ICMA
International Capital Market Association

The functioning of the EU securitisation framework


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Reviving the EU's securitisation market

Following the US sub-prime mortgage crisis and the subsequent near collapse of the European banking system, regulations introduced in the EU post the global financial crisis contributed to a reduction in issuance and fewer investment opportunities in the European securitisation market. These prudential and regulatory changes have impeded investment opportunities, contributing to a reduction in issuance in the EU market over the past decade. Although some regulatory changes were also introduced in the US post the crisis, these changes have not impeded the recovery of the US securitisation market.

A main building block of the EU Capital Markets Union/Savings and Investment Union is the plan to revive the EU securitisation market to create deeper capital markets and increase the EU's competitiveness. A succession of reports, including those from Christian Noyer, Enrico Letta and Mario Draghi, have supported this ambition.

Securitisation markets can play a crucial role in the broader financial system by:

- allowing financial institutions to convert illiquid assets, such as mortgages, auto loans or credit card receivables, into tradable securities, freeing up capital for new lending activities;
- providing investors with opportunities to invest in a diverse range of asset-backed securities that offer varying risk profiles and yields;
- enhancing market liquidity by providing investors with alternative investment options and facilitating the trading of securities in secondary markets;
- supporting risk management by enabling financial institutions to transfer credit risk from their balance sheets to investors who are willing to bear such risks in exchange for potential returns, helping to diversify and manage risk more efficiently within the financial system; and
- encouraging financial innovation and the development of new financial products.

Following groundwork undertaken by DG FISMA in the European Commission early in 2024 to review securitisation, in October the European Commission launched a two-month targeted consultation on *The Functioning of the EU Securitisation Framework 2024*. The consultation was targeted towards market participants with practical expertise in the EU securitisation market. The consultation sought to gather views and collect evidence on the current EU securitisation framework and its subsequent amendments.

ICMA is supportive of efforts by the European Commission to revive the European securitisation market. ICMA established a joint taskforce comprising ICMA's sell-side and buy-side members to share views on practical changes necessary to improve the effectiveness of Europe's securitisation framework and to respond to this consultation.

In addition to its consultation response, ICMA was also pleased to join a consortium of leading trade associations supporting the efforts of the European Commission to review and address the different areas of the framework which hinder growth of the securitisation market.

Summary of ICMA response to EC consultation

The key points in ICMA's response to the consultation are as follows:

- *Jurisdictional scope:* The current jurisdictional scope of the application of the Securitisation Regulation (SECR) is now well understood and any reopening of the scope of the SECR, especially on its expansion to cover new ground and entities, would create uncertainty.
- *Due diligence requirements:* ICMA acknowledged that an appropriate due diligence process is key to ensuring that investors are aware of what they are buying while assessing the risks of their investment in a commensurate

manner. Members have commented on the need to recalibrate the due diligence requirements of Article 5 of the SECR by taking a more principles-based, proportionate and less complex approach, given the direct and opportunity costs associated with compliance.

- In particular, ICMA members noted that:
  - Investors in securitisation are sophisticated investment entities with extensive internal due diligence processes and criteria and understand the relevant risks of investing in securitisation trades. However, the high barriers to entry and costs of due diligence may act as a deterrent to investment.
  - There is a lack of parity between different asset classes with comparable risk profiles to securitisation transactions, such as covered bonds.
  - Due diligence requirements on investors in the EU are extremely burdensome compared with the US, which does not impose any specific due diligence obligations for investors in securitisation beyond their typical fiduciary duties. The UK has also moved towards a principles-based approach.
  - Due diligence requirements can affect the speed and execution of transactions, which can in turn create market stability and price discovery issues that are important from a prudential regulation perspective.
- In addition, ICMA recommended that diligence should be conducted prior to making an investment decision as compared to fulfilling diligence requirements post-investment. Pre-investment due diligence requirements should be amended *vis-à-vis* proportionality and a principles-based approach. It was noted that investors documenting compliance with verification requirements after an investment within a prescribed window add an unwelcome burden to ensure compliance.
- *Transparency requirements and definition of public securitisation:* Regarding transparency requirements, and to ensure that investors and supervisors have sufficient access to information under Article 7, ICMA members noted that a suggested option to streamline the current disclosure templates for public securitisations and to introduce a simplified template for private securitisations is the closest to the envisaged reforms that members want to see, subject to several caveats:
  - ICMA members disagreed with the proposal for private securitisations to report to a repository.
  - The discussion around streamlining disclosure templates for public securitisations should be separate from discussions regarding scope of public securitisations; the overall effect of having streamlined templates but greater scope of public securitisations would not overall help streamline due diligence obligations.
  - Treating third country securitisations as private securitisations would be necessary to enable EU entities to be globally competitive.
- *Supervision:* ICMA members raised the issue of NCAs taking divergent approaches to reporting obligations over and beyond those provided at EU level (ie gold-plating).
- *STS standard:* In principle, ICMA members supported the simple, transparent and standardised (STS) securitisation framework. However, in its current form, the STS label has failed to scale up the EU securitisation market. While amendments that provide a more favourable regulatory capital treatment of STS labels would be helpful, members questioned whether this in and of itself would scale up the EU securitisation market significantly. Instead, reforms need to be broad-based, rather than focusing exclusively on STS labels to the exclusion of other parts of the securitisation market.
- *Prudential treatment of securitisation for banks:* In relation to banks' issuance of and demand for traditional securitisations (ie true sale, where a special purpose vehicle acquires assets and pays a purchase price), ICMA noted that, from an issuance standpoint, a significant proportion of the investor base is comprised of bank treasury investors for whom High Quality Liquid Assets (HQLA) are important. Given that the Liquidity Coverage Requirement (LCR) eligibility has been tied to STS classification, this means that non-STS has a structurally more restricted investor base than STS. Members recommend that both non-STS and STS securitisations should be considered as eligible instruments under the LCR, in line with other instruments such as covered bonds (where both regulated and non-regulated and even unrated covered bonds are eligible).
- *UCITS Directive and SECR:* Some ICMA members also commented that the 10% acquisition limit for debt securities in a single issuing body imposed under Article 56 of the UCITS Directive hinders their ability to make larger allocations when investing in a securitisation. For example, in certain cases this restriction can make it impossible for a large UCITS investor to subscribe for full or a substantial part of a tranche in a securitisation because the issuing body is a stand-alone securitisation special purpose entity (and not a programme ABS issuer). This restriction reduces the ability of some UCITS investors to play a bigger role in growing the securitisation market and drives more UCITS investments towards unsecured corporate credit with higher risk of defaults, less protections and lower rates of return compared to securitisation. ICMA members who raised this comment therefore propose that this restriction should be removed.
- *Securitisation for green transition financing:* ICMA highlighted that in June 2022 the Executive Committee of The Principles, supported by the ICMA Secretariat,

updated the guidance on sustainable securitisation as, especially in the European market, members had seen a split in the type of green bond being issued. All of these were use-of-proceeds bonds, but for some transactions the use of proceeds was for the collateral securing the bond and in other transactions it was observed that the use of proceeds was ignoring the collateral and looking through to the originators or sponsors behind the transaction.

Looking to the future

The review of the EU securitisation framework provides the opportunity to deliver appropriate regulatory and prudential changes necessary to revive the EU securitisation market, to create deeper capital markets, support the EU Savings and Investment Union and Increase the EU's competitiveness. ICMA is glad to bring a joint sell-side/buy-side voice to this important conversation.

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