

Brussels, 2 September 2021

EBF_045294

Relaunching the European Union's securitisation market: What needs to be done in the context of the Capital Markets Union

Executive Summary

In late 2021, policymakers in the EU and the industry will start discussing about the review of the EU securitisation framework. According to the European Commission's Capital Markets Union 2020 Action Plan, the European Commission will table a new proposal to review the EU securitisation framework with the objective "to scale-up the securitisation market in the EU (...) to enhance banks' credit provision to EU companies"¹. Judging from public interventions by policy making institutions and the industry, it seems to be consensus that the EU securitisation market remains underdeveloped and that the volume of securitisation transactions executed in the EU remains below its true potential. This is in spite of the fact that important regulatory novelties like the simple, transparent and standardised (STS) framework for securitisations have been introduced. Moreover, it is also commonly accepted that the market for securitisation transactions in the EU remains underdeveloped in comparison to the market in the United States. This will add further to the discussion about how a scaling-up of the securitisation market can be accomplished.

The discussion about possible reforms for the EU securitisation framework will then also be held in the context of the upcoming challenges that the EU is facing. In a post-Covid-19 recovery, there will likely be an increase in non-performing exposures (NPEs) and this will put NPE securitisation back into the spotlight. While this challenge is an important one there will be other longer-term challenges to deal with, one of the most important being the greening of the economy and promoting sustainable finance. The Commission has made the green transition a priority by announcing a European Green Deal, and regulators and supervisors are moving forward on the topic of climate risk management. In addition, Covid-19 has demonstrated the importance of digital technologies to the economy, which will also require funding. To give an example, in its new sustainable finance strategy from July 2021, the European Commission estimates a financing need for the EU of "EUR 350 billion in additional investment per year over this decade to meet its 2030 emissions-

¹ https://eur-lex.europa.eu/resource.html?uri=cellar:61042990-fe46-11ea-b44f-01aa75ed71a1.0001.02/DOC_1&format=PDF

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EU Transparency Register / ID number: 4722660838-23



reduction target in energy systems alone, alongside the EUR 130 billion it will need for other environmental goals”².

In this context, securitisation can make an important contribution. The benefit of securitisation is that this can be applied to any type of loans, which can be bundled into one product, and open up investment opportunities for capital market investors. This helps to diversify funding sources for the financing of the economy and complement bank lending, but it also allows banks in many cases to free up capital, which again spurs further lending to the economy. This is particularly true for traditional securitisation, and asset-backed commercial paper. Both types of securitisations can be used as means to finance businesses, like SMEs, which otherwise would have no access to capital markets. Through the securitisation structure those loans can be used to create a product that offers a satisfactory size and remuneration structure for institutional investors. Of course, securitisation is not limited to SME loans, but it can also find applications in the area of consumer and auto-loans, and other areas. In the context of sustainable finance, a securitisation based on small projects aimed at reducing emissions, like green mortgages or energy storage project, can be used to enhance the funding capacities of the economy. Also of high importance are synthetic securitisations and NPE securitisations. In synthetic securitisations the loans are held on the balance sheet of the originating institutions, which allow banks to better manage their credit risk. NPE securitisations helps banks more easily to reduce the NPEs on their balance sheet and sell them to investors.

Recognizing the importance of securitisation as a tool in structured finance, there have been several proposals put forward by stakeholders to revive the EU securitisation market³. The ones that are recognised by the European Banking Federation as the most important ones are the following: (i) addressing capital non-neutrality, (ii) streamlining and harmonising the significant risk transfer (SRT) process, (iii) improving the liquidity treatment, and (iv) making disclosure requirements more targeted. The rationale for reviewing those parts would be to increase the efficiency of the securitisation framework. Moreover, it is important to also revisit certain parts of the framework considering the improvements introduced by the STS-framework, which is particularly pertinent for the capital non-neutrality. On the basis of the STS reforms, it would be justified to address sources of capital non-neutrality in the securitisation framework. Other parts, such as the SRT process and disclosure requirements should be looked at from the perspective of reducing the operational burden. With the benefit of the experience of how those requirements have worked in practice, not all of them have proven equally useful. An in-depth review and discussion about the regulatory requirements would allow to harness that potential of the framework. Besides the efficiency enhancing aspects, it is also important to set additional incentives to use securitisations, like an improved liquidity treatment that is more reflective of the actual characteristics of securitisation.

Lastly, it is important to also keep in mind the impact of the output floor which will be introduced through the Finalisation of Basel III and which will impact the capital treatment of securitisations through the standardised approach and also affect securitisations under the internal ratings based approach (IRBA) for which risk weights will increase. Therefore, the discussion about the general review of the securitisation framework needs to keep this in mind to ensure that the efforts by policymakers carried out under the Commission’s CMU Action Plan are not put at risk by the output floor.

² Communication from the Commission to the European Parliament, the Council, The European Economic and Social Committee and the Committee of Regions: Strategy for Financing the Transition to a Sustainable Economy, 6 July 2021

³ Final report of the High-level Forum on the Capital Markets Union – A new vision for Europe’s capital markets, 10 June 2020

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1. Introduction

Future challenges ahead of the EU economy

One of the important policy debates of the past years that have so far not been brought to a satisfactory conclusion, as recognized by the public sector and the industry alike⁴, is the discussion about the EU securitisation framework and what should be done to help relaunching the EU securitisation market. It seems to be consensus that the volume of securitisation transactions remains below its true potential and that securitisation is not used as much as would be desirable.

At the end of 2021 and beginning of 2022, policy makers will start thinking about reforms for the regulatory framework for securitisations in the EU. The general review of the framework, which will be an important point on the EU regulatory agenda for financial services, comes at a point in time when the economies of the EU member states are at a crossroad. Due to the Covid-19 pandemic, there is a risk that EU banks will experience an increase in default rates, as a result of which their capital ratios would worsen and so their capability to provide new lending due to their shortage of free fresh CET1 capital. Furthermore, one of the key priorities of the current European Commission is the European Green Deal and governments are emphasizing more and more the need to move to a greener economy. At the same time regulatory and supervisory institutions are moving forward on the topic of sustainable finance and climate risk related risk management. In addition to the climate risk challenge, the past year has highlighted the need to make progress on the digitalisation of the economy. Covid-19 has accelerated the move towards digitalisation and highlighted the importance of digital technologies to the economy. However, transitioning to a greener and more digital economy will require substantial investments.

Presently, the recovery post-Covid-19 crisis and those new investments in the Green and Digital economy will have to rely on the financing from the banking sector, because capital markets in Europe cannot yet fill the financial gap due to their relative underdevelopment in comparison to other jurisdictions. Nevertheless, due to the sheer size of the investments and financing needed, banks alone will not be in a position to provide all the funding by themselves. Once the Covid-19 crisis has passed, banks will likely have to manage a strong increase in non-performing exposures (NPEs). This will bind significant amounts of capital and reduce the banking sector's capacity to use this capital for the financing of the economy. This is where securitisation comes in as a means to finance the recovery and those new investments. However, this is just one area of application for securitisation. In fact, securitisation can be applied to all types of loans and, thereby, diversifying the financing sources for the economy. Because of securitisation, loans can be bundled to allow capital market participants to invest in it, which opens up new investment opportunities and – where applicable – frees up bank capital.

State of play

In the European Union, the current market standard for securitisations is the simple, transparent, and standardised (STS) securitisations label, even though securitisations that do not have the STS label remain important. The stated purpose of the STS securitisation standard, which entered into force in 2019, was to identify the shortcomings of the existing regulation and put in place a standard that allows to conduct transactions in way that exploits the benefits of securitisations while, at the same time, strengthening the prudential framework. Even though this standard has been enacted quite recently, one

⁴ See for example the view of the European Commission and French Ministry of Economy and Finance in the context of the Eurofi from September 2020

can already draw some conclusions, one of which is that the STS standard has not been able to live up to the expectations and that the EU securitisation market is still rather underdeveloped in comparison to the market in the US, where, on the other hand, an analogous STS framework, even if foreseen in the Basel framework, was never implemented and the securitisation market is flourishing. The key figure, which support this statement is the amount of issuance, which was 194.7bn Euros in the EU and 3354.9bn Euros in the US in 2020⁵. The key question is why STS has not achieved its goals to create a standard that while maintaining safety from a prudential point of view would also promote a deep market for securitisation. As it seems to be the case with the current framework, even though securitisation is recognized as a key instrument to foster the lending to the real economy, banks do not find it sufficiently attractive from an economic perspective. This consequently implies a lower level of lending from banks and missed opportunities for those corporates looking for support in new investment. Most recently, as part of the actions to strengthen the recovery from the coronavirus crisis, some elements of the securitisation framework have been put again on the agenda and found their way into the regulation as part of the Capital Markets Recovery Package (CMRP). While the impact of those proposals remains to be seen, the view of the industry is not reassuring. Also, in 2021/2022 there will be a general review of the securitisation framework in the EU. This general review will be an opportunity to discuss again the state of the European securitisation market.

Obstacles in the regulatory framework to be addressed

As will be explained in this paper, there are several reasons as to why the securitisation market in the EU remains underdeveloped relative to other jurisdictions. According to the view of the EBF, several parts of the framework need to be adjusted. Most importantly, the EU will need to tackle the problem of capital non-neutrality, better aligning the non-performing exposure (NPE) securitisation framework more closely to the EBA's Opinion⁶, improve the process of the significant risk transfer (SRT), address the eligibility of senior tranches as high-quality liquid assets (HQLA), and promote a more efficient use of transparency requirements which are required by article 7 of the Securitisation Regulation, in particular the usefulness of the ESMA templates for private securitisations. It is important to have a more agile framework that is more efficient and also reflects the accomplishments of the post-crisis regulatory agenda. For example, capital non-neutrality is a problem, as will be explained in section 4, although the STS regulation has helped to bring about a safer and more prudent framework and make securitisations a safer instrument. However, this has never been reflected in prudential requirements for securitisations, which should have received a more appropriate capital treatment. Nevertheless, a regulatory framework, like the one on securitisation, needs to be better calibrated and should set the right incentives for banks, otherwise it will not be used, and it will miss its purpose. In addition to that, the EBF also strongly believes that in addition to STS securitisations, lawmakers should continue to support non-STS transactions in the general securitisation framework given their importance in the EU.

The document is structured as follows: Section 2 will outline the benefits of securitisation and put these into a broader perspective, along with section 3 that highlights the historical performance of securitisations. In section 4 it is explained what can be done to boost the EU's securitisation market and the key concerns for the EBF members are outlined, while

⁵ AFME Securitisation report Q4 2020

⁶ Opinion of the European Banking Authority to the European Commission on the Regulatory Treatment of Non-Performing Exposure Securitisations dated 23 October 2019

the appendices provide more specific, technical comments with concrete amendments and supporting information.

2. The benefits of securitisation: different types of securitisations

Traditional and synthetic securitisation

Securitisation is a way to open up new investment opportunities in capital markets. The key idea behind securitisation is that a pool of a certain type of asset, which underlies the securitisation transaction, is bundled together in one instrument called a security, which is either sold to capital markets in a traditional securitisation transaction or used as risk management tool, as is the case for synthetic securitisations.

The specific characteristics of a securitisation allows also to offer investment possibilities to investors depending on their risk appetite. Securitisations are structured in multiple tranches, often including senior, mezzanine, and junior tranches. Each tranche carries a different level of risk and return. For example, while a senior tranche has the lowest risk profile, the mezzanine tranche has a higher risk, and the junior / equity tranche is the riskiest. The junior tranche is also called the first loss tranche, because it is the first tranche to absorb losses and thereby protects the other tranches. The tranche structure of securitisation is also guiding how investors can invest in securities depending on their willingness to take risk. The most risk averse investors would invest in the safest, the senior tranche, whereas investors seeking a potentially higher return, like high-yield investors, would invest in the riskier junior tranche.

The key difference between a traditional (or “true sale”) securitisation, and synthetic securitisation, is how the market can invest in those securities. In a traditional securitisation, the assets are transferred to a special purpose vehicle whose issued notes are sold to the market (or used as collateral) and thereby removed from the balance sheet. The purpose of this for the originator can be both, generating liquidity and reducing capital requirements. In the case of synthetic securitisations, the assets remain on the balance sheet of the originating bank, but the bank acquires a credit protection, usually for the junior tranche. The credit protection can be acquired, for example, by way of credit derivatives or financial guarantees for which the originator has to pay a fee on an ongoing basis. In a synthetic securitisation, the security is not a way to create liquidity, but is instead a risk management tool that helps to reduce capital requirements for the originating bank in exchange for a transfer of risk to investors.

In addition to the abovementioned benefits, securitisation also has numerous benefits for the real economy. One of the most important benefits that is especially relevant in the context of the CMU is that it can complement the funding sources, which are present in bank-based economies such as the ones in Europe. For example, securitisation offers a way for SMEs to find investors. SMEs do not have the possibility to borrow from capital markets as large corporations do, however, securitisation allows SME exposures to be bundled into the pool underlying the securities and therefore open them up to capital markets investors. Securitisation therefore is a means of diversifying the funding sources of the real economy. The main advantage is that the diversification of funding sources also makes the real economy and financial system more resilient. Securitisation in particular, and CMU in general, would reduce the reliance of the economy on bank funding. In some cases, for example during a recession, it may be difficult for banks to maintain their level of lending to the economy due to economic stress that they are themselves exposed to. Securitisation can free up capital, balance sheet and liquidity that can in turn be used to provide additional lending or to attract other types of investors which would help to fund business that can support a recovery.

An example for the use of securitisation to support the real economy is the securitisation activity of the European Investment Bank / European Investment Fund (EIB / EIF). The EIB Group has the status as a multilateral development bank, which allows for a 0% risk weight under CRR. The EIB Group is involved in the securitisation market by, on the one hand, providing unconditional and irrevocable guarantees in synthetic securitisations on the mezzanine tranche, which frees up regulatory capital on the balance sheet of the originator. On the other hand, the EIB Group also provides debt service guarantees on ABS tranches purchased by third party investors and outright cash investments. In return for its investments EIB group requires the originators to provide lending to SMEs and small mid-caps by a multiple of the invested amounts. Therefore, the EIB Group is a good example to show how securitisation can be used to facilitate and catalyse lending to SMEs and small mid-caps.

ABCP transactions

Securitisations via Asset-Backed Commercial Paper ("ABCP") allow for funding raised by corporates/financial intermediaries via conduit financing on a roll-over basis in the money market. This type of transaction could be set up for an unlimited period with large and medium-sized companies which provide on a revolving basis trade receivables as the securitized assets, as well as with financial intermediaries (including small-mid consumer loan providers, credit card companies, lending platforms, etc.) which have access to conduit financing and the underlying assets can also include financial assets such as consumer loans, leases, SMEs loans, etc. The receivables are originated from the regular business activities of the company and are due in 30-180 days (usually, financial assets show longer maturities). Each ABCP transaction is usually reinforced, other than backed by the receivables themselves, by additional collateralisation measures as credit enhancement in the form of cash reserves, dilution reserves, pledged collection accounts, overcollateralization or tranching which results in default probabilities of the notes in the rating range from A to AAA. As a result, ABCP are mainly set-up to finance the real economy as an instrument that offers medium sized corporates and financial intermediaries a sustainable form of financing that is almost independent from their own rating and at low cost compared to the case in which the company would have been directly financed by the bank. On the other hand, also investors benefit from this structure, because ABCP are highly collateralised and therefore, even in the event of the insolvency of a seller company of receivables, no loss is to be expected. Support is also provided by conduit sponsors through liquidity lines that not only absorb liquidity risk but also credit risk. However, in case of liquidity shortages, ABCP suffers from investors' who may withdraw from the market, as it happened at the beginning of the pandemic. Consequently, the liquidity shortage is rapidly translated to the real economy in a moment when the companies are more vulnerable. In some major jurisdictions, like the US and the UK, central banks have rapidly identified this issue and have intervened in the market by including ABCP as an asset class in their purchase programme. In the EU, however, no such action has been taken.

