



Bank of England and European Central Bank: The case for a better functioning securitisation market in the European Union. A discussion Paper. May 2014

Background

The Dutch Securitisation Association (DSA) was established in 2012 as representative body of the Dutch securitisation industry. Our membership includes issuers of securitisations both from the insurance and the banking industry, and we are operating in close cooperation with the Dutch investor community.

Our purpose is to create a healthy and well-functioning Dutch securitisation market. We try to achieve this i.a. by providing a standard for documentation and reporting of Dutch RMBS transactions, promoting (in close cooperation with PCS) further standardisation and improvements in transparency, and active involvement in consultations about future regulation of the securitisation market.

Against this background, we would like to comment, on behalf of all Dutch RMBS issuers joined in the DSA, on the Discussion Paper.

Our comments are provided in the order of the questions raised in the Paper:

· Do respondents agree with the benefits of a well- functioning securitisation market as outlined in Section 2?

In general, we do agree with the benefits mentioned. In addition we would like to stress the following points:

39. Investor base: Dutch banks are historically faced with a “funding gap”: due to the very high percentage of contractual savings through Pension Funds, savings deposits on bank balance sheets are relatively low and insufficient to fund all loans to the “real economy”; securitisation provides a way to bridge this gap with wholesale funding attracted from (foreign) investors with an appetite for specific Dutch asset classes (in particular Dutch residential mortgages).

Also, on a more micro level, new (foreign) entrants in the Dutch mortgage market will typically have insufficient retail funding sources, and therefore securitisation can help promoting competition by providing entrants the funding they need to build up their product offering.

44. Transferring risk and 47. Risk weights: Although we are fully supportive of risk retention rules as a way to maintain “skin-in-the-game” and prevent a return to the negative aspects of the “originate-to-distribute” model, we have to stress that for Dutch RMBS, with cumulative loss rates of below 0.5%, a 5% retention requirement is at odds with anything close to significant risk transfer.

Anyway, a 5% retention requirement irrespective of the loss rates on the underlying portfolio, is not helping securitisations of assets with low loss rates, like Dutch RMBS.

So Dutch RMBS under current regulation is and will be mostly a funding tool. Consequently, most originators will only sell the “liquidity products”, and keep the mezzanine tranches or “credit products” since the spreads on these products will not be commensurate with the still very low embedded risk.

49. Liquidity asset. We have to point to the self-fulfilling-prophecy issue around the LCR. The uncertainty about the regulatory treatment of RMBS in the LCR led to a waiting game on the part of investors, which surely did not help to increase the market liquidity of the product. The currently proposed inclusion of RMBS in level 2B is not a proper reflection of the liquidity characteristics of the product should the period of uncertainty have been shorter.

- Do respondents agree with the impediments to and economic concerns of investors that have been identified? Do respondents think that there are any additional impediments to investors, and if so, what are they?

Again we fully agree with your analysis, but with two additional remarks:

73. Liquidity requirements. We would like to emphasize the impact of the regulatory treatment of the trading book on secondary markets. This creates a vicious cycle. Less market liquidity leading to more adverse regulatory treatment leading to smaller trading books, leading to less liquidity etc.

76. Chart 7. While the difference between EMEA and Global is striking, the result would be even more extreme for Dutch RMBS (and other high quality European ABS such as UK RMBS, German Auto ABS) instead of the collective securitisations of EMEA.

- Do respondents agree with the impediments to and economic concerns of issuers that have been identified? Do respondents agree that the infrastructure concerns raised above affect the economics of securitisation? Do respondents think that there are any additional impediments to issuers, and if so, what are they?

In addition to your analysis, we would like to mention:

83. Retention: we also refer to our comment on 44. above.

84. Regulatory uncertainty: we also refer to our comment on 47. above. For issuers of Dutch RMBS there is no tangible capital relief left, even under current and proposed regulations.

Most of our concerns are now about the regulatory uncertainty of investors.

88. Systems. While the systems infrastructure in the Netherlands is of high quality, and through independent third parties also available to smaller originators, we note that the uncertainty about permanently changing additional systems requirements is a serious impediment. A point in case is the CRA3 implementation, where a legislation intended to regulate the Credit Rating Agencies ends in a huge systems challenge for issuers, even those who issue unrated paper.

92. Alternative Funding Conditions. With the TLTRO, the “progressive withdrawal” has come to an end. By the time the withdrawal resumes, the securitisation infrastructure may have disappeared and official sector schemes may have to take a more permanent position.

- Do respondents agree that market liquidity may be a barrier to a well-functioning securitisation market?

We do agree, but we have our doubts about the perceived low liquidity of the securitisation markets. Investors are currently in a holding pattern. There is lack of supply, and exchanging short maturities for longer ones does not make sense against the background of regulatory uncertainty. However, those investors who want to sell have no problem to do so. Not surprisingly, Spanish RMBS was one of the most liquid markets in recent years.

- The view of the Bank of England and the ECB is that a ‘qualifying securitisation’ should be defined as a security where risk and pay-offs can be consistently and predictably understood. Do respondents agree with this definition? What characteristics of a ‘qualifying securitisation’ not already included in the principles in Box 3 should warrant such treatments? Do respondents have any comments on the principles in Box 3?

If the definition conforms to the statement in 126. “to identify securitisations where their simplicity, structural robustness and transparency enable investors to model risk with confidence”, we do agree.

We would however like to comment on the following points:

126. “The designation would apply to all tranches of the transaction”. In our view it becomes increasingly difficult for investors (and issuers alike) to model risk with confidence when you enter mezzanine or subordinated territory, especially if these tranches are in short supply in primary issuance markets.

