



Seizing the opportunity to restore the market for high quality securitisation in Europe

More ambition is needed to comprehensively revise the calibrations for Solvency 2 and the LCR

Investors, insurance companies, issuers and other market participants represented by the below signatories are committed to supporting a safe and sustainable securitisation market that serves the real economy in Europe.

We support the new common framework for all securitisations (“the Common Framework”) and the framework for simple, transparent and standardised (“STS”) securitisations (the “STS Framework”), which come into effect on 1 January 2019. We hope that the long-term impact of the new legislation will be positive and contribute to the development of the Capital Markets Union.

However, for STS securitisation to be successful, and for the wider securitisation market to recover, it is critical that related pieces of EU legislation are calibrated to create the right conditions and incentives to support and encourage this. The new framework will change very little if not recognised appropriately in other related legislation.

Since the financial crisis, excessive capital and liquidity requirements on banks and insurers, together with other factors, have been set so as to discourage the recovery of securitisation markets in Europe. Some of the harsh calibrations have been calculated based on the very poor performance of the US sub-prime mortgage market and do not reflect the strong historic credit and price performance of European securitisations, especially of STS securitisations which have now been recognized by the STS Framework.

We welcome the European Commission’s consultations on the calibrations for securitisation investments in Solvency 2 and the Liquidity Coverage Ratio (LCR) in early 2018. However, we are concerned that the proposed revisions do not go far enough in addressing the harsh treatment of securitisation. We are concerned that without a more ambitious approach that fully recognises the prudential strength of securitisation in Europe, especially STS securitisations, the new Common Framework and STS Framework may become a missed opportunity.

Solvency II: Risk factors remain too high for non-senior tranches of STS securitisations, and for all non-STS securitisations

Summary: While we welcome proposed improvements in relation to senior tranches of STS securitisations, the proposed Solvency II risk factors remain much too high for the mezzanine and junior tranches of STS securitisations, and for all non-STS securitisations.

Solvency II specifies the risk factors to be applied by insurance companies that wish to invest in securitisation, which for many years have been too punitive. As a result, European insurers have



reduced their holdings of securitisation assets. The revision of capital charges for securitisations in Solvency II is therefore essential both for the recovery of an investor base that has shrunk considerably in recent years.

We therefore welcome the Commission’s proposals to amend Solvency II to ensure that the new calibrations in the insurance and banking sectors will apply on the same date. An updated calibration should consider the difference in the risk profile and tolerance between insurance companies and banks. The revised calibration should make it attractive for insurers to invest in European securitisations, and level the playing field with whole loan investment so as not to incentivise investment in the same underlying assets in an un-securitised and illiquid format.

We support the revised capital charges proposed for senior STS, which are justified and result in a closer alignment with corporate and covered bonds. However, insurance company investors have an important role to play at the mezzanine and junior level. These levels match the risk-return investment needs of insurance companies and enable them to perform the vital function of transferring risk in the financial system. The capital relief (or transfer of risk) which banks could achieve from selling mezzanine or subordinated bonds to insurers would free up bank capital that would then flow back into the real economy.

It is therefore crucial that revised calibrations under Solvency II be further adjusted at the non-senior STS level. Based on the recent Delegated Act adopted by the Commission (dated 1 June 2018), as illustrated in the table below, the capital charges for non-senior STS securitisations remain disproportionately high. The same is true for non-STS securitisations, which must continue to play a role in the future market. Several tough new regulatory requirements in the Common Framework apply to all securitisations, not just STS.