Green securitisation

One example that further illustrates how securitisations can be applied is the one of green securitisations. In recent discussions, the industry, for example, has proposed green securitisation as a way to provide funding to projects which have the purpose to promote sustainable / green projects. Green securitisations could be applied to smaller projects like green mortgages or small SME loans that are for example intended to be used for energy storage projects. The process of securitisation, to aggregate a number of smaller loans

and to bundle them in one structure, could make a significant contribution to the challenge related to reducing the carbon footprint of the EU's economies. Through a securitisation those loans can be turned into a product that offers a satisfactory size and remuneration structure for institutional investors. As of now, green securitisations, as is true for other securitisations, are not yet where they could be in terms of potential.

Non-performing exposure securitisation

Another type of securitisation that has received increasing attention, in particular as a means for banks to manage their Covid-19 related NPEs, is the concept of NPE securitisation. Even though work has been carried out already before the crisis, the Covid-19 crisis has given this topic more publicity as is also reflected in the European Commission's Capital Markets Recovery Package and the latest technical amendment of the Basel Committee to the securitisation framework⁷. In the latest discussions, NPE securitisations have been identified as an additional tool to allow banks to dispose of their existing NPEs, but also as a way to tackle NPEs that might be the result of the economic downturn which will most likely follow the coronavirus pandemic. NPE securitisations function in the same way as traditional securitisations, however, the distinctive characteristic of NPE securitisations is that they are largely based on pools of non-performing exposures. Normal securitisations, however, are tailored to the specific characteristics of performing exposures, which is also reflected in the regulatory framework. Nevertheless, the risk related to NPE securitisations is a different one, which also needs to be fully integrated into the prudential framework. Whereas credit risk is the main risk driver next to other types of risk, in securitisations that have non-performing exposures as the underlying asset, default and so credit risk has already materialised. The factor that mainly determines whether or not investors will be paid back for the investment in NPE securitisations is the success of the work-out process of the underlying NPEs managed by a specialised servicer and hence expected recovery or expected loss given exposures are defaulted. Consequently, securitisations of NPEs merit a different prudential treatment, with specific RW formulae, that can account for those differences.

Current experience demonstrates that NPE securitisations have been particularly successful in markets with high NPE ratios like Italy, when supported by government guarantee schemes. Across the different member states there are different schemes, one of the most prominent one being the *GACS* (Garanzia sulla Cartolarizzazione delle Sofferenze) scheme in Italy or *Hercules* in Greece, which provides a guarantee for the senior tranche of a securitisation and therefore provides additional protection to investors of that tranche. However, NPE securitisation outside those markets and without guarantees have not yet taken off as a tool for offloading NPEs. Nevertheless, the value of NPE securitisations has in principle both been recognized by the regulators and private sector stakeholders. Importantly, NPE securitisations can have a positive impact on the entire banking sector as they allow smaller banks to dispose of their NPEs much more easily. The past years have shown that disposals of large NPE portfolios can only be done by relatively large banks, since there is a market for it. Medium-sized banks, however, find it more difficult to place their NPEs directly with investors.

3. Historical performance

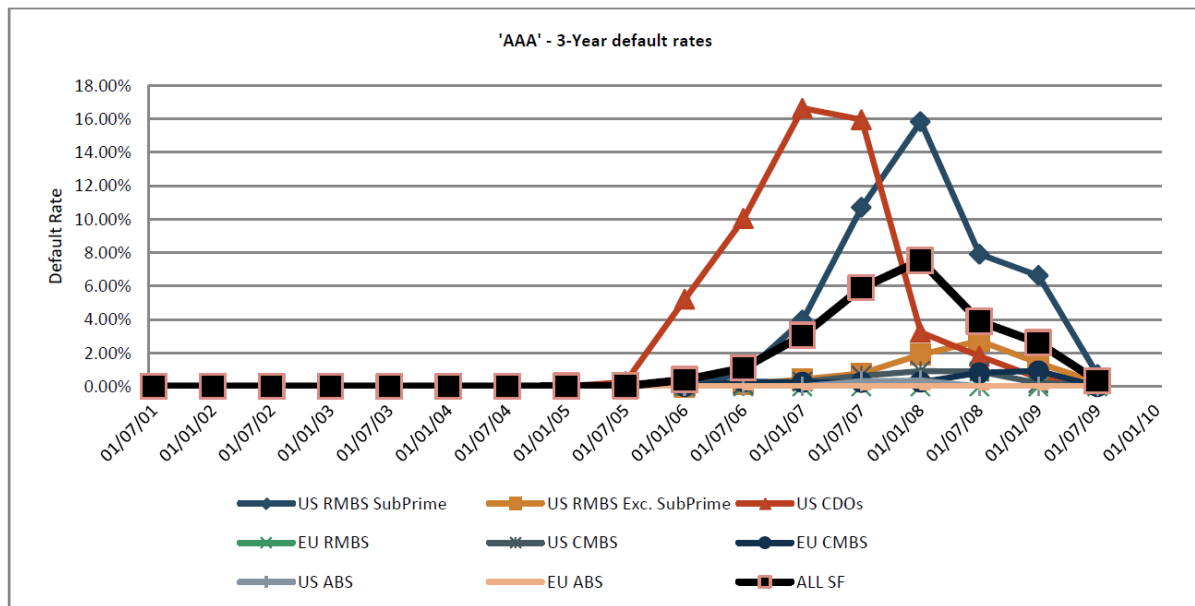
After the 2008 financial crisis, it had become clear that securitisation transactions which had been executed in the US were much riskier than what they had initially appeared to

⁷ <https://www.bis.org/bcbs/publ/d511.htm>

be. This insight was the result of what is now known as the US sub-prime crisis in which mortgage-backed securities that were backed by subprime mortgages exhibited huge losses for investors. The reasons leading to this situation and why those securitisations in the US were particularly risky are now known and well-understood⁸.

One aspect however that is often eclipsed is that this was a problem primarily related to securitisations in the US, because they were structured in a very particular manner. As is evidenced by data collected during the sub-prime crisis that compares default rates in the EU and US. European securitisations were structured much more prudently, as is also reflected in their default rates. Figure 1 illustrates this by comparing the three-year default rates for securitisations rated as AAA. For example, EU residential mortgage-backed securities (RMBS) showed much lower loss rates (0.1% of cases at the height of the crisis) than US RMBS with the same rating, where this was a multiple (16%) of the EU loss rates⁹.

Figure 1: Three-year default rates at AAA level per asset class (July 2001-Jan 2010 – S&P, Moody's and Fitch).
Source: *EBA Report on Qualifying Securitizations*, p. 12



In addition to traditional, true-sale securitisations, it is also worthwhile to also focus on synthetic securitisations. There are two types of synthetic securitisations. The most important one being balance sheet synthetic securitisations, where the exposures are kept on the balance sheet of the bank and the bank transfers the credit risk related to the underlying exposures by means of financial guarantees or credit derivatives. Another type of synthetic securitisation is arbitrage synthetic securitisation, where the underlying assets may not be owned by the originator of the securitisation. The purpose of arbitrage synthetic securitisation is to achieve an arbitrage gain that arises from the spread between the return earned on the underlying exposures and the lower return paid on the respective notes to investors, which were issued as part of the securitisation product. For that

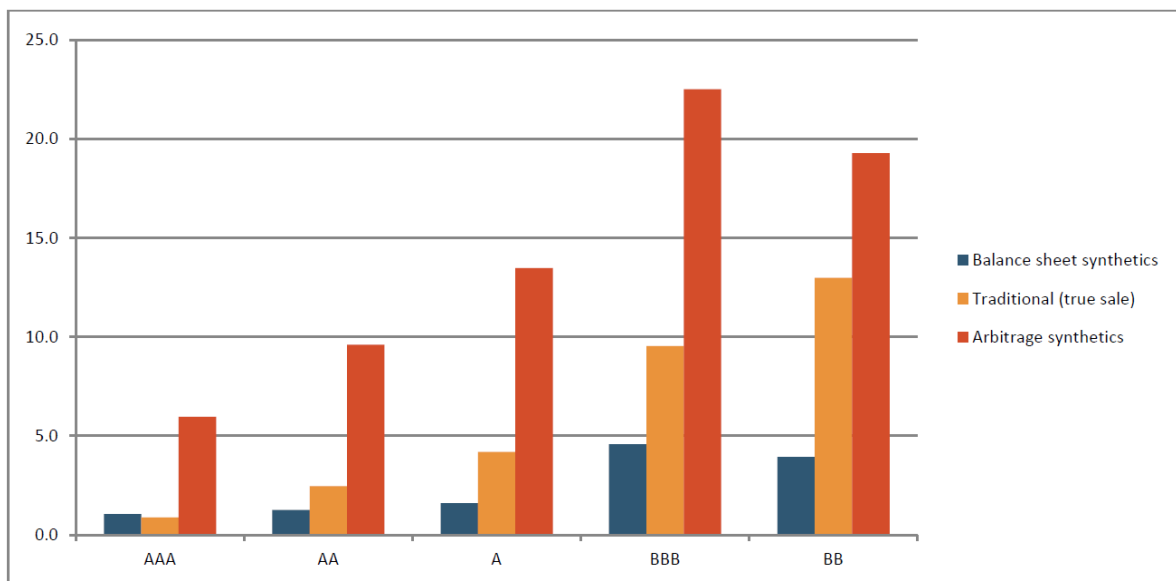
⁸ For a discussion on why the US securitisations during the subprime crisis were so risky, see PCS' "Basic Overview" on securitisation, https://pcsmarket.org/wp-content/uploads/publications/5f1b5/Basic_Overview_.pdf

⁹ European Commission Memo: A European Framework for Simple and transparent securitisation, https://ec.europa.eu/commission/presscorner/detail/en/MEMO_15_5733

purpose, the underlying exposures, which may have had a comparatively long maturity, were funded with notes of relatively short maturity.

As a result of the financial crisis, synthetic securitisation is seen as having contributed to the severity of the 2008 crisis. However, as with traditional securitisations, the losses that investors and originators accrued during the financial crisis were very much dependent on the type of synthetic securitisation that was being used, and the performance of balance sheet synthetic securitisation was very good, in some cases even better than the performance of traditional securitisations, as demonstrated by EBA data in figure 2. The very severe losses were largely associated with arbitrage synthetic securitisations.

Figure 2: Lifetime default rate (%): balance sheet synthetic tranches, arbitrage synthetic tranches, traditional tranches, per rating grade. Source: [EBA report on synthetic securitisation, EBA/Op/2015/26, page 17](#)



Balance sheet synthetic securitisations and arbitrage synthetic securitisations have a number of different features, which are outlined in table 1. For example, as described above, arbitrage synthetic securitisations were based on a maturity mismatch that, once market conditions deteriorated and funding dried up, pushed up the default rates. Other features were for example the use of implicit support, which in the end has the potential to undermine the risk transfer, or arbitrage synthetic securitisations could have highly heterogeneous portfolios, whereas in balance sheet synthetic securitisations portfolios are relatively homogeneous by relying only on one assets class, for example, consumer or corporate loans.

Arbitrage synthetic securitisations do no longer play a role in current securitisation markets and the synthetic securitisations in the market are almost exclusively balance sheet securitisations, and that is for good reasons. It also needs to be noted that for balance sheet synthetic securitisations many of the problematic features of arbitrage securitisations are not relevant, because either they are not admissible due to regulation or market practice has moved away from those features. Table 1 provides an illustrative overview of those different characteristics.

Table 1: Structural differences between balance sheet synthetic securitisations and arbitrage synthetic securitisations

Characteristic	Balance sheet synthetic securitisation	Arbitrage synthetic securitisation
Credit derivative as underlying	No	Yes
Implicit support	No ¹⁰	Yes
Non-contingent premiums	No	Yes
Re-securitisation	No ¹¹	Yes
Heterogeneous portfolios	No	Yes
Structured Investment Credit Vehicles (SCIVs/ SIVs)	No	Yes

4. The current state of securitisations in Europe: What needs to be done?

When examining the EU regulatory framework for securitisation, it should be kept in mind that securitisation is a tool that can enlarge the possibilities for banks to provide funding to the economy, diversify their portfolio, manage risk, reduce their cost of funding etc. However, whether or not banks will use the full potential of securitisations hinges on the question as to whether or not the incentives to securitise assets are sufficient. For banks to find securitisation an attractive tool, it must remain economic from the banks' point of view. The economics may be impacted by several factors, such as the cost of capital associated with securitisation, the operational burden with providing certain information, or restrictions in the regulation that put unnecessary limits on the structuring of those transactions. At the same time, some features of the regulation can make it more attractive to use securitisation, such as the possibility to recognise certain securitisations as high-quality liquid assets, if justified by their characteristics. Consequently, any review of the securitisation framework that seeks to address the problem described above, which is the underdevelopment of the EU securitisation market, needs to start by looking at the framework from that perspective and to examine which parts of the regulatory framework might deter market participants from using it.

The most important issues that require changes in the regulations are the following:

1. The impact of capital non-neutrality
2. The complicated "Significant Risk Transfer" (SRT) process and lack of harmonisation of SRT rules
3. The impact of the liquidity coverage ratio
4. The extensive and duplicating disclosure requirements

The impact of capital non-neutrality

First, from the industry's point of view the most pressing problem is related to the capital non-neutrality of the framework. Capital non-neutrality in the context of securitisation

¹⁰ Article 250 CRR and the EBA Guidelines on implicit support for securitisations

¹¹ Article 8, Securitisation Regulation

means that assets which are securitised attract a significantly higher capital requirement than assets which are not securitised. Capital non-neutrality raises the costs of originating and holding securitised assets relative to non-securitised assets, because of the costs that are associated with holding capital. The fact that securitised assets were seen as riskier assets vis-à-vis non-securitised assets from a regulatory point of view has previously been justified with reference to the presence of agency risk that was created by the securitisation. While agency risk is not always clearly defined, this generally refers to risk which arises because of the structure of securitisations. Whilst the industry did not fully agree with this position previously, what is certainly clear now is that, as has been argued by industry representatives¹², recent reforms as part of the new STS framework have addressed these agency risks. However, the EU's securitisation framework never recognized this improvement with a commensurate capital relief. In the formula which determines the capital requirement the so-called "p"-factor is intended to cover those risks. Following from what is written above, it would make sense to reduce this factor to account for the lower level of risk associated with securitisation. This position is also supported by a broad range of stakeholders in the EU's High-level Forum on the Capital Markets Union.

Lastly, even though not directly related to the subject of capital non-neutrality, in the discussion about the relaunch of the securitisation framework, one point that has also often been mentioned is the recalibration of risk weights that apply to positions held by insurers under Solvency II. The consensus among stakeholders as also reflected in the final report of the High-level Forum on the Capital Markets Union is that the capital treatment of Solvency II limits the investment by insurers.

