European Union Roundtable of Financial Centres (EU-RFC)

"A targeted reform of the EU securitisation framework is key to meet the needs of the digital and sustainable transition"

EU-RFC position paper

Brussels, February 2025:

The EU Roundtable of Financial Centres (EU-RFC) met in Brussels to discuss strategies for enhancing the competitiveness of the EU's financial industry, identifying the revival of the EU securitisation market as a top priority.

The competitiveness of the EU in financial services and beyond is a significant concern to all members of the EU-RFC. The roundtable members welcome statements made by the EU authorities and key-policymakers to improve the competitiveness rapidly and comprehensively. Otherwise, the EU risks falling further behind its global competitors in key domains such as capital markets. More competitive EU financial markets should prioritise addressing the needs of EU businesses, citizens, and the broader economy.

The EU-RFC reaffirms the need to urgently relaunch the securitisation market in Europe. A robust securitisation market is essential for enabling banks, insurance companies and asset managers to further support financing the economy while managing risks with other market participants through more efficient regulation.

EU securitisations have always been safe assets

Securitisations are often seen as the root cause of the 2008 economic and financial crisis, which would be true when one reduces securitisations to US-issued subprime mortgage-backed securities. EU securitisations were not the cause of the Global Financial Crisis (GFC), but they have certainly become one of its collateral victims.

The default rates of European securitisations have consistently been low. Even during the GFC and the subsequent euro-crisis, the failure rate did not skyrocket as it did in the US; instead, it rose moderately to just 3%. European securitisations outperformed their US counterparts both during and after the GFC. As stated in a report by the Bankenverband, this strong performance can be attributed to the fact that lending standards in Europe have traditionally been much stricter than those in the US.[i]

EU-RFC members:

- Berlin Finance Initiative
- Febelfin
- Finance Estonia
- Finance Malta
- Finanzplatz Hamburg
- Fin.Connect.NRW
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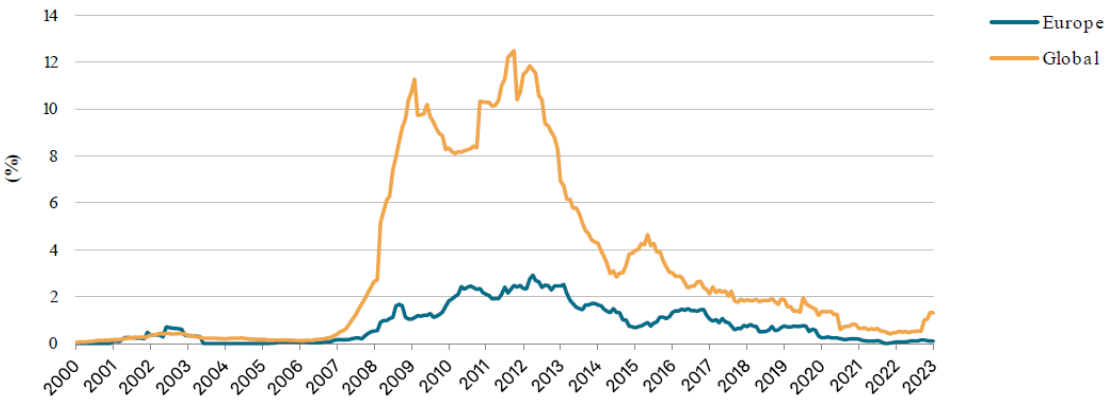
European structured finance 12-month-trailing default rates



Source: S&P Global Ratings Credit Research & Insights.

Nevertheless, the European securitisation market has been significantly impacted by the negative reputation stemming from the US sub-prime mortgage securitisations and has never fully recovered from the consequences of the GFC among which the overregulation in the EU that came about as a result of the GFC. While the European securitisation market amounted to 85% of the US market in 2008, currently, with an outstanding amount of EUR 1.2 trillion, it stands at only 10% of the size of the US market (with an outstanding amount of USD 13 trillion). In contrast, in most other jurisdictions, such as Canada, Australia, Japan, the securitisation market has recovered to above its pre-crisis level. Annual issuance of securitisations in the EU stood at just 0.3% of GDP in 2022, compared to 4% in the US.[ii]

EU securitisations have become even safer

The post-crisis reforms implemented in the EU have largely eliminated potential moral hazards through stricter regulation of the banks, as originators of most of the loans to be securitised, as well as the securitisations themselves.