Table 1: Solvency II capital charges and proposed amendments for STS securitisation:

Credit quality step Credit rating	0	1	2	3	4	5 and 6
	AAA	AA	A	BBB	BB	B and below
Corporate Bonds	0.90%	1.10%	1.40%	2.50%	4.50%	7.50%
Covered Bonds	0.70%	0.90%				
Current Securitisation Type 1	2.10%	3.00%	3.00%	3.00%		
Current non-senior Securitisations Type 1	12.5%	13.4%	16.6%	19.7%	82%	100%
Proposed Delegated Act senior tranches STS securitisation	1.00%	1.20%	1.60%	2.80%	5.60%	9.40%
Proposed Delegated Act non-senior tranches STS securitisation	2.80%	3.40%	4.60%	7.90%	15.80%	26.70%



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Current Type 2 (non-STS) senior and non-senior tranches	12.5%	13.4%	16.6%	19.7%	82%	100%
Differential Delegated Act senior STS – Corporate Bonds	0.10%	0.10%	0.20%	0.30%	1.10%	1.90%
Differential Delegated Act non-senior STS – Corporate Bonds	1.90%	2.30%	3.20%	5.40%	11.30%	19.20%

Source: European Commission; BofA Merrill Lynch Global Research

Moreover, we note that while the reduction in required capital for non-senior STS positions is material, the absolute level is still relatively onerous (particularly further down the capital structure), which may continue to discourage insurance company participation in this segment of the asset class. This is particularly evident when comparing the re-calibrated insurance company capital requirements with those for bank investors under the revised CRR (set to apply from 1st January 2019); Solvency II capital requirements remain visibly higher.

In relation to Asset Backed Commercial Paper (ABCP), the current Solvency II treatment is very punitive with hardly any insurance company investing in European ABCP programmes. The STS ABCP criteria have been drawn so restrictively that very few, if any, existing ABCP programmes will qualify as STS. Fully supported ABCP programmes as defined in the Money Market Funds Regulation should benefit from the same improved regulatory treatment as term STS securitisations under Solvency 2.

Fully-supported ABCP programmes are 100% wrapped by a liquidity line provided by a bank, so that the investors in the ABCP have dual recourse not just to the securitised assets but also the bank provider of the liquidity line.

Liquidity Coverage Ratio: Senior tranches of STS securitisations and fully supported ABCP programmes should be promoted under the LCR

Summary: The strength of the European securitisation framework should be recognised by reclassifying the senior tranches of STS term securitisations as Level 2A assets and fully supported ABCP either as Level 2A assets or Level 2B assets with a haircut of 15% under the LCR.

The LCR creates an incentive for bank investors to buy certain types of securities which can count towards the investing bank’s LCR. Different amounts of credit towards this ratio are granted, depending on the types of securities bought. All securitisations are today classed as Level 2B assets.

Many types of securitisations have demonstrated good levels of liquidity performance through and since the crisis. Supporting the eligibility of senior tranches of STS securitisations under the LCR will be a crucial opportunity to send a strong signal regarding the prudential strength of the STS framework. It will create an incentive for bank investors to invest in the senior tranches of



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the highest quality securitisations and will redress to some extent the continuing very uneven playing field with other fixed income instruments.

We propose therefore that senior tranches (and only the senior tranches) of all STS term securitisations should be classified as Level 2A assets with maximum allocations and minimum haircuts equivalent to the current treatment of covered bonds of CQS 2.

Regarding fully supported ABCP programmes (even if not STS), we propose that this form of real economy financing should qualify either as Level 2A assets or as Level 2B assets with a haircut of 15%. In Europe fully supported ABCP programmes have been growing for more than fifteen years in very safe conditions even during the financial crisis due to both a regulated legal framework and investor's protective market practice. Besides, the Money Market Fund (MMF) Regulation (regulation 2017/1131/EU), which requires MMFs to invest only in liquid assets, includes fully supported ABCP programmes within the list of liquid assets.

Conclusion

The adoption of the new Common Framework for all securitisations and the STS Framework represent a crucial milestone in the development of the Capital Markets Union. We urge policymakers to build on this momentum and to ensure that other, related legislation supports the objective to develop successful securitisation markets in Europe.

The European securitisation market will only recover if there is robust demand from institutional investors such as insurers and banks. Of course, this requires a prudent framework for investment but not at the cost of capital charges which discourage investment in securitisation and which are not proportionate or consistent with competing fixed income products in the now simpler, more transparent securitised world.