The complicated "Significant Risk Transfer" (SRT) process and lack of harmonisation of SRT rules

Second, another part where improvement could be achieved is the area of significant risk transfer (SRT). The SRT process accounts for the fact that as part of securitisation, originators can transfer a significant portion of the credit risk associated with the assets underlying the securitisation from their balance sheet to the market. This risk sharing between originators and market participants then in turn justifies a reduction in the capital requirements. However, to have this risk transfer recognised is a very complicated process. The SRT transaction has to be notified to the relevant competent authority, like the ECB, several months ahead of the transaction, which will then assess to what extent the transactions fulfil the conditions for SRT. Only after that assessment, originators will know whether or not their transaction meets the conditions, or whether contractual modifications are needed. In the experience of the industry¹³ some of the characteristics of the transactions, like market prices can change within that period. This is a significant constraint as those factors are taken into consideration by the supervisor for their assessment. In the worst case, this would mean that the transaction fails the assessment and needs to be stopped or executed without any capital relief. Another problem related to SRT is the lack of harmonisation and not enough clarity as to how discretion is exercised. Consequently, more harmonization regarding the SRT process and a strengthened dialogue between the industry and regulators like the EBA and ESMA is needed to reduce uncertainty and make the process more predictable. In this respect it is also important to point out that, even though, some EBF members have seen a recent improvement in the communications with JSTs, a further improvement is still required. The recently published EBA report on the SRT from November 2020 already makes some useful

¹² https://www.eurofi.net/wp-content/uploads/2020/04/relaunching-securitisation-in-the-eu_zagreb_april20.pdf

¹³ https://www.eurofi.net/wp-content/uploads/2020/04/relaunching-securitisation-in-the-eu_zagreb_april20.pdf

recommendations, but needs to be subject of further discussions between the industry and the public sector stakeholders, since the industry does not believe that all recommendations would have the intended effect.

The impact of the liquidity coverage ratio

Third, currently the treatment of securitisations in the liquidity coverage ratio is considered to be rather penalizing and not reflective of the actual characteristics of highly rated securitisations. To make it easier for banks to hold securitisations and to make securitisations more attractive, we would propose to align the regulatory treatment of securitisation tranches in the liquidity framework with that of covered bonds. The current treatment of securitisation does not sufficiently recognise improvements in the regulatory framework as well the performance of securitisations during the financial crisis of 2008/2009 in comparison to similar asset classes. Consequently, as a first step¹⁴, senior STS tranches with an AA- rating (equivalent to Covered Bonds) should be allowed to be treated as high quality liquid assets of the highest level and those tranches could be considered in the liquidity coverage ratio (LCR), with haircuts similar to those that apply to covered bonds. The calibration of the eligibility criteria for level 2A and 2B should be done in a similar fashion. In a second step, it could also be considered to extend the HQLA eligibility to a wider set of tranches, i.e. tranches with a BBB- rating, if supported by quantitative evidence or increase their Level to 1 under certain specific circumstances as applicable to covered bonds.

The extensive and duplicating disclosure requirements

Fourthly, another point which can complicate securitisation transactions are the rigid and, in some cases, poorly targeted transparency / disclosure templates. The industry is fully supportive of initiatives designed to further increase transparency and disclosure within the market, with issuers already disclosing significant information to investors, potential investors and regulators. However, if we want to make meaningful progress on the relaunch of the securitisation framework, it is very important to examine the different requirements and assess which requirements add sufficient value or where some requirements merely duplicate the information already provided to investors in their bespoke reporting arrangements. In this respect, we would propose to review the disclosure requirements for private securitisations contained in the ESMA templates under article 7 of the Securitisation Regulation to identify key requirements that could provide useful information vs. excessive information requirements that provide limited value to investors. This is an important point, considering that investors already insist on extensive bespoke reporting arrangements that better suit their requirements and do not refer to the data stored in the ESMA databases (for an excellent explanation of this point, please refer to the paper titled *ESMA Templates: not fit for risk sharing transactions*¹⁵ by PGGM, one of Europe's largest investors in private securitisations). In any case, simplifying the ESMA transparency templates not only for private deals but also for public ones would represent a significant step forward, which will make the overall securitisation framework more efficient and reduce the operational burden related to securitisation.

¹⁴ Even though the ECB is not the primary addressee of this paper, it should be highlighted that a better recognition of securitisation in the ECB's collateral framework for repo transaction would have a positive effect as well

¹⁵ <https://www.pggm.nl/media/quifc0jm/pggm-paper-esma-templates-not-fit-for-risk-sharing-transactions-november-2019.pdf>

Appendix 1: Specific proposals

1.1. Capital treatment in the securitisation framework

1.1.1 Recalibrate the capital treatment of securitisations

Addressing the capital non-neutrality

One of the key issues to be addressed as part of the general review of the securitisation framework is the capital non-neutrality of the framework. As also mentioned in the EU's High-level Forum (HLF) on Capital Markets Union (CMU) recommendations, the non-neutrality of the capital regime, intentionally introduced primarily through the supervisory "p" factor and the risk-weighting floor of senior tranches, is disproportionate. The EBF would welcome the European Commission to adopt the recommendations of EU's High-level Forum (HLF) on Capital Markets Union (CMU) for Articles 259-262 of EU 2017/2401 and a) recalibrate the fixed parameters that are components of the "p" factor for SEC-IRBA, b) introduce a 7% RW floor for SEC-IRBA and SEC-SA in case of STS securitisations as well as c) introduce a p-factor of 0.25 for SEC-SA in case of STS securitisations and 0.5 for non-STs. Likewise, the risk-weights in the tables of Articles 263-264 applying in the SEC-ERBA should be reduced in line with the changes described above and a 7% risk weight would be warranted for AAA rated senior securitisation tranches in line with the capital treatment of covered bonds as it was the case for all AAA senior securitisation tranches in the past for IRB banks before the implementation of the recent securitisation package.

Recalibration of risk weights for senior tranches for originator and sponsor institutions

In addition, the EBF believes that the retained senior securitisation tranches should benefit from further changes to the preferential "STS" risk weighted formula. Originator and sponsors already have a very good knowledge of the underlying assets and risks involved and such adjustments would better account for this knowledge. This would also ensure a level playing field between EU and US banks, whereby the latter still benefit from the Supervisory Formula Approach (SFA) under the IRB approach, which was present in the previous version of the framework in the EU, under the IRBA approach compared to the more conservative SEC-IRBA methodology now being used in the EU. To address this issue, we would recommend introducing at least for originators, but we suggest also for sponsor institutions, a 7% RW floor for non-STs senior tranches treated with SEC-IRBA/SEC-SA/SEC-ERBA (and IAA) as it was in the previous framework (so called SFA formula). Despite any changes to the RW floors for STS and non-STs securitisation, policymakers should also take into account the impact of the output floor in the Final Basel III standards, which has the potential to lead to a significant increase of RWs for IRB approaches through the standardised approach output floor. Therefore, the discussion on the Basel implementation will have a significant impact on the EU securitisation framework.

To recalibrate the risk weights for senior tranches for originating and sponsor banks, the EBF recommends the following changes:

Proposed amendments to CRR
Article 259 CRR
<p>Calculation of risk-weighted exposure amounts under the SEC-IRBA</p> <p>"1. Under the SEC-IRBA, the risk-weighted exposure amount for a securitisation position shall be calculated by multiplying the exposure value of the position calculated in accordance with Article 248 by the applicable risk weight determined as follows, in all cases subject to a floor of 15 %:</p>

(...)

$$p = \min[0,75 ; \max [0,25 ; 0,5 * (A + B * (1/N) + C * K_{IRB} + D * LGD + E * M_T)]]$$

(...)

9. By way of derogation from paragraph 1, originator and sponsor institutions shall assign a risk-weight floor of 7% to the senior securitisation positions."

Article 260 CRR

Treatment of STS securitisations under the SEC-IRBA

"Under the SEC-IRBA, the risk weight for a position in an STS securitisation shall be calculated in accordance with Article 259, subject to the following modifications:

risk-weight floor for senior securitisation positions = **7% for originator or sponsor institutions and 10 % in the other cases**

$$p = \min[0,3 ; \max [0,1 ; 0,5 * (A + B * (1/N) + C * K_{IRB} + D * LGD + E * M_T)]]"$$

Article 261 CRR

Calculation of risk-weighted exposure amounts under the Standardised Approach (SEC-SA)

"1. Under the SEC-SA, the risk-weighted exposure amount for a position in a securitisation shall be calculated by multiplying the exposure value of the position as calculated in accordance with Article 248 by the applicable risk weight determined as follows, **in all cases** subject to a floor of 15 %:

(...)

$$p = 0,5 \text{ for a securitisation exposure that is not a re-securitisation exposure}$$

(...)

4. By way of derogation from paragraph 1, originator and sponsor institutions shall assign a risk-weight floor of 7% to the senior securitisation positions"

Article 262 CRR

Treatment of STS securitisations under the SEC-SA

"Under the SEC-SA the risk weight for a position in an STS securitisation shall be calculated in accordance with Article 261, subject to the following modifications:

risk-weight floor for senior securitisation positions = **7% for originator or sponsor institutions and 10 % in the other cases**

(...)

$$p = 0,25"$$

In order to ensure consistency among the different approaches, the treatment for the external-ratings-based approach (SEC-ERBA) should be aligned with the IRBA. Consequently, and in line also with the recommendation of the High-Level Forum on the Capital Markets Union, the senior tranches held by originator and sponsor banks (for both

STS and non-STS securitisations), should receive a risk weight of 7% for exposures that meet Credit Quality Step (CQS) 1 and 2. To recalibrate the Risk weights as proposed for SEC-IRBA and SEC-SA, for Article 263 CRR, the recalibration would consist of replacing the tables of Article 263 CRR with the tables 4 of Article 264 CRR, while maintaining a minimum risk weight of 15%. In addition, in this table a 7% RW should apply for CQS 1 and 2 in the case of originator or sponsor banks.

For what concerns STS securitisation, a new mapping table, more beneficial than the current table 4 of Article 264, between CQS and RW should be defined allowing, as foreseen above, a minimum of 7% for senior tranches retained by originator or sponsor banks and 10% for the other cases.

For Article 264 CRR, a proposal for the adjustment to the SEC-ERBA would be as follows:

Proposed amendments to CRR				
Article 264 (3) CRR				
Treatment of STS securitisations under the SEC-ERBA				
<p>"3. For exposures with long-term credit assessments or when a rating based on a long-term credit assessment may be inferred in accordance with Article 263(7), risk weights for originator and sponsor positions shall be determined in accordance with Table 4, adjusted for tranche maturity (M_T) in accordance with Article 257 and Article 263(4) and for tranche thickness for non-senior tranches in accordance with Article 263(5).</p> <p>Risk weights for other securitisation positions shall be determined in accordance with Table 5, adjusted for tranche maturity (M_T) in accordance with Article 257 and Article 263(4) and for tranche thickness for non-senior tranches in accordance with Article 263(5):"</p>				
Table 4				
Credit Quality Step	Senior tranche		Non-senior (thin) tranche	
	Tranche maturity (M_T)		Tranche maturity (M_T)	
	1 year	5 years	1 year	5 years
1	7%	7%	15%	40%
2	7%	7%	15%	40%
(...)				
Table 4 5				
Credit Quality Step	Senior tranche		Non-senior (thin) tranche	
	Tranche maturity (M_T)		Tranche maturity (M_T)	
	1 year	5 years	1 year	5 years
1	10%	10%	15%	40%
2	10%	10%	15%	40%
(...)				

The impact of the output floor on securitisations

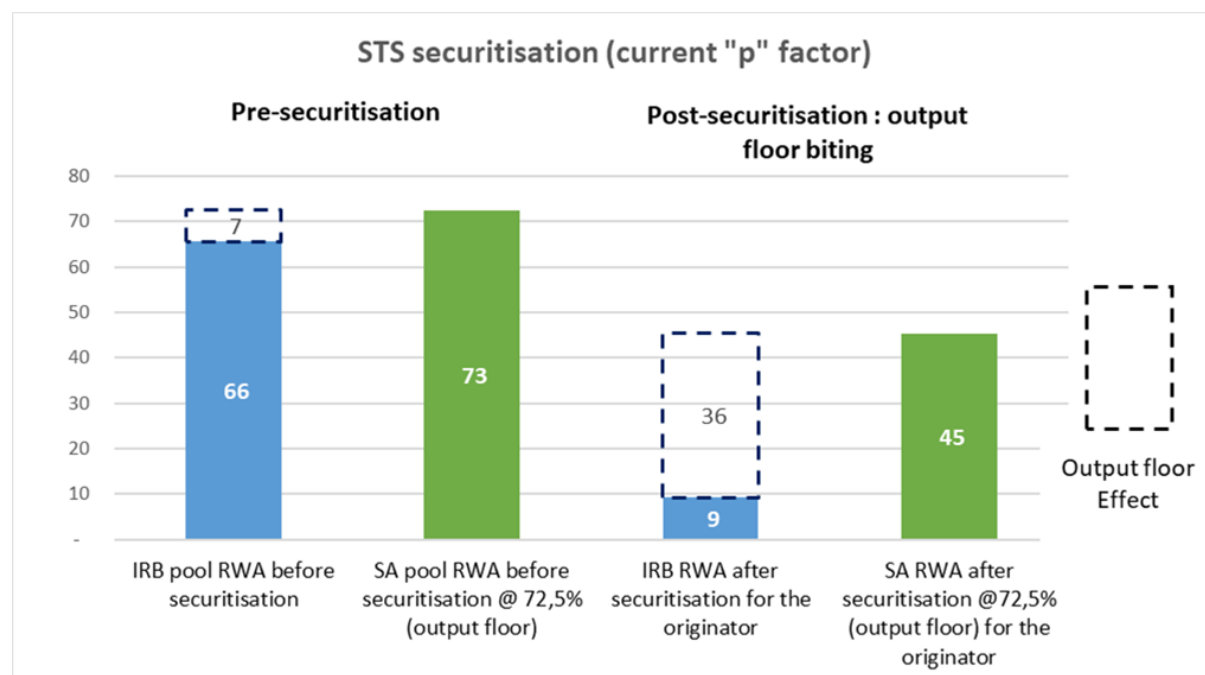
Adjusting the p-factors is also important in light of the implementation of the finalization of Basel III and the introduction of the output floor. Since the output floor is always based on the standardized approach, it will have an impact on internal models. This topic has not received a lot of attention in the impact studies which are available, and it is important to be aware of potential unintended effects of the application of an IRB output floor based on Standard RWA.

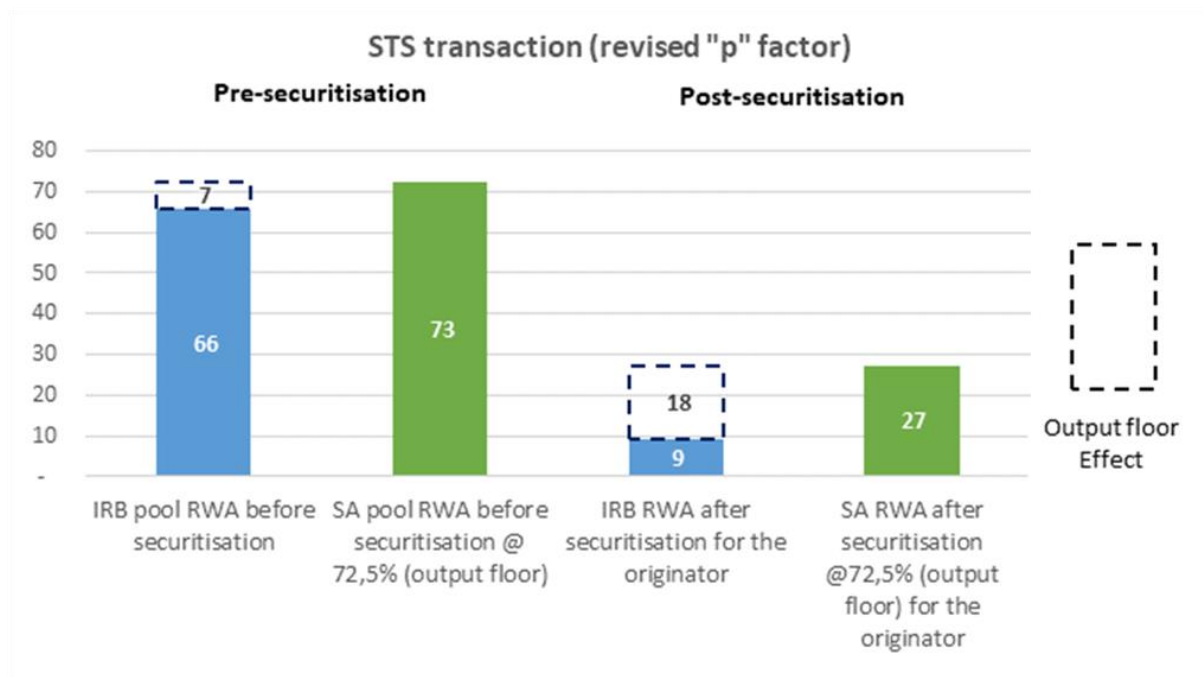
When simulating the impact on own-account securitisation structures covering IRB portfolios, one can observe the following: Although the securitisations are efficiently structured to release RWA under the SEC-IRBA, they are inefficient or even worsen the effects of the output floor. This is due to the conservative calibration of the SEC-SA, which was designed before the introduction of the output floor by the finalisation of Basel III. In relation to the securitisation framework, the standardised approach output floor results in a magnified impact: firstly, use of the standardised approach to credit risk under chapter 2 on the underlying pool to determine the RWA of the portfolio; and, secondly, through the use of the SEC-SA formula which is, by construction, more punitive than SEC-IRBA.