- Permanent reviews and assessments of banks' governance and risk management systems by supervisors ensure that banks' criteria for granting and monitoring loans are robust and effective. This ensures resilient, high-quality loans, which can form the basis of securitisation transactions, ultimately benefiting investors as well.
- In addition, in order to benefit from a risk transfer and capital release, banks are subject to a notification and pre-approval of each transaction by its Competent Authority, based on a highly developed "Significant Risk Transfer Assessment" framework.
- The EU credit rating agency regulation reinforces the reliability of methodologies behind the analysis of the creditworthiness of securitised

paper. Moreover, it addresses potential conflicts of interest on behalf of the rating agencies.

- The securitisation market itself has undergone drastic reforms:
  - Retention requirements by the issuer. This prevents an issuer to simply onboard risks with a view to lay them off as quickly as possible via a securitisation, as happened often in the US in the period just before the GFC, as a large part of sub-prime loans were originated by unregulated mortgage brokers. Nowadays, an issuer must retain at least 5% of the risks that it securitises (for Simple, Transparent and Standardised (STS) transactions and non-STS transactions). The issuer thus remains exposed to those risks and has no interest in using more lenient risk criteria.
  - Transparency and disclosure requirements oblige the sponsor to display on a regular basis information about the securitisation and its underlying exposures to the investors and regulators so that the actual performance of the securitisation is made transparent to all concerned parties.
  - The ban on re-securitisations increases transparency and eliminates concentration and correlation risks.
  - The definition of STS transactions is based on more than 100 structuring and portfolio criteria.

According to S&P, lifetime default rates for European securitisations issued since the 2007-2008 financial crisis are just 0.2% across approximately 7,500 tranches - comparable to investment-grade corporate bonds. European securitisations are therefore no riskier than direct economic investments.

EU securitisations support the economy and competitiveness

The EU financial markets are heavily reliant on banks, which account for 70% of business debt and 90% of household debt, according to the Noyer Report. The ability of banks to extend loans is vital for supporting corporate investment and driving economic growth.

Facing continuous regulatory pressure which limits banks from growing their Risk Weighted Assets (RWA), securitisations have the potential of increasing banks' balance sheet velocity and investors' ability to support the EU economy as per the goals of the Savings and Investment Union. Bank capital is no longer tied up in long term credits granted in the past, but as risks are transferred to market participants, bank capital can be freed up and re-invested in new loans. Securitisations are thus a necessary tool that should be made more easily available such that ample new loans can be granted and European growth can be supported.

Furthermore, the effect of securitisations on the economic cycle tends to be asymmetric. When the economy grows they are rather pro-cyclical, reinforcing growth as they feed into the risk appetite of both debtors and investors. Whilst when the economic cycle turns, securitisations have a countercyclical effect, as exposures within the bank sector have been distributed over the whole investor community. Many of them, notably pension funds and insurance companies, are long term investors with a buy and hold strategy, making them less vulnerable to potential market volatility. As a result, banks will be less impacted when the economy deteriorates meaning they can keep on granting loans when it is really necessary, thereby mitigating the effects of the downturn.

The ESRB plays a crucial role in monitoring systemic risks across the whole financial system, to screen for potential vulnerabilities.

European securitisations also offer an attractive asset class to investors and allow to keep European money invested in the European economy. Institutional investors, like UCITS, are looking for liquid and diversified investment opportunities across the maturity and risk spectrum, subject to the attractiveness of risk/return and the ease of market access.

Others, like life insurance companies, credit insurance or re-insurance companies, could have appetite to take credit risk, as part of their liability matching strategy and their very diversified underwriting portfolio. In both cases, the EU insurance and re-insurance industry, despite being among the largest globally, faces unnecessary obstacles to use securitisation as a diversification instrument, due to excessive conservatism of capital / risk weightings under EU insurance regulation, excessive administrative burden in prescriptive one size fits-all due diligence, and insufficient liquidity, and, in the case of credit insurance, a de facto exclusion from the STS label.

