the MEPs are expected to send their amendments before summer, which are going to be discussed in the autumn.

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