To remedy this situation it is important that RWA inflation due to the introduction of IRB input floors and the SA output floors on securitised pools is not magnified further by the non-neutrality of the securitisation risk weight functions, and hence a re-calibration of the SEC-IRBA and SEC-SA formulae should be undertaken. For example, adjustment of the p-factor for SEC-SA to 0.5 for non-STIS (this would align to the US SSFA formula) and to 0.25 for STIS and an appropriate adjustment to the p-factor for SEC-IRBA as we have proposed above. The following examples demonstrate that addressing capital non-neutrality is also justified in view of the Basel implementation, which will run in parallel. The examples below show the difference between the capital requirement with the p-factors that are currently required by legislation and the ones proposed by EBF.

Example 1 (STIS transactions):

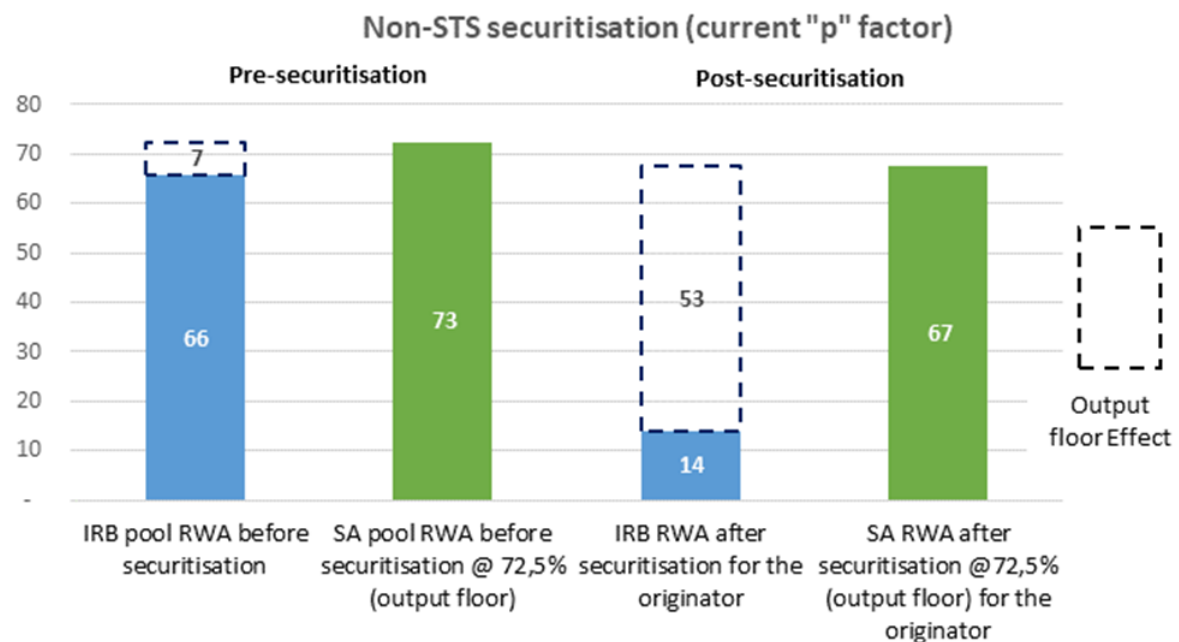
Lowering p-factor under SEC-SA from 0.5 to 0.25 to STIS securitisation will mitigate the output floor effect by half.

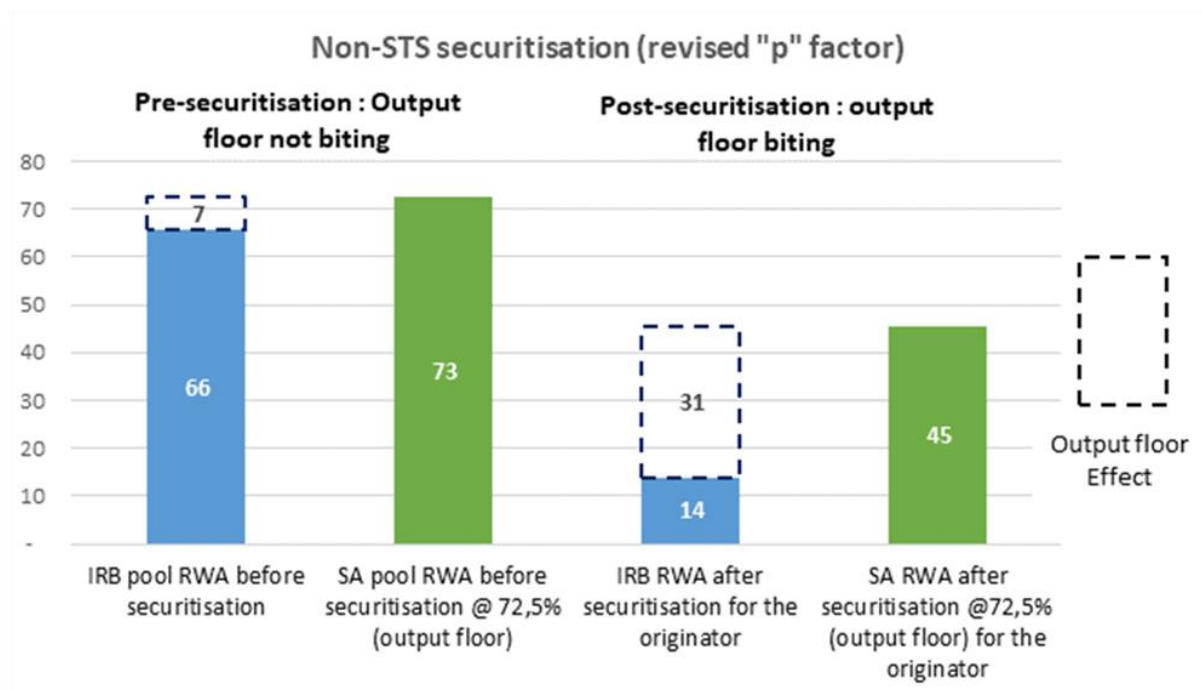




Example 2 (non-STs transactions):

Lowering the p-factor under SEC-SA from 1 to 0.5 to non-STs securitisation will reduce the output floor effect by 44%.





As it can be seen, even after the proposed recalibration of the p-parameter of SEC-SA, the RWA is still 3 times that one obtained with SEC-IRBA. As a consequence, we suggest to investigate further mitigants, as, for example, (i) the reduction of output floor percentage from 72.5% to 25% or (ii) a definition of an 'ad hoc' SEC-SA formula for this context where the K_{SA} is computed using Standardized approach whilst the p-parameter of 0.3 in the SEC-IRBA formula is applied.

Case study of a synthetic securitisation and the impact of the 15% capital floor

The example below illustrates a case where the impact of the current RW floors is demonstrated with the example of a synthetic non-STS securitisation, which is based on SME loans. The example shows how the economic viability of this synthetic deal would change if the RW floors for the senior tranche was changed from 15%, which is the current requirement, to 7% as has been called for by several stakeholders in the context of the High-level forum of the Capital Markets Union.

Characteristics of the underlying exposures including regulatory treatment

Assumptions ¹	
Turnover SME (M€)	30
Maturity pool (years)	4
PD pool ²	1,77%
LGD pool ²	34%
Fixed rate SME loans	1,80%
Funding cost ³	0,35%
Expected loss	0,60%
SME Supporting Factor ⁴	80%
RW pool (SME) ⁵	75,0%
Required capital ratio ⁶	12%
Mezzanine spread	9%

1 "real-life" assumptions. Blue figures are core assumptions, on the basis of which black figures are calculated

2 Based on a real-life securitisation portfolio

3 Indicative figure for a 5-y senior CDS spread on an EU G-SIB

4 Conservative Average SME supporting factor based on CRR Article 501.

5 Including the effect of the SME supporting factor

6 Estimate of total CET1 requirements for an EU GSIB

7 Retained

8 Sold to investors

Before securitisation	
Portfolio RoE	9,42%

Structure of the securitisation transaction

	Detachment	Attachment	Thickness	Tranche RW
Senior ⁷	100%	8%	92%	15%
Mezzanine ⁸	8%	1%	7%	n/a
Junior ⁷	1%	0%	1%	1250%

After securitisation	
Cost of capital transferred	10,78%
RoE	6,91%
Economic value	Negative economic value

The approach taken in this example is one in which the cost per unit of capital relief is calculated. This in turn gives an indication of the Return on Equity (RoE) that needs to be achieved for the investment of the freed-up capital. In the example below, the senior and junior tranches are retained, while the mezzanine tranche is sold to investors. In addition, the underlying exposure benefits from the SME supporting factor.

The RoE before securitisation is calculated by deducting the expected loss and the funding costs from the net interest income and dividing it by the risk weighted assets times the capital ratio. In this example the RoE before securitizing the exposures is 9.42%. This then gives the minimum RoE at which the capital that is freed up as part of this synthetic transaction needs to be reinvested to remain economical.

In a second step, the originating bank would apply for a significant risk transfer which allows the originator to apply more favorable risk weights, provided that the competent authority allows it. In a third step, with the capital requirements for the securitisation

transaction and the amount of mezzanine spread paid as interest to the investor in the mezzanine tranche (9%), it is possible to calculate the cost that needs to be paid in order to accomplish the capital relief, which is achieved due to selling of the mezzanine tranche, which in this case is 10.79%. Therefore, the originator needs to invest the freed-up capital with a target RoE of 10.79%, otherwise it will not be possible to cover the costs of the capital relief. Therefore, the transaction shown here is uneconomical, because the RoE for those same SME loans, which could be invested in with the freed-up capital, is only 9.42%. An adjustment of the RW floor for the senior tranches to 7%, on the other hand, would ensure the economic viability of the transaction, because under this scenario, the cost of capital relief would decrease to 9.36%, and the bank could reinvest the freed-up capital at a slight profit. Moreover, a notable observation is that the RoE of the retained tranches is significantly lower than before the securitisation. Therefore, under the current regulation, this securitisation would not be executed.

Review of the recognition of credit risk mitigation techniques in the CRR

In the context of securitisations, it should be possible to allow different forms of coverage/credit enhancement for noteholders (or lenders) in a SPV and to align and update this with current market practices, other than, as is in the current CRR text only allowing the provision of a guarantee directly on the securitisation position. We would recommend to account for situations in which credit risk mitigation (funded and unfunded) is provided directly to an SPV to cover the credit risk (usually first loss risk) of the securitized portfolio. The aim of the amendment would be to grant a benefit to noteholders or lenders of the SPV by providing them with the possible recognition of credit risk mitigations on their own exposures, which could be recognised in a commensurate capital relief.

Under the current framework, the SPV represents the legal owner of the receivables, which have been purchased by issuing securities or raising loans. Because the SPV is the legal owner of the receivables, it is formally also the only one entitled to the benefit of the credit risk mitigation. As a result, article 213 of the CRR, which regulates who can benefit from credit protection with respect to the prudential capital requirements, creates several challenges in ensuring that both, the noteholders (in case of securities) and the lenders (in case of loans), can benefit from the credit protection for the RWA computation. Consequently, we would recommend amending article 213 by specifying amongst the conditions for recognition of credit risk mitigation that the credit protection is feasible directly or via a bankruptcy remote SPV. Therefore, paragraphs 7(b) and 8 of Article 249 (Recognition of credit risk mitigation for securitisation positions) should be reviewed to enable to identify the "protected portion" of a securitisation position by not only looking at the part covered by partial guarantees provided directly on the note, but equally at the part which is assisted by eligible credit risk mitigation covering the SPV's securitized portfolio. This amendment would allow noteholders (or lenders) to benefit from a prudential perspective, not only from credit protection that covers directly their notes (or loans in case of lenders), but also indirectly from credit protection that covers the underlying exposures of the securitisation portfolio. This would be justified where noteholders (or lenders) can benefit from the credit protection from an economic point of view in case the portfolio incurs losses.

Proposed amendments to CRR
Article 213 CRR
Requirements common to guarantees and credit derivatives

"1. Subject to Article 214(1), credit protection deriving from a guarantee or credit derivative shall qualify as eligible unfunded credit protection where all the following conditions are met:

(a) the credit protection is direct **or via a bankruptcy remote SPE;**"

Art 249 (6)(b) CRR

Recognition of credit risk mitigation for securitisation positions

"6. Where a securitisation position benefits from full credit protection or a partial credit protection on a pro-rata basis, the following requirements shall apply:

(...)

(b) the institution buying **or benefitting from** credit protection shall calculate risk-weighted exposure amounts for the protected portion of the position referred to in point (a) in accordance with Chapter 4.

The credit protection from which the securitisation position could benefit shall be provided on the securitized portfolio or directly to the securitisation position."

Art 249 (7)(b) CRR

Recognition of credit risk mitigation for securitisation positions

"7. In all cases not covered by paragraph 6, the following requirements shall apply:

(...)

(b) the institution buying **or benefitting from** credit protection shall calculate risk-weighted exposure amounts for the protected portion of the position referred to in point (a) in accordance with Chapter 4. The institution shall treat the portion of the securitisation position not benefiting from credit protection as a separate securitisation position and shall calculate risk-weighted exposure amounts in accordance with Subsection 3, subject to paragraphs 8, 9 and 10."

The credit protection from which the securitisation position could benefit shall be provided on the securitized portfolio or directly to the securitisation position.

Art 249 (8) CRR

Recognition of credit risk mitigation for securitisation positions

"8. Institutions using the Securitisation Internal Ratings Based Approach (SEC-IRBA) or the Securitisation Standardised Approach (SEC-SA) under Subsection 3 shall determine the attachment point (A) and detachment point (D) separately for each of the positions derived in accordance with paragraph 7 as if these had been issued as separate securitisation positions at the time of origination of the transaction. **In case the credit protection is provided directly on the securitized portfolio, its attachment point (A) and detachment point (D) shall be applied to identify the protected portion of the securitisation position.** The value of K IRB or K SA , respectively, shall be calculated taking into account the original pool of exposures underlying the securitisation."