The LCR and Solvency 2 are two critical pieces of regulation which, properly calibrated and with carefully considered grandfathering provisions, have the potential to create the right conditions and incentives to support the recovery of safe and well-regulated securitisation in Europe.

The undersigned organisations, representing leading participants in the European securitisation markets, are convinced that securitisation can play an important role in building the Capital Markets Union and we stand ready to work with European policy makers to complete the work necessary to achieve this.



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About the signatory trade associations

Association for Financial Markets in Europe (AFME)

The Association for Financial Markets in Europe (AFME) is the voice of all Europe's wholesale financial markets, providing expertise across a broad range of regulatory and capital markets issues. We represent the leading global and European banks and other significant capital market players. We advocate for deep and integrated European capital markets which serve the needs of companies and investors, supporting economic growth and benefiting society. We aim to act as a bridge between market participants and policy makers across Europe, drawing on our strong and long-standing relationships, our technical knowledge and fact-based work.

www.afme.eu

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Dutch Securitisation Association (DSA)

The Dutch Securitisation Association was established in 2012 as representative body of the Dutch securitisation industry. Our membership includes issuers of securitisations both from the insurance and banking industry, and we are operating in close cooperation with the Dutch investor community. Our purpose is to create a healthy and well-functioning Dutch securitisation market. We try to achieve this i.a. by providing a standard for documentation and reporting of Dutch RMBS and Consumer ABS transactions, promoting further standardisation and improvements in transparency, and active involvement in consultations about future regulation of the securitisation market. For more information, please see our website

www.dutchsecuritisation.nl

Eurofinas

Eurofinas, the European Federation of Finance House Associations, is the voice of consumer credit providers in the EU. As a Federation, Eurofinas brings together associations throughout Europe that represent consumer credit providers. The scope of products covered by Eurofinas members includes all forms of consumer credit products such as personal loans, linked credit, credit cards and store cards. In 2016, consumer credit providers that are members of Eurofinas helped support European consumption by making more than 457 billion EUR goods, services, home improvements and private vehicles available to individuals, reaching 1.024 trillion EUR of outstandings at the end of the year.

www.eurofinas.org

European Banking Federation (EBF)

The European Banking Federation is the voice of the European banking sector, bringing together 32 national banking associations in Europe that together represent some 3,500 banks – large and small, wholesale and retail, local and international – employing approximately two million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that securely handle more than 400 million payment transactions per day. Launched in 1960, the EBF is committed to creating a single market for financial services in the European Union and to supporting policies that foster economic growth.



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International Capital Market Association (ICMA)

ICMA is the trade association for the international capital market with over 530-member firms from more than 60 countries, including banks, issuers, asset managers, infrastructure providers and law firms. It performs a crucial central role in the market by providing industry-driven standards and recommendations for issuance, trading and settlement in international fixed income and related instruments. ICMA liaises closely with regulatory and governmental authorities, both at the national and supranational level, to help to ensure that financial regulation promotes the efficiency and cost effectiveness of the capital market.

www.icmagroup.org

@icmagroup

Leaseurope

As a Federation, Leaseurope brings together 45 associations throughout Europe representing either the leasing, long term and/or short term automotive rental industries. The scope of products covered by Leaseurope's members ranges from hire purchase and finance leases to operating leases of all asset types (automotive, equipment and real estate) and also includes the rental of cars, vans and trucks. In 2016, total new leasing volumes worth €333.7 billion were granted by the firms represented through Leaseurope's members. The portfolio of leased assets (outstandings) in Europe amounted €779.1 billion at the end of 2016. It is estimated that Leaseurope represents approximately 94% of the European leasing market.

www.leaseurope.org

TSI

Structured finance in Germany and TSI – the two go hand in hand. True Sale International GmbH (TSI) was founded in 2004 as an initiative launched by 13 banks in Germany to further the German securitisation market. Today, TSI and its meanwhile more than 50 partners deal with a far wider range of issues, covering broad segments of the asset based finance market.

For further information, please visit our website at www.true-sale-international.com.