So far, insurance companies have invested marginally in securitisation, due to severe Solvency II rules in terms of capital charges, , thereby materially disincentivizing investment in securitisation exposures, especially non- STS structures, which are unfairly charged as the riskiest of all assets in financial markets. Additionally, the EU Securitisation Regulation provides for a large number of requirements for institutional investors investing in securitisations, which lead again to disproportionately high costs and less attractive for insurers to invest in.

“Green” securitisation: a tool for the sustainable transition

Securitisation is a key mechanism for unlocking financing for the EU’s energy transition. “Green” securitisations can mobilise private capital for renewable energy and green infrastructure projects. This is vital given the €800 billion annual investment needed for Europe’s green and digital transitions.

“Green” securitisations free up capital to accelerate the financing of green assets, fostering a dynamic financial market and broadening the investor base by attracting sustainable finance-focused investors.

The EU Green Bond Regulation (EU GBR), effective from December 2024, introduces optional standards for green securitisation. It focuses on the use of proceeds by the originator rather than solely on green-backed assets, with an attention to strike a balance between fostering market growth and maintaining risk control.

However, barriers remain, including regulatory complexity, concerns over greenwashing, and insufficient clarity in green finance regulations. Addressing these issues is essential for the "green" securitisation market development. Moreover, a more comprehensive framework is needed, including synthetic securitisations, as the EU GBS Regulation currently excludes them from its scope.

This being said, limiting the reforms to "green" securitisation would not be sufficient, as Europe needs the broader securitisation market to grow, in order to reach the critical mass allowing issuers and investors to allocate human and capital resources to this asset class. Securitisation should be a viable option for issuers and investors, irrespective of the underlying asset class, taxonomy aligned or not, retail or corporate, performing or NPL, ... lowering the current barriers to entry, broadening the range of options across asset classes and risk levels, and favouring market depth.

Securitisations need better, not less regulation

The existing regulatory framework overshoots to some extent, as it hinders the creation of a robust market. This cannot be the intended purpose of the current set of rules. The reform should, therefore, focus on addressing specific flaws within the securitisation market participants' chain (e.g., issuers, investors, liquidity providers) to enable the market to develop and thrive while maintaining its objective of ensuring a risk-controlled environment.

Notably, aspects that warrant reconsideration include the recalibration of some prudential requirements for banks and insurance companies, the simplification of burdensome due diligence and reporting requirements, and certain unnecessarily dissuasive criteria for obtaining the STS label. In addition, to stimulate the securitisation market, the disadvantages associated with the excessively high risk charges of non-STS securitisations compared with STS securitisations should be reviewed.

In particular, the recalibration of prudential requirements and the review of the treatment of securitisation in the liquidity coverage ratio (LCR) for banks should be taken into account, as should the review of Solvency II to facilitate investment by insurance companies. In addition, the onerous due diligence and reporting requirements or some of the unnecessary criteria for obtaining the STS label are excessively complex and difficult to implement (particularly in cases where the underlying assets are loans to SMEs), the Significant Risk

Transfer (SRT) assessment process is overly complex and burdensome and discourages potential issuers. These aspects of the regulatory framework need to be reviewed. In addition, the discussion on the review of securitisation regulation should also include NPE securitisations.

Conclusion

The EU-RFC welcomes the consultation launched by the EU Commission and looks forward to a set of targeted reforms to take place as a legislative proposal as soon as possible. It is essential to address the obstacles present in the whole value chain of the securitisation process, from issuance to investment and to liquidity in the secondary market, in order to revive the whole EU securitisation ecosystem.

The EU-RFC underlines that it is essential that the revisions address the needs of all Member States, including those with less developed capital markets, and therefore address both STS and non-STS markets, as well as both IRB and SA banks.

The longer the EU waits to fix the regulatory flaws, the more we continue to expose the EU to the deepening in the financing and competitiveness gap identified as existential in the Draghi report. Therefore, we urge the Commission to maintain its goal to issue a targeted legislative proposal at the end of Q2 as announced, and to implement those changes in a fast track process, in order to reap the benefits as early as possible in the new legislative cycle.

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[i] BVB/TSI : A strong, competitive Europe: unlocking the potential of securitisation, September 2024, link: https://bankenverband.de/en/bankenaufsicht/report-strong-competitive-europe-unlocking-potential-securitisation.
[ii] Source – Draghi Report, link: https://commission.europa.eu/topics/eu-competitiveness/draghi-report_en#paragraph_47059.