1.1.2. Recalibrate the capital treatment for securitisation tranches under Solvency II

One of the main problems that has prevented EU securitisations from growing has been the capital treatment applied to insurers under Solvency II. To re-incentivise the participation of this large investor base, we would welcome if policymakers could recalibrate the capital treatment applied, in particular for investment grade mezzanine tranches of STS securitisations. Another advantage of reviewing the Solvency II calibration of securitisation capital would be to facilitate insurance companies to invest in safer senior tranches instead of investing directly in the underlying illiquid assets, where there is no credit enhancement. Thus, the spread risks applied to senior STS securitisation positions could be aligned with those applied to bonds and loans. Consequently, we recommend amending the title in such a way that the risk factors designed for bonds and loans under the current framework also apply to STS senior tranches. Following from that, Article 178 (3) currently applying to STS senior tranches should be deleted.

Proposed amendments to Solvency II
Article 176 of Commission Delegated Regulation (EU) 2015/35
We recommend amending the title of Article 176 as follows: "Spread risk on bonds, and loans and STS senior tranches "

1.2. Adjust the Significant Risk Transfer Assessment (SRT) process

Despite the 2014 EBA guidelines on the supervisory practices overseeing SRT transactions, there is still need for greater harmonisation of the practice across the EU. Because of that, divergent interpretations by competent authorities/JST teams around certain SRT requirements remain. With the advent of a more centralised supervisory system via the SSM, there is an opportunity to further harmonise the practice across the EU and provide market participants with more clarity around certain technical requirements, and predictability in the overall process. Some concrete measures that policymakers could consider are the following:

1. The EBF supports the proposal to adopt a delegated act harmonising the process and grounds for SRT assessments, thereby removing the supervisory uncertainties and inconsistencies experienced in the market.
2. Provide market participants with further FAQs with respect to the regulatory requirements relating to securitisations, particularly for new and innovative securitisations (i.e. how does a buy-to-let portfolio meet the requirements of a "mixed pool"). To complement this, it would also be welcome if the EBA was also in a position to provide bilateral information on regulatory requirements to market participants to ensure requirements are met in a timely manner. Of course, this also concerns securitisations for which no SRT is sought and should be seen as important for those securitisations as well. However, in the context of the SRT, this is particularly acute, because a lack of clarification prolongs the process of SRT approval and makes it more unpredictable and more complex.
3. Clarify in Art 244 CRR the supervisory discretion to use qualitative criteria in the SRT assessment. At present, it is unclear how supervisory discretion should function alongside the quantitative criteria outlined in Article 244 (2) of the CRR. This will ensure a more predictable outcome for market participants, while also ensuring a more streamlined assessment. In addition, we would welcome if policymakers could clarify the cases in which

competent authorities can undertake an ex-ante SRT assessment if CRR criteria are already met.

Moreover, we would like to state that the report of the EBA from November 2020 on the SRT is a welcome step in the right direction. However, some of the existing obstacles related to the SRT are not yet sufficiently addressed and in some respects those recommendations would make the SRT recognition even more difficult in comparison to the current status quo. Some structure topologies and features could preclude reducing the economic effectiveness of securitisation originated for capital relief purposes. In our view, this should not be the objective of the regulation. Therefore, we recommend a continued interaction with the banking industry with a focus on the more technical part, most notably, on the following aspects: (i) the definition of safeguards, (ii) the allocation of lifetime expected loss (LTEL) and unexpected loss (UL) to tranches, (iii) SRT/CRT tests, (iv) the framing of the process, (v) banks' self-assessment, (vi) the definition of synthetic excess spread, and (vii) the eligibility of collateral.

1.3. Upgrade the HQLA eligibility of senior tranches

As initially envisaged by the Commission, the STS label should have provided an "upside" in terms of LCR recognition for STS securitisations, rather than create a "downside" for the non-STS market segment. Until recently, all senior tranches of securitisations, subject to specific liquidity-related criteria, were eligible as HQLA assets.

In July 2018, the Commission published the final text of revisions to the LCR Delegated Act (applicable as of April 30, 2020), which has fallen short of providing a proper treatment of senior STS tranches of securitisations. Senior STS tranches are classified as Level 2B assets, with an associated 25%/35% discount, whereas covered bonds may qualify as high as HQLA level 1 assets ("extremely high quality") or level 2A ("high quality") which, for an equal issue size and rating, reduces relative demand for securitisations from bank treasuries (see appendix 2 for comparison of asset-based securities: covered bonds vs. securitisation). In addition, non-STS positions have been fully disallowed from Level 2B, creating a cliff effect for positions previously held in bank treasuries. Furthermore, after the regulatory change, eligible ABS securitisation positions are required to be assigned a credit assessment of the highest quality of assets (Credit Quality Step (CQS) 1) issued by a nominated External Credit Assessment Institution (ECAI) on the basis of Article 264 of Regulation (EU) 2017/2401 and no longer based on Articles 251 (Standardized Risk Weights) or 261 (Rating Based approach) of the previous version of the CRR. Pursuant to Article 264 and also on the basis of the clarification of the credit quality steps provided by the EBA in the Q&A (2018_4274) published in January 2019, the applicable required CQS 1 would be equivalent to a AAA rating assessed by two different ECAI.

This modification has further increased the disproportionate treatment of securitisations that need to be rated AAA at senior level and be STS to be considered Level 2B while covered bonds, for the same Level, do not have to comply with any minimum CQS limit. A concrete remedy to this issue would be to promote STS senior tranches to Level 1 (for residential and auto loans, which are the most liquid types of securitisation) and Level 2A (SME loans and other consumer loans) under the LCR, and to allow qualifying non-STS securitisations to classify as Level 2B, with haircuts aligned to those applying to covered bonds (see appendix 2). This would send a strong positive signal and encourage further investment. Such a treatment would remain prudent compared to the ECB collateral eligibility rules, which apply a 5% haircut on the best ABS categories. It should also be highlighted that this view is shared by the European Parliament which stated, in its September 2020 report on further development of the CMU, that amendments to the EU

securitisation package could include “the realignment of the treatment of cash and balance-sheet synthetic securitisations and of regulatory capital and liquidity with that of covered bonds and loans”. To reflect these proposed changes, we would recommend amending the regulation accordingly.

Lastly, it should be considered to also extend the HQLA eligibility to a wider set of tranches, i.e. tranches with a BBB- rating, if supported by quantitative evidence or increase their Level to 1 under certain specific circumstances as applicable to covered bonds.

To ensure further alignment of the HQLA requirements for securitisations with those of the HQLA rules for covered bonds, a few targeted changes would need to be introduced to Article 13 of the LCR on level 2B assets, as illustrated in the below draft proposals for Article 13. The three suggested amendments would have the following effect:

1. Amendment of paragraph 2 (a) of the Corrigendum: This amendment would ensure that external rating criteria for STS securitisations would be the same as for level 2B covered bonds (minimum external rating set at BBB-). Therefore, the proposal would be to change the constraining CQS requirement for STS securitisations. In this context, no less than BBB- rating implies CQS no less than 10 given the reference to Article 264 of CRR amendment (EU) 2017/2401 that applies to securitisations.
2. In addition to STS-only criteria, the second amendment to article 13 would add the criteria of the former Article 13 (as per Delegated Regulation (EU) 2015/61) for securitisations, i.e. the criteria for securitisations regardless of STS compliance. This is including the original external ratings criteria (no less than AA-) as opposed to the upwardly revised external rating requirement of “Corrigendum” (EU) 2018/1620 which is AAA only. Given the reference to Article 264 of the CRR amendment (EU) 2017/2401 that applies to securitisations, AAA corresponds to CQS1 – only while no less than AA – rating corresponds to a CQS no less than 4.
3. The last amendment for Delegated Regulation applicable to LCR proposes a unique haircut for Level 2B securitisations that would match the one applicable to Level 2B covered bonds

Proposed amendments to LCR	
Article 10 of Delegated Regulation (EU) 2015/61	
Level 1 assets	
<p>“1. Level 1 assets shall only include assets falling under one or more of the following categories and meeting in each case the eligibility criteria laid down herein:</p> <p>(...)</p> <p>(h) exposures in the form of asset-backed securities where the following conditions are satisfied:</p> <p style="padding-left: 40px;">(i) the designation ‘STS’ or ‘simple, transparent and standardised’, or a designation that refers directly or indirectly to those terms, is permitted to be used for the securitisation in accordance with Regulation (EU) 2017/2402 of the European Parliament and of the Council and is being so used;</p> <p style="padding-left: 40px;">(ii) the position has been assigned a credit assessment by a nominated ECAI which is at least credit quality step 4 in accordance with Article</p>	

264 of Regulation (EU) No 2017/2401 or the equivalent credit quality step in the event of a short term credit assessment;

- (iii) the issue size of the tranche shall be at least 500 million (or the equivalent amount in domestic currency);**
- (iv) the criteria laid down in the following paragraphs of Article 13 are met:**
 - a. paragraph 2 with the exception of (iii) and (v) of paragraph (g)**
 - b. paragraphs 10, 12 and 13**

2. The market value of extremely high-quality covered bonds **and extremely high quality asset-backed securities** referred to in paragraphs 1(f) **and 1(h)** shall be subject to a haircut of at least 7%. Except as specified in relation to shares and units in CIUs in points (b) and (c) of Article 15(2), no haircut shall be required on the value of the remaining level 1 assets"

Article 11 of Delegated Regulation (EU) 2015/61

Level 2A assets

"(f) exposures in the form of asset-backed securities where the following conditions are satisfied:

- (i) the designation 'STS' or 'simple, transparent and standardised', or a designation that refers directly or indirectly to those terms, is permitted to be used for the securitisation in accordance with Regulation (EU) 2017/2402 of the European Parliament and of the Council and is being so used;**
- (ii) the position has been assigned a credit assessment by a nominated ECAI which is at least credit quality step 7 in accordance with Article 264 of Regulation (EU) No 2017/2401 or the equivalent credit quality step in the event of a short term credit assessment;**
- (iii) the issue size of the tranche shall be at least 500 million (or the equivalent amount in domestic currency);**
- (iv) the criteria laid down in the following paragraphs of Article 13 are met:**
 - a. paragraph 2 with the exception of (i) (ii) and (iv) of point (g)**
 - b. paragraphs 10, 12 and 13"**

Article 13 of Commission Delegated Regulation (EU) 2018/1620

Level 2B securitisations

Paragraph 2 (a) of the Corrigendum to be amended as follows:

"the position has been assigned a credit assessment by a nominated ECAI which is at least credit quality step 10 in accordance with Article 264 of Regulation (EU) 2017/2401 or the equivalent credit quality step in the event of a short-term credit assessment".

Paragraph 2(a) of article 13 (from (EU) 2015/61) would become:

“the position has been assigned a credit assessment by a nominated ECAI which is at least credit quality step 4 in accordance with Article 264 of Regulation (EU) 2017/2401 or the equivalent credit quality step in the event of a short-term credit assessment”.

Former paragraph 14 of Article 13 mentioned above to be replaced as follows:

“the market value of each of the Level 2B asset-backed securities shall be subject to a haircut of at least 30%”.

1.4. Adjust the transparency requirements in the Securitisation Regulation (Regulation 2017/2402) under Art 7

Originators, sponsors and securitisation special purpose entities (SSPEs) must make available to holders of a securitisation position, competent authorities and, upon request, to potential investors, certain information on the transaction and underlying exposures.

The relating ESMA templates are extremely granular, prescriptive and rigid. Although they have been simplified in January 2019 notably for ABCPs, they continue to apply to both public and private transactions, penalising the less standardised private market. Securitisation market participants have faced major difficulties in achieving the new standard because of very substantial additional information required to be made available, beyond long-standing market practices as required by investors and rating agencies. This is particularly pressing for less sophisticated issuers, and in particular for corporates who rely upon private securitisation to finance trade receivables – an important source of funding for the real economy. Achieving complete compliance across all market sectors and asset classes is not possible as a practical matter. Therefore, disclosure templates should be adapted to various asset classes and unrealistic expectations should be eliminated, based on an open dialogue with market practitioners. Indeed, the critical information is currently diluted and may thus not be given the required attention.

The disclosure requirements for private transactions should be reviewed. The goal should be to gain a better understanding of which disclosures actually deliver an added value to the investor and which do not. To improve the quality of the disclosures, it could be useful to reflect to what extent an alignment with the disclosure requirements in the covered bond framework could be a meaningful remedy. In the same vein, it would make sense to apply an exemption to private transactions where the investor is directly involved in deciding the fields that are reported by the originator, which will already guarantee that the investor has all the necessary information to perform due diligence. This is the case for bilateral private transactions in particular. Moreover, an exemption for private transactions without a third-party investor, as also suggested by the ESAs in their “Joint Committee report on the implementation and functioning of the securitisation regulation (Article 44)”¹⁶, would eliminate a reporting requirement that is not useful. The recommendation of the ESAs report to register all private securitisation in a securitisation repository should be reconsidered, since all private securitisations would have to comply with the ESMA templates, which is incompatible with the bespoke reporting that is used in bilateral transactions. Also, it should be considered that in those transactions, investors and competent authorities already receive this information. Therefore, the added value may be limited considering the significant additional operational burden.

¹⁶ ESA’s Joint Committee report on the implementation and functioning of the securitisation regulation (Article 44), 17 May 2021, page 29/30

In the meantime, the European Commission could clarify that the extensive disclosure and due diligence requirements imposed on securitisations are actually to be met only for public transactions, and more specifically should encourage ESMA to: (a) differentiate disclosure requirements for public securitisations and for private cash and synthetic securitisations; (b) establish the principle of proportionality in the application of disclosure and due diligence requirements; and (c) allow permanently for long-term use of ND (no data available) fields and for a transition period for the reduction, if practically achievable, of ND fields. Such flexibility may be achieved through issuing an interpretative communication specifying that the disclosure requirements developed under Articles 7.3 and 7.4 of Regulation (EU) 2017/2402 will apply only to securitisations with a prospectus drawn up in compliance with Directive 2003/71/EC. The originator, sponsor and SSPE of a securitisation without a prospectus drawn up in compliance with Directive 2003/71/EC shall provide information under Article 7 (1) (a) of Regulation (EU) 2017/2402 required by the investor(s) in such securitisation and deemed by such investors sufficient to perform due diligence on the securitisation exposures proportionate with its risk profile.

Regarding the due diligence requirement in Article 5 (1) (d), to check that “if established in a third country, the originator, sponsor or original lender retains on an ongoing basis a material net economic interest which, in any event, shall not be less than 5 %, determined in accordance with Article 6”: a good solution would be to introduce an equivalence regime, where an EU-regulated investor will be able to hold a securitisation position in a third-country securitisation compliant with the local regulation on risk retention, provided that the third country applies prudential and supervisory regulation at least equivalent to those applied in the Union (equivalence to be established by the European Commission).

Regarding the due diligence requirement of Article 5(1)(e), to check that “*the originator, sponsor or SSPE has, where applicable, made available the information required by Article 7 in accordance with the frequency and modalities provided for in that Article*”, the ESA opinion seemed to recently clarify that it is sufficient if an EU-regulated investor in third-country securitisations receives the same information as required by the ESMA template to meet the requirements to carry out their due diligence obligation proportionate to the risk profile of the securitization exposure, without having necessarily received the ESMA Templates. However, this is an issue for the EU banks entering into third country securitisations. While the investors do receive asset-level data, those third country sell-side parties are unlikely to be willing to provide additional information which is not produced or used by that originator in its business. Therefore, this represents an existential issue for the non-EU securitisation lending businesses of EU lenders. If the wording were to be clarified to require detailed reporting in the form of the EU templates, or to require provision of information in relation to all the data fields in those templates, this will clearly put EU lenders at a competitive disadvantage. Article 5 (1) (e) should be therefore amended accordingly:

Proposed amendments to the Securitisation Regulation
Article 5 (1) Securitisation Regulation
Due-diligence requirements for institutional investors
(...)
(e) <u>if established in the Union</u> , the originator, sponsor or SSPE has, where applicable, made available the information required by Article 7 in accordance with the frequency and modalities provided for in that Article. <u>If established in a third country, the originator, sponsor or SSPE has, where applicable, made available asset-level data such that the investor can do its own due-diligence, but the originator,</u>

sponsor or SSPE shall not need to provide the full list of data as required by the ESMA template;

It should be highlighted that the European Parliament has also identified that a revisiting of those requirements may be necessary. In its September 2020 report on further development of the CMU, it asked for “a review of the disclosure and due diligence requirements for third-party securitisation, covered bonds, and simple, transparent and standardised (STS) securitisation”.

1.5. Facilitating the application of the STS framework for ABCP conduits

The Securitisation Regulation (EU 2017/2402) covers ABCP in Section 2. Art 24 (Transaction-level requirements) provides the STS criteria for ABCP transactions. An unknown number of ABCP transactions has qualified as STS, because the ESMA website notifications are overstating the real number, since for transactions with multiple ABCP conduits involved, each will notify individually.

Art 25 (Sponsor of an ABCP programme) and 26 (Programme-level requirements) have to be complied with in order to qualify according to Art 23 as an STS ABCP programme.

As of now, no European ABCP Conduit (there are 15-20 of them active) has applied for STS status and most of the sponsors have indicated not to be able to meet the STS requirements. The main issues that prevent the STS qualification for ABCP Conduits are:

- Art 26 (1): all transactions (with a 5% temporary carve-out for a few requirements) should fulfil the STS criteria at transaction level
- Art 26 (2): the remaining weighted average life (WAL) should be < 2 year

In both cases a much wider carve out should be available: many ABCP transactions may fall short on criteria like homogeneity, no defaulted assets, or historic data, while still being transactions with a good credit profile. Also, the WAL calculation is difficult or providing counter-intuitive results for certain asset classes (like credit cards, revolving consumer loans etc.)

Furthermore, it should be taken into account that the (high) costs of making a Conduit STS are for the account of the sponsor, while the benefits are for the (CP-)investor through lower capital requirements and/or the seller, by way of lower funding costs.

We propose to amend Art 26.1 and 2 in a way that only 50% of the transactions should be STS and for only 50% of the transactions the average WAL should be < 2 year.

1.6. NPEs and securitisation

1.6.1 General considerations on NPE securitisations

In June 2020, the Basel Committee on Banking supervision (BCBS) published for consultation a technical amendment on the capital treatment of securitisations of non-performing loans. According to the BCBS, securitisations of NPEs are subject to different risk drivers compared to securitisations of performing assets. As a result, the proposed amendment established a 100% risk weight for certain senior tranches of NPEs securitisations while the risk weights applicable to the other positions should be determined by the existing hierarchy of approaches, in conjunction with a 100% risk weight floor and a ban on the use of certain inputs for capital requirements. Since then, EBF argued that the Basel proposal seemed to be rather conservative, not risk sensitive

and not fully aligned with the EBA Opinion recommending to remove regulatory obstacles to NPE securitisation leaving them at a considerable capital disadvantage.

The adaptation of the BCBS text in the EU Regulation¹⁷, has shown some improvements but still misses the general goal to consider the specific characteristics of the securitisations of NPEs when capital requirements are determined. Indeed, treating such transactions in a similar way to a securitisation of performing loans (and consequently applying the same p- factor of SEC-IRBA and SEC-SA defined for performing transactions) ends up penalizing excessively the former.

Nonetheless, the final text does not appear fully in line with the objective of encouraging securitisations of NPEs. Even if the capping mechanism for senior notes may allow in the short term some intuitions to benefit from capital savings, on the long run, EBF believes that an overall risk sensitive review of the framework leveraging on the EBA's expertise and opinion and including also all the other NPE securitisation notes (Junior and Mezzanine) is needed. Furthermore, in detail, the final text of the Capital Markets Recovery Package (CMRP) displays the following points that need to be addressed:

1. A 100% floor to the RW of NPE securitisation positions is a potential further conservative and non-risk sensitive measure that goes in the opposite direction to the original rationale of the framework and should be removed.
2. Furthermore, the formula proposed in Art. 269a (6) for the RW corridor 50% - 100% on senior tranches seems to be not so effective as it is very common to end up on the upper bound. Moreover, the introduction of a floor of 50% applicable to the senior tranche could be extremely conservative in some cases like UTP securitisations. Finally, use of the formula in Art. 269a (6) should be available to originators, sponsors and investors.
3. It's also important that the 50% threshold foreseen for the NRPPD in order to define a qualifying traditional NPE securitisation is brought down to a range of 20% - 30% to include the whole spectrum of non-performing transactions (i.e. UTP securitisations). As second-best alternative, at least Article 269a (6) should be applicable to "non-qualifying" NPE securitisation too. This is necessary for the originator to avoid the situation of having post-securitisation capital requirements significantly higher than pre-securitisation ones, for a sponsor to be able to hold an appropriate level of capital for the risk it retains and enable institutional investors to facilitate sale of NPE portfolios by banks at resilient prices and so mitigate additional adverse impact on such banks' capital.
4. The mechanics that need to be applied to compute over time the amount of NRPPD generate ambiguity and further costs for NPE securitisations originators. Keeping in mind the extreme granularity of common NPE portfolios, it would be very complicated to set up the activity to track loan by loan the realised losses, particularly on existing securitisations where contracts with servicers are already in place. Moreover, the reason why only losses should be considered while profits seem to be discarded is unclear.

¹⁷ Regulation (EU) 2021/558 of the European Parliament and of the Council of 31 March 2021 amending Regulation (EU) No 575/2013 as regards adjustments to the securitisation framework to support the economic recovery in response to the COVID-19 crisis.

5. Explicit exclusion of securitised exposures and securitisation tranches from the minimum loss coverage requirement introduced by Regulation (EU) 2019/630 ("The NPL backstop regulation"), amending Article 47a CRR.
6. Some technical adjustments are needed to the paragraph that rules the application of SEC-IRBA when the NPE securitized portfolio is treated with Foundation approach. Based on the current text the presence of one single exposure in the portfolio seems to be sufficient to disqualify the securitisation from the application of SEC-IRBA. It would be instead more meaningful to require only to disregard the portion of the portfolio treated with the Foundation approach, considering to be analogous to the Standard approach, for the purpose of the minimum 95% IRB requirement of SEC-IRBA.

The main conclusion is the need, as suggested also by the EBA's Opinion, of an ad-hoc parametrization of SEC-IRBA and SEC-SA formulae for NPE securitisations in order to be able to provide more meaningful and risk-sensitive Risk Weighted Assets.

Another improvement that should be made is allowing banks that apply the standardized approach on their investor positions in securitisation to benefit from the cap as per article 268 to ensure a level playing field with IRB Banks. This would be particularly beneficial for investor position in NPE securitisations, both directly or through funds (for example the Italian Recovery Fund, so called Atlante), and aligned with the spirit of the overall reform aimed at reducing the burdensome capital requirement of NPE securitisations to strengthen the post-Covid-19 recovery.

Proposed amendments to CRR
Article 269a CRR
<p>Treatment of non-performing exposures (NPE) securitisations</p> <p>"2. The risk weight for a position in an NPE securitisation shall be calculated in accordance with Article 254 or 267. The risk weight shall be subject to a floor of 100%, except when Article 263 is applied.</p> <p>(...)</p> <p>4. Institutions that apply the IRB Approach to any exposures in the pool of underlying exposures in accordance with Chapter 3 and that are not permitted to use own estimates of LGD and conversion factors for such exposures shall not use the SEC-IRBA for the calculation of risk-weighted exposure amounts for a position in an NPE securitisation and shall not apply paragraph 5 or 6 not consider them as IRB when computing the percentage of the underlying exposure amount for which the institution is able to calculate K_{IRB} in accordance with article 258 (1) (a) for the calculation of risk-weighted exposure amounts for a position in a traditional NPE securitisation. For purposes of using the SEC-IRBA for a position in an NPE securitisation or to apply paragraph 5 and 6, the capital requirement of such exposures would be calculated under the Standardized Approach foreseen in Chapter 2.</p> <p>5. For the purposes of Article 268(1), expected losses associated with exposures underlying a qualifying traditional NPE securitisation shall be included after deduction of the non-refundable purchase price discount and, where applicable, any additional specific credit risk adjustments. By way of derogation from paragraph 1 of Article</p>

268, this paragraph applies also to other institutions using the SEC-SA or the SEC-ERBA for a securitisation position in a traditional NPE securitisation.

(...)

6. By way of derogation from paragraph 3 of this Article, where the exposure-weighted average risk weight calculated in accordance with the look-through approach set out in Article 267 is lower than 100 %, institutions may apply the lower risk weight, subject to a **50 15** % risk-weight floor.

For the purposes of the first subparagraph, originator, **sponsor and investor** institutions that apply the SEC-IRBA to a position and that are permitted to use own estimates of LGD and conversion factors for all underlying exposures subject to the IRB Approach in accordance with Chapter 3, shall deduct the non-refundable purchase price discount and, where applicable, any additional specific credit risk adjustments from the expected losses and exposure values of the underlying exposures associated with a senior position in a **qualifying** traditional NPE securitisation, in accordance with the following formula:”

With regards to the NPL backstop regulation, the following CRR articles must be amended to explicitly clarify that securitised exposures and securitisation tranches are out of scope from this NPL backstop requirement:

Proposed amendments to CRR
Article 247 (1) CRR
<p>Calculation of risk-weighted exposure amounts</p> <p>“1. Where an originator institution has transferred significant credit risk associated with the underlying exposures of the securitisation in accordance with Section 2, that institution may:</p> <p>(a) in the case of a traditional securitisation, exclude the underlying exposures from its calculation of risk-weighted exposure amounts, and, as relevant, expected loss amounts and minimum loss coverage requirement in accordance with Article 47a;</p> <p>(b) in the case of a synthetic securitisation, calculate risk-weighted exposure amounts, and, where relevant, expected loss amounts, with respect to the underlying exposures in accordance with Articles 251 and 252. In this case, the securitised exposures are also excluded from the minimum loss coverage requirement in accordance with Article 47a.</p>

Proposed amendments to CRR
Article 47a (1) CRR
<p>Non-performing exposures</p>

"1. For the purposes of point (m) of Article 36(1), exposure shall include any of the following items, provided they are not included in the trading book of the institution:

(a) a debt instrument, including a debt security, a loan, an advance and a demand deposit;

(b) a loan commitment given, a financial guarantee given or any other commitment given, irrespective whether it is revocable or irrevocable, with the exception of undrawn credit facilities that may be cancelled unconditionally at any time and without notice, or that effectively provide for automatic cancellation due to deterioration in the borrower's creditworthiness.

Exposures to securitisation tranches are out of scope of this term 'exposure' for the purpose of Article 36(1)(m)."

The Regulation (EU) 2021/557 amending the Securitisation Regulation concerns credit granting criteria for the underlying exposures that are NPE at the time the originator purchased them from the relevant third party. We believe that this provision could be improved, by excluding all NPE securitisations from the observance of the credit granting criteria. This should be done based on the consideration that a third-party investor is totally aware of the defaulted status of the underlying portfolio and it is not affected by the credit policies that were applied in the credit granting phase.

Proposed amendments to the Securitisation Regulation

Article 9 (1) Securitisation Regulation

"The requirement set out in this paragraph shall not apply ~~By way of derogation from the first subparagraph, with regard~~ to underlying exposures that are non-performing exposures as referred to in Article 47a(3) of Regulation (EU) No 575/2013 ~~at the time the originator purchased them from the relevant third party, sound standards shall apply in the selection and pricing of the exposures~~"

1.6.2 The case of Unlikely-To-Pay (UTP) exposures

One drawback of the new rules on NPE securitisation is associated with exposures that are classified as Unlikely to pay (UTP) exposures, which might not fall under the definition of "qualifying traditional NPE securitisation" under Article 269a (1b) as their characteristics are very different to other NPEs. Broadly speaking, UTP loans refer to customers who are facing temporary difficulty and the bank evaluates that it is unlikely, without the liquidation of the collateral, that the customer fulfils her/his obligation. This assessment will be done before the explicit anomaly (failed repayment) has occurred as long as there are elements implying a likely risk of the obligor's default. Generally, as a result of the Covid-19 crisis it is expected that there will be a significant increase of exposures that banks will classify as UTP.

In line with the above, UTP loans are characterized by lower discount prices than doubtful exposures (which have lower recovery expectations) when they are sold, given that UTPs may migrate to the bonis (or to doubtful) status. The NRPPD for UTPs might likely be below the 50% threshold introduced by the Capital Markets Recovery Package and is usually in the range of 20% to 30%. The fact that UTPs have lower discounts, which in turn results

in higher prices for investors, is justified by the higher recovery rates for those exposures¹⁸. Consequently, the NRPPD threshold of 50% for qualifying traditional securitisation, which may have been set with only doubtful exposures in mind, excludes UTP exposures from the treatment provided by the new rules. Conversely, the 20% NRPPD proposed by the EBA in their opinion on NPE securitisation would allow to apply the new rules also to UTPs. In particular, it should be allowed also for UTP securitisations that the Expected Loss Best Estimate (ELBE) can be reduced by the NRPPD, whatever its level is, both for the calculation of the maximum capital requirement and the maximum risk weight on the senior tranche.

Furthermore, it is also important to ensure that the NPE securitisation rules apply to UTP loans, as UTPs also reported in line with the relevant regulatory standards¹⁹ and, consequently, need to be included and reported in the NPE ratio of banks. Ultimately banks will have to implement NPE strategies in line with the EBA Guidelines on management of non-performing and forborne exposures (EBA/GL/2018/06)²⁰ in case the NPE ratio exceeds 5%. Therefore, it would only be consistent to ensure that banks can resolve UTPs through the means of securitisation. Finally, to avoid regulatory arbitrage, it should be clarified that the treatment set out in article 269a (1b) and (6) only applies to exposures which have been formally marked as UTPs in line with the relevant bank's credit underwriting standards.

Proposed amendments to CRR	
Article 269a (1) CRR	
Treatment of non-performing exposures (NPE) securitisations	
<p>"1. For the purposes of this Article:</p> <p>(a) "NPE securitisation" means an NPE securitisation as defined in point (25) of Article 2 of Regulation (EU) 2017/2402;</p> <p>(b) "qualifying traditional NPE securitisation" means a traditional NPE securitisation where the non-refundable purchase price discount is at least 50 20% of the outstanding amount of the underlying exposures at the time they were transferred to the SSPE."</p>	

1.6.3 The definition of non-refundable purchase price discount

The definition of "non-refundable" requires that the discount is not structured in a way that it can be refunded to the originator. The wording of this definition should be adjusted to make it clear that a purchase price discount is also non-refundable if (i) the nominal of all issued tranches are assumed to be equal²¹ or lower than the sale price of the portfolio, i.e. depending on provisions already booked, the originator incurs a corresponding loss in this amount and (ii) the potential unexpected upside, defined as excess/variable return, might, however, be distributed to the originator/original lender if it holds the junior tranche.

¹⁸ Those rates are also regularly reported to the regulators

¹⁹ Cf. EBA Implementing Technical Standards on Supervisory Reporting amendments with regards to FINREP, Annex 5, paragraph 213

²⁰ EBA Guidelines on management of non-performing and forborne exposures (EBA/GL/2018/06)

²¹ In practice, the sum of all tranche nominals might be higher than the purchase price due to additional costs such as legal costs.

The rationale is that the potential unexpected upside is not included in the nominal of the junior tranche, i.e. legally, there is no claim over variable returns by junior noteholder. In addition, the treatment is aligned to the regulatory intention of the rules as due to the loss incurred by the originator/original lender, the remaining loss risk for all tranches is reduced in this amount, and the NRPPD can be treated akin to a specific credit risk adjustment, see e.g. the reduction of the EL that is allowed in certain circumstances.²²

Furthermore, this treatment is also aligned to the example in the EBA opinion on NPE securitisations.²³ This clarification as proposed above is important, especially for cases where a third party purchases the NPE exposures and subsequently securitises them since it is common that the risk retention is undertaken through a first loss tranche.

Proposed amendments to CRR
Article 269a (7) CRR
<p>Treatment of non-performing exposures (NPE) securitisations</p> <p>"7. For the purposes of this Article, the non-refundable purchase price discount shall be calculated by subtracting the amount referred to in point (b) from the amount referred to in point (a):</p> <ul style="list-style-type: none"> (a) the outstanding amount of the underlying exposures of the NPE securitisation at the time those exposures were transferred to the SSPE; (b) the sum of the following: <ul style="list-style-type: none"> (i) the initial sale price of the tranches or, where applicable, parts of the tranches of the NPE securitisation sold to third party investors; and (ii) the outstanding amount, at the time the underlying exposures were transferred to the SSPE, of the tranches or, where applicable, parts of tranches of that securitisation held by the originator. <p>(...)</p> <p>Where a discount is structured in such a way that it can be refunded in whole or in part to the originator, such discount shall not count as a non-refundable purchase price discount for the purposes of this Article. In case the originator or the original lender retains a first loss tranche which entitles the retainer to benefit from variable returns, the discount shall be considered non-refundable if such variable return was unexpected at the time the tranches were issued. In any case, the discount shall be deemed to be non-refundable if the amount computed under point (b) of this Article was equal or lower than the sum of the initial outstanding amount of all the tranches issued."</p>

²² EBA Opinion on NPE securitisations explains that the beneficial treatment is granted to reflect the RWA treatment of the securitised pool if they had not been securitised by "taking into account that the underlying exposures are transferred at inception to a securitisation SPV and the transfer at a discount has the effect of writing off the underlying exposures' expected losses and leaving a residual value subject to the risk that recoveries may be insufficient to repay that residual value (unexpected losses). For direct exposures under IRBA, purchase price discounts for defaulted exposures are treated akin to specific credit risk adjustments, i.e. are used to reduce the EL (see Art. 159 CRR).

²³ See figure 13 in the EBA Opinion on NPE securitisations

The same question arises for the definition of “non-refundable purchase price discount” for the purpose of the beneficial treatment for calculating the risk retention amount, i.e. based on the purchase price in case of a non-refundable purchase price discount vs. the nominal amount of the securitised portfolio. Art. 2, point (31) Securitisation Regulation provides a similar definition compared to the CRR definition above for the term of ‘non-refundable purchase price discount’:

Proposed amendments to the Securitisation Regulation
Article 2 Securitisation Regulation
<p>“(31) ‘non-refundable purchase price discount’ means the difference between the outstanding balance of the exposures in the underlying pool and the price at which those exposures are sold by the originator to the SSPE, where neither the originator nor the original lender are reimbursed for that difference. In case the originator or the original lender retains a first loss tranche which entitles the retainer to benefit from variable returns, the discount shall be considered non-refundable if such variable return was unexpected at the time the tranches were issued. In any case, the discount shall be deemed to be non-refundable if the initial sale price of the portfolio was equal or lower than the initial outstanding amount of the tranches issued.</p> <p>(32) “variable return” means the upside generated by any residual amounts a first loss tranche retainer can benefit from when the principal and interest amount of all tranches have been fully redeemed.”</p>

1.6.4 Loan loss provisioning in a securitisation: the case of synthetic securitised portfolios

It is not clear in Regulation EU 2019/630 whether underlying portfolios of synthetic securitisation for which the originator has achieved SRT as per article 245 are in or out of scope of the minimum loss coverage requirement for non-performing exposures. It is not foreseen that an explicit exclusion of an underlying portfolio of synthetic securitisations for which SRT has been recognized would apply even if it would be coherent with the rest of the framework on provisioning. When the conditions of article 245 are fulfilled, the portfolio, even if still on the balance-sheet of the originator, is no longer subject to regulatory capital computation, with EL and RWA being substituted by the RWA of the tranches. The provision by which SRT is allowing the originator to exclude from the capital requirement the underlying portfolio EL (also any eventual shortfall) and RWA should be explicitly extended also to the minimum loss coverage. This would be also coherent with the fact that synthetic securitized pools are not subject to credit risk adjustments in case the first loss piece (FLP) coverage provided by protection sellers is sufficiently thick. A clarification reference should be added in article 245 specifying that the underlying portfolio is excluded from the scope of this minimum loss coverage requirement.

Proposed amendments to CRR

Article 251 CRR

Originator institutions' calculation of risk-weighted exposure amounts securitised in a synthetic securitisation

1. For the purpose of calculating risk-weighted exposure amounts for the underlying exposures, the originator institution of a synthetic securitisation shall use the calculation methodologies set out in this Section where applicable instead of those set out in Chapter 2, **the minimum loss coverage requirement shall be zero**. For institutions calculating risk-weighted exposure amounts and, where relevant, expected loss amounts with respect to the underlying exposures under Chapter 3, the expected loss amount and **the minimum loss coverage requirement** in respect of such exposures shall be zero.

1.7. Additional points on synthetic securitisations

1.7.1 The definition of synthetic excess spread

The synthetic excess spread (SES) is a mechanism commonly used in the securitisation of certain asset classes for originators and investors to reduce the cost of protection and the exposure at risk, respectively. There are two types of synthetic excess spread: trapped excess spread and use-it-or-lose-it (UIOLI) excess spread²⁴. The difference is that trapped excess spread accumulates over a given number of periods, while UIOLI excess spread is lost after each period and goes back to the originator, unless it is used to absorb losses. According to market practice, future period is usually defined as a period of one year.

The Regulation (EU) 2021/558 amending CRR introduces specific rules for the synthetic excess spread, in order to avoid that it could be used for regulatory arbitrage purposes. While we agree with that objective, however the provision that the exposure value of a synthetic excess spread shall include, as applicable, also any synthetic excess spread contractually designated by the originator for future periods, appears too burdensome and could represent an obstacle for the development of the securitisation market. The consequence of this new provision, which was introduced in the context of the European Commission's Capital Markets Recovery Package, is that in a very conservative reading of Article 248(4) CRR, future period can be understood as the remaining lifetime of a securitisation transaction. The novelty of the Capital Markets Recovery Package is that originators must now hold capital against SES, which will lead to a very significant increase of capital requirements for the originator institution. The result of this legislative change is that there will be a double counting of reserves. Because the SES is used to cover the expected loss, it is already covered by provisions. The capital requirement will be on top of that. This is exacerbated by the fact that there is no limit on the future periods, which means that this double counting will extend to the lifetime SES.

This new requirement will also apply to all synthetic securitisations, regardless of whether or not they qualify as STS. The change proposed by the EBF would clearly define future periods as a period of one year and therefore maintain the distinction between UIOLI and

²⁴ For an explanation of the two concepts, see the [EBA Report on Synthetic Securitisation](#), EBA/Op/2015/26, page 29

trapped excess spread. The impact of the new requirement is further elaborated in section 1.7.1.1 which demonstrates the impact in a set of case studies.

Lastly, it should also be kept in mind that committing too much excess spread has the potential to undermine the SRT process, because it will lead to a situation where “under no realistic scenario will the protection provider’s securitisation positions be eroded by losses, resulting in no effective risk transfer”²⁵. This has been identified as an obstacle to SRT by the EBA in their dedicated report, who then also recommends committing synthetic excess spread on a yearly basis.

Proposed amendments to CRR
Article 248 (1) (e)
<p>Exposure Value</p> <p>“(e) the exposure value of a synthetic excess spread shall, include, as applicable, the following:</p> <ul style="list-style-type: none"> (i) any income from the securitised exposures already recognised by the originator institution in its income statement under the applicable accounting framework that the originator institution has contractually designated to the transaction as synthetic excess spread that is still available to absorb losses; (ii) any synthetic excess spread contractually designated by the originator institution in any previous periods that is still available to absorb losses; (iii) any synthetic excess spread contractually designated by the originator institution for the current period that is still available to absorb losses; (iv) any synthetic excess spread contractually designated by the originator institution for future periods. <p>Where synthetic excess spread is made available on non-cumulative basis (i.e. use-it-or-lose-it-basis) per annum, the exposure value shall be capped at the per annum exposure value. Any synthetic excess spread should be equal or inferior to the expected loss.</p> <p>For the purposes of this point, any amount that is provided as collateral or credit enhancement in relation to the synthetic securitisation and that is already subject to an own funds requirement in accordance with this Chapter shall not be included in the exposure value.”;</p>

1.7.1.1 Case studies on synthetic excess spread: 4 real-world examples

As is explained above, the new capital requirement for the synthetic excess spread (SES) will have a significant impact on the economics of synthetic securitisation transactions. The SES requirement will apply to all synthetic securitisations and not only the ones qualifying for STS. A conservative reading of the regulatory text could result in very high capital charges for SES, since it can be understood to include lifetime expected SES, instead of the SES for a certain, limited period which would allow the originator to collect

²⁵ EBA Report on Significant Risk Transfer in Securitisation under Articles 244(6) and 245(6) of the Capital Requirements Regulation, EBA/Rep/2020/32, page 24

excess spread which has not been used to absorb losses after, for example, a period of one year.

The impact of this requirement is likely going to be significant and will impact the way originators have to structure their securitisations and will reduce the economic benefit up to the point that some securitisations may become uneconomical. The following real-world examples demonstrate the impact on different types of securitisations by comparing how those transactions would be structured for the purpose of maximizing the capital relief obtained for each synthetic securitisation transaction when accounting for the rules which have been adopted in the context of the Capital Markets Recovery Package. All the examples make use of use-it-or-lose-it excess spread. Some assumptions are made regarding potential guidance from the supervisor.

Case study 1: SME leasing

The first example (see figure 3) illustrates the impact on a securitisation of SME leasing exposures where the originator applies the capital/full deduct approach according to Article 245 (1)(b) CRR, where the originator can either apply a RW of 1250% to all retained securitisation positions or deducts them from their CET1 capital. The key point regarding the full deduct approach is that none of the retained tranches are subject to securitisation risk weights. Therefore, any measure that could be applied to mitigate the impact of the capital requirements for the SES (i.e. adjusting the attachment and detachment points in line with Article 256 CRR, or the STS RW floor for the senior tranche) will not be able to offset the impact of the new SES requirement.

The example shown here demonstrates a significantly reduced capital relief. Instead of an initial CET1 reduction of 88% the bank will only accomplish a capital relief of 54% under the new rules. More crucially, the deal becomes economically unviable for the originating bank.

Case study 2: Consumer

The second example (see figure 4) shows a securitisation based on a consumer portfolio for which SRT would be achieved. The initial transaction did not use any type of SES. Under the new rules, the inclusion of SES could justify amending the tranching of the securitisation structure, under the important assumption that both investors and the JST agree with the originator's assessment of credit enhancement and leverage levels.

In this example, the SES essentially replaces the first loss tranche, which allows the originator to amend the tranching of the mezzanine and senior tranche. Removing the first loss tranche should have a mitigating impact on the overall capital consumption of the retained securitisation positions of the transaction. Nevertheless, the actual capital requirements for the retained tranche, the senior tranche, are still too high because the senior tranche is increasing in size and cannot benefit fully from the new 10% STS RW floor. The new requirement to hold capital for the SES outweighs the benefits that would result from amending the tranching of the structure. Consequently, the capital relief obtained from this particular synthetic securitisation decreases from an initial capital relief of 73% of CET1 to a CET1 reduction of 54%. Taking this into consideration, the transaction is only just economically viable, thereby significantly reducing the incentives to execute such a transaction.

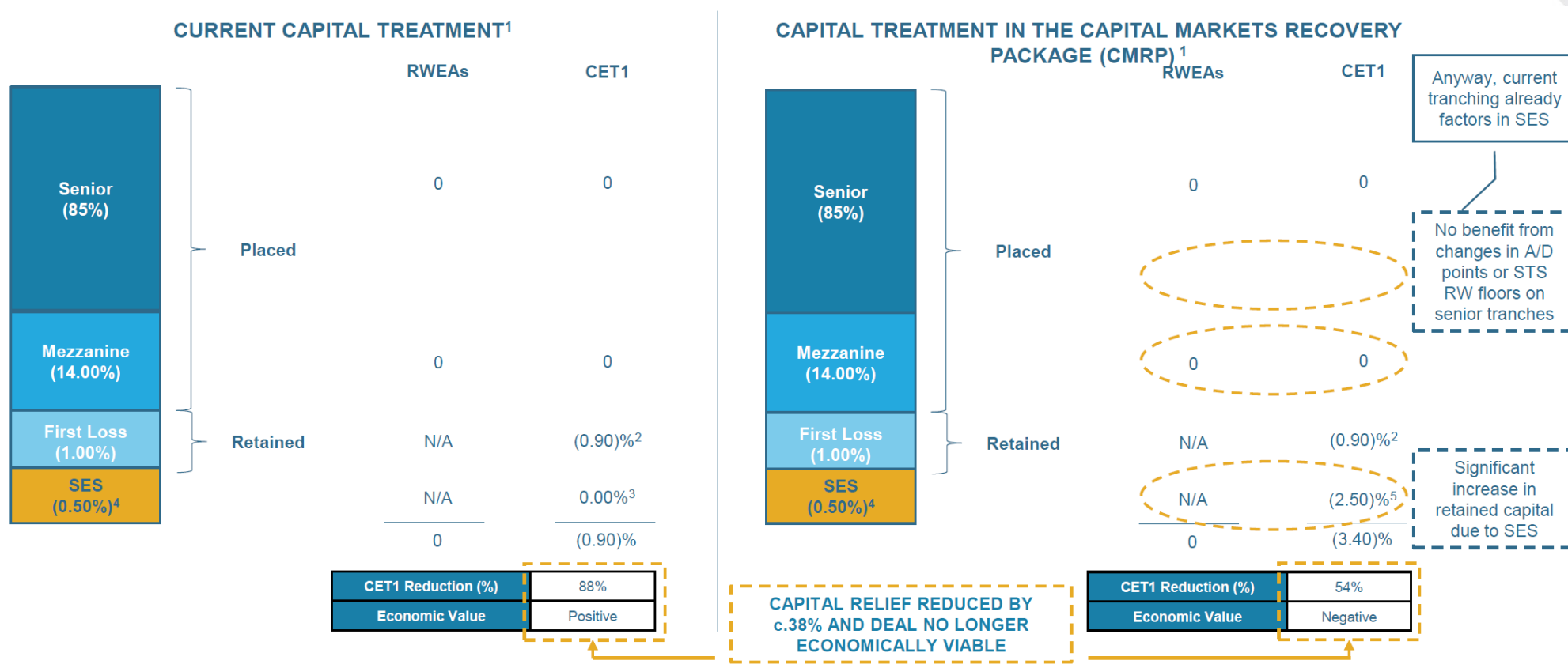
Case study 3: SME

This example (see figure 5) shows a securitisation with SME loans as underlying assets, similarly to the previous transaction, SRT has been achieved and originally no SES was included in the transaction. The example shown assumes that STS treatment will be obtained for the transaction. Under the consideration of the new rules, the tranching can be amended to reduce the size of the first loss tranche due to the inclusion of SES, which allows to increase the capital relief obtained from the transaction.

Overall, the capital relief obtained by this transaction is higher as compared to the previous treatment. The capital relief increases from a CET1 reduction of 61% to a CET1 reduction of 67%. However, this improvement hinges on the key assumptions that i) STS treatment can be obtained for this transaction and ii) the amended tranching/leverage levels are acceptable to both the investors and the JST, otherwise the economic value of this transaction would be reduced compared to the previous rules.

Further, for similar transactions that have no retained first loss tranche, there would be no offset available to the new capital charges, meaning the structures would have significantly reduced capital saving levels.

Figure 3: Case study 1, SME leasing portfolio, format: synthetic full deduct, Use of SES: Yes



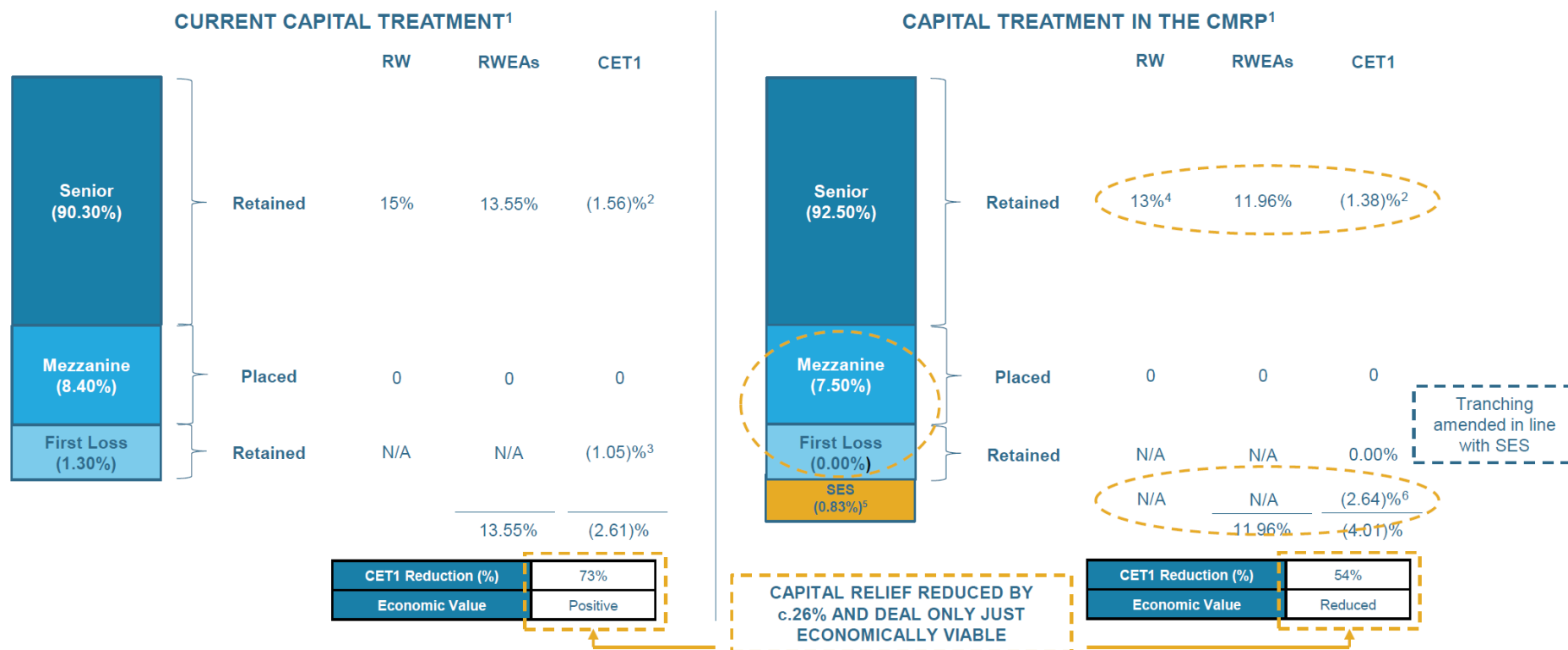
¹ As at the closing date. | ² 1.00% first loss tranche, net of IFRS 9 provisions. | ³ Average consumption across the life estimated to be c.(0.25)%. | ⁴ SES tranche matches regulatory EL. | ⁵ Based on lifetime excess spread, net of provisions

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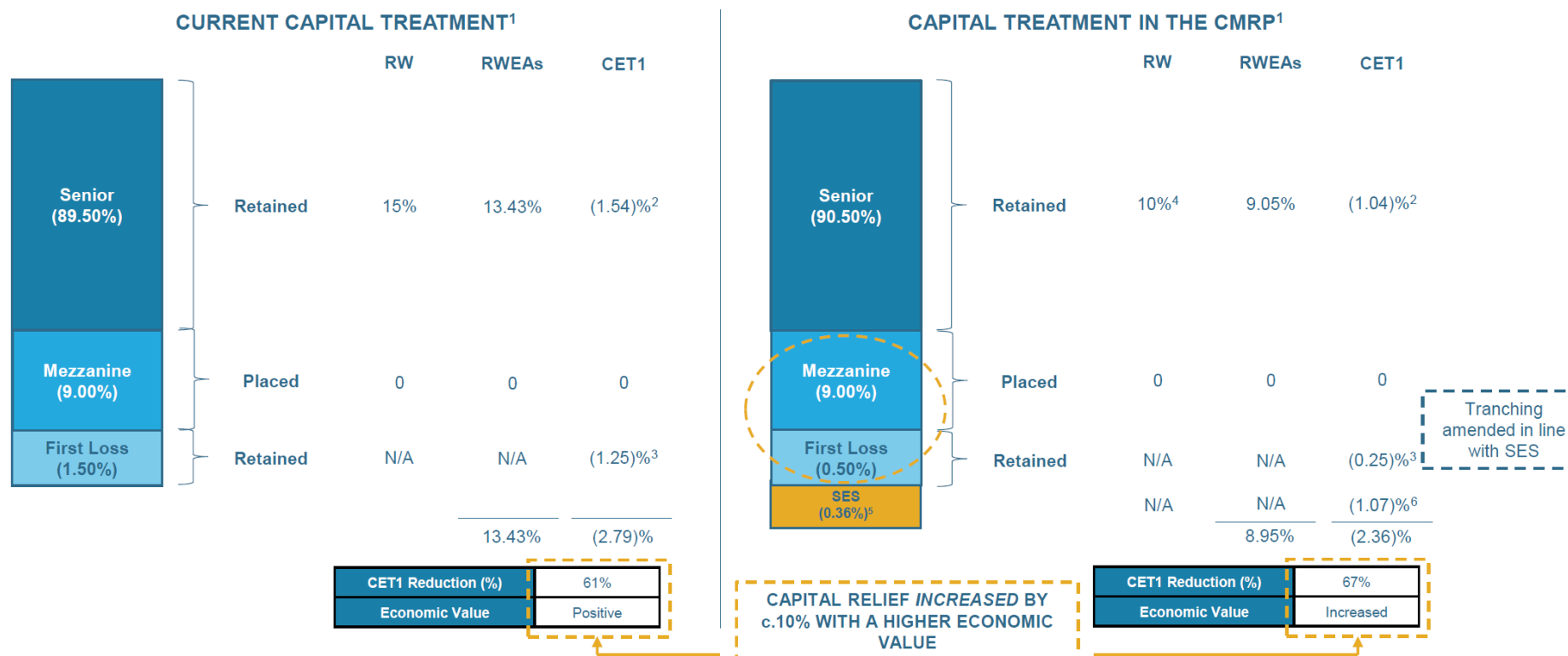

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Figure 4: Case study 2, Consumer portfolio, format: synthetic SRT, Use of SES: No



¹ As at the closing date. | ² Based on a CET1 ratio of 11.50%. | ³ 1.30% FLT, net of IFRS 9 provisions. | ⁴ Assumption that STS treatment is obtained for the transaction. | ⁵ SES tranche matches regulatory EL. | ⁶ Based on lifetime excess spread, net of provisions

Figure 5: Case study 3, SME portfolio, format: synthetic SRT, Use of SES: No



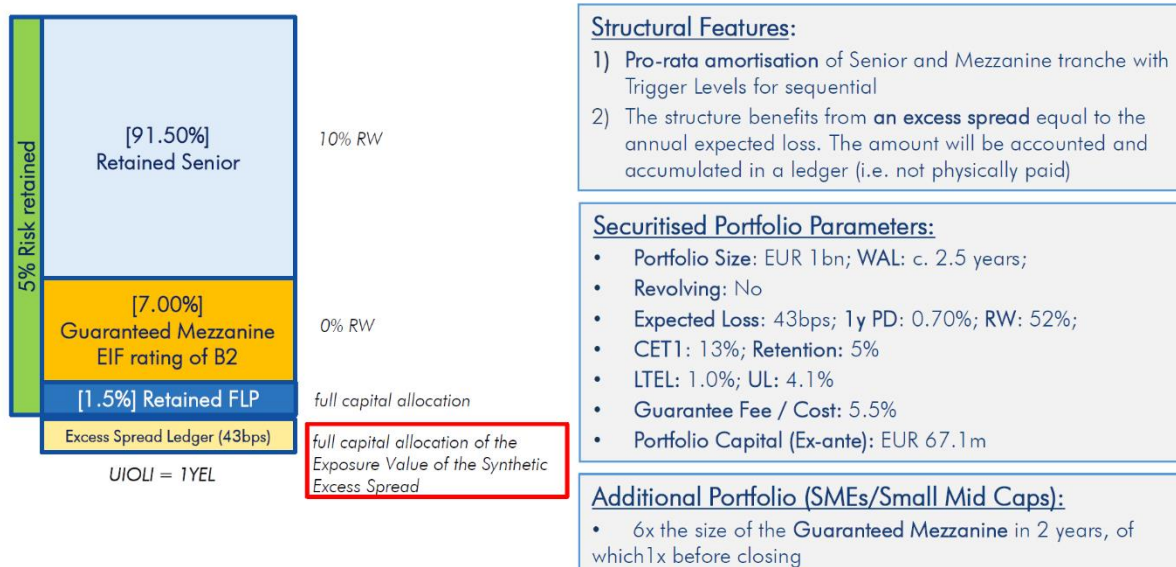
¹ As at the closing date. | ² Based on a CET1 ratio of 11.50%. | ³ 1.50% FLT, net of IFRS 9 provisions. | ⁴ Assumption that STS treatment is obtained for the transaction. | ⁵ SES tranche matches regulatory EL. | ⁶ Based on lifetime excess spread, net of provisions

Case study 4: SME loan portfolio with the European Investment Bank Group

In addition to making the execution of synthetic transactions more burdensome for the originating banks, it also has a negative impact on the investor. Taking the example of the European Investment Bank Group, which includes the European Investment Fund (EIF), it is expected that the new rules on SES would make its investments significantly less attractive for the originating banks.

The EIF is a public investor that specializes on implementing policy goals (e.g. Juncker Plan, Covid-19 response measures) to facilitate lending to SMEs across Europe. Amongst other activities, it provides guarantees for the mezzanine tranches of synthetic securitisation transactions with SMEs as underlying assets. The guarantee allows for a significant risk transfer to release capital, which ultimately needs to be reinvested in SME lending. The EIF usually requires originators to on-lend a multiple of its invested amounts (the higher the risk, the higher the multiplier). The EIF is widely recognized as a reference investor in the synthetic SME market, with invested volumes in of c. EUR 3.5bn in 2020 alone, which led to committed new lending to SMEs of around EUR 10bn²⁶.

The below stylized example demonstrates a standard EIF synthetic securitisation transaction under the Juncker Plan:



Source: European Investment Bank Group

²⁶ Source: European Investment Bank Group

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Current treatment vs New Article 248

Stylised European Transaction

Current Treatment	
EVSES = 1Y SES - Provisions – Losses	
Ex-Post Capital ¹	26.9
Capital Relief	59.9%
Cost per unit of capital	9.6%

New Article 248	
EVSES = Lifetime SES	
Ex-Post Capital ¹	26.9
Capital Relief	45.6%
Cost per unit of capital	12.6%

¹ Ex-post Capital = Senior tranche capital + Mezzanine tranche capital + Full capital deduction FLP + Full capital deduction EVSES

Source: European Investment Bank Group

SME-lending in Europe.

Under the newly proposed rules of the CMRP, the economics of this transaction will drastically worsen, because the required capital for SES is no longer capped at 1 year expected loss, which is currently common market practice. Ultimately, the protection provided by the EIF would become more expensive. Under the current rules, in the above example the costs per unit of capital released at origination would be around 9.6%. This cost increases to 12.6% if the proposed rules were to be implemented. This represents an increase of costs of around 30% (9.6% vs. 12.6%) and, as a result, the transaction will likely become uneconomical.

Out of 19 synthetic securitization transactions closed by the EIF in 2020, 15 featured such SES mechanism. The new set of rules may therefore likely close out a large majority of EIF

transactions, having a detrimental impact on

Key takeaways from the case studies

Based on the above examples, it becomes clear that the new rules on SES which were introduced by the Capital Markets Recovery Package in 2021 have the potential to create obstacles for originators to successfully structure synthetic securitisation transactions. Much of the impact of those new rules will depend on how the new rules are going to be interpreted and how the EBA will fulfill their mandate to develop draft regulatory technical standards, which is laid out in Article 248 (4) CRR. However, if a conservative interpretation were to prevail, the following consequences are considered as a likely outcome:

1. The impact on securitisations which employ the full deduct approach in line with Article 245(1)(b) is going to be significant, because: i) there is no offset of new capital requirements from adjusting the detachment and attachment points, and ii) as the senior tranche is not retained in those type of transactions, the lower RW floors for STS transactions can also not compensate the increase in capital requirements for the SES
2. Deals where there is no or only a small retained first loss tranche are negatively impacted, because the amended tranching will not provide a sufficient reduction in senior retained capital to offset the new SES requirements
3. It is extremely hard to include SES for portfolios with a higher expected loss, like consumer portfolios
4. Lastly, certain investors such as the EIF would no longer be able to participate, which would have a negative impact on SME lending

In the case of SME/large corporate portfolios, the only option to keep capital consumption constant (or reduced) in those structures is to obtain i) STS treatment, and ii) amending the tranching. However, this is based on the key assumption that STS treatment can be obtained and that investors and JSTs will allow the amended tranching/leverage levels.

Appendix 2: LCR eligibility of covered bonds vs securitisation

Current LCR eligibility – Commission delegated regulation (EU) 2015/61 of October 10, 2014 to supplement Regulation (EU) No 575/2013

Covered Bonds				Securitisations		
	Type of Assets	Rating Min	Haircuts	Type of Assets	Rating Min	Haircuts
Level 1	Extremely High Quality	AA-	7% (art. 10.2)			
Level 2A	High Quality	A-	15% (art. 11.2)			
Level 2B	Other Covered Bonds		30% (art. 12.2(d))	STS (*) Residential and auto loans	AAA	25% (art. 13.14.(a))
				STS (*) SME loans and other consumer loans		35% (art. 13.14.(b))
Not eligible				Non - STS		N/A

(*) Commission delegated regulation (EU) 2018/1620 of July 13, 2018 to supplement Commission delegated regulation (EU) 2015/61

Proposed LCR eligibility

Covered Bonds				Securitisations		
	Type of Assets	Rating Min	Haircuts	Type of Assets	Rating Min	Haircuts
Level 1	Extremely High Quality	AA-	7%	STS - Residential and auto loans	AA-	7%
Level 2A	High Quality	A-	15%	STS - SME loans and other consumer loans	A-	15%

Level 2B	Other Covered Bonds		30%	STS that do not meet the issue size criteria for Levels above 2B	BBB-	30%
				Non - STS	AA-	30%

About EBF

The European Banking Federation is the voice of the European banking sector, uniting 32 national banking associations in Europe that together represent some 4,500 banks - large and small, wholesale and retail, local and international - employing about 2.1 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 300 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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