134. Although we agree that certain commercial real estate mortgages qualify, we wonder what criteria you have in mind to choose between qualifying and non-qualifying transactions. Criteria like granularity, both in terms of loans and maturity of the loans, may play a role here.

- Do respondents think that a liquid market for ‘qualifying’ securitisations used for funding would result from a ‘qualifying certification’?

Leaving aside the question about the current level of liquidity in the markets, using the concept of ‘qualifying securitisations’ to reduce the regulatory capital requirements for the trading book would certainly help to increase liquidity.

- These principles may then provide a framework to aid various authorities and market participants to set their own eligibility criteria. How might such a framework be developed? What role could the appropriate authorities play in the process of certifying that a transaction is a ‘qualifying securitisation’? What are the associated risks?

We envisage a structure such as the one developed for loan level data with the European Data Warehouse, where a private/non-profit organization, funded by the industry, would be able to quickly turn around requests for confirmation of the ‘qualifying’ status.

PCS, maybe in a somewhat amended set-up, could also fulfil this role.

In this respect we subscribe to the analysis as provided by PCS on this subject in their comments on your paper.

- Do respondents think that harmonisation and further conversion software could bring benefits to securitisation markets? If so, which asset classes should be targeted? How can accessibility to the existing loan level data be improved, so that it provides most value to investors?

All qualifying asset classes should provide loan level data.

The European Data Warehouse, supported by their shareholders, including the Dutch Securitisation Association, are actively promoting better data quality and accessibility.

- Do respondents think that initiatives currently undertaken by authorities in the area of standardisation of prospectuses and investor reports and trade transparency are sufficient or is there scope for further improvements? Would the availability of prospectuses and standardised investor reports in a single location be helpful to securitisation markets?

From our practical experience over the last one and a half year we have learned that standardisation of prospectus lay-out and definitions as well as investor reports has been extremely helpful in promoting a relatively healthy Dutch RMBS market.

We encourage other jurisdictions to follow the example of the Dutch Securitisation Association and in a next stage would like to work together with other jurisdictions in further standardisation efforts.

- Do respondents agree that facilitating investors' access to credit data in an appropriate manner could support the emergence of securitisation markets? Would credit registers be helpful in this respect? If so, which asset classes should be targeted? In what form could access be granted to ensure that borrowers' confidentiality is preserved? With a proper emphasis on standardisation and transparency, we do not see the addition of credit data registers as an urgent requirement. In the longer run, credit data registers could help the development of the SME securitisation market, but setting up these registers will be a complex and costly exercise.

- In order to aid performance measurement and to provide investors with industry-level data, would it be helpful if certain macro-economic data were disclosed or if banks/non-banks published certain aggregated standardised data? What are the challenges of providing potential investors with sufficient borrower and loan-level data to enable them to model credit risk, and how can these be overcome? What other elements would in your view help to improve secondary market functioning for high-quality securitisation? For most active securitisation markets, rating agencies and (investment) banks publish comprehensive accumulated data derived from the investor reports of the outstanding transactions. Further standardisation of these investor report may help in improving these aggregated data. Aggregate data for all assets of a certain asset class (whether or not securitised) show, at least in the Dutch experience, minimal deviations from the data on the securitised assets. However for newly (re-)emerging asset classes (like SME securitisation) aggregate market data may be useful as long as insufficient data on securitised pools are available.

We see primarily a role for national regulators to collect and publish these statistics as an independent source of information.

On a related point, standardized definitions in Europe, like a uniform definition of Default, would be beneficial.

- Do respondents think that authorities should consider encouraging the industry to develop such benchmark indices? What risks might these give rise to? What indices would be useful and which could be easily produced?

The fragmented nature of the European market, with different characteristics of transactions coming from different jurisdictions, dilutes the benchmark concept. Only when the market returns to the volumes seen in the past, benchmark indices for certain asset classes might gain value. The existing benchmark for Dutch RMBS currently does not add much value.

- Do respondents agree that additional information in the form of a matrix showing implied ratings if the sovereign and ancillary facilities rating caps were to be set at higher levels would be helpful in supporting the investment process and contribute to increased transparency and liquidity?

Providing this kind of information would, in addition to their own analysis, be very helpful for investors, so should be encouraged.

- How important do respondents see the impediment related to the availability of ancillary facilities? Would the benefits of facilitating SPV bank accounts that fall outside the originator's insolvency estate outweigh the costs of such an initiative? Are there other initiatives in this area that would be beneficial?

Although we do not experience a direct problem in this respect for Dutch issuers, we agree that counterparty and concentration issues facing the providers of these facilities, may hamper the future growth of securitisation markets. So solutions like central bank provided/guaranteed facilities and facilities in a custodian like environment, are welcome. Also a further reduction of rating dependency for these kinds of facilities would be beneficial.

- With regard to the policy options mentioned, are there any other considerations authorities should be mindful of?

Although implicitly mentioned in your document, we would like to emphasize that apart from differentiating regulatory treatment between "qualifying" and "other", an overall adjustment of capital and liquidity requirements for securitisations, bringing the requirements more in line with those for Covered Bonds, whole loan purchases etc., would be essential for a revival of the securitisation industry.

- Do respondents think there are other policy options authorities should consider to support the emergence of simple, transparent and robust securitisation markets? Further harmonisation of the legal and tax structure between European jurisdictions would help to develop a more pan-European securitisation market.

- Beyond securitisation, might there be other ways of achieving (some of) the benefits of securitisation as outlined in Section 2? What might be the associated risks of such options?

Other products (like Covered Bonds) share some of the benefits of securitisation, but also have their own disadvantages. Securitisation is part of the funding mix of financial institutions, but should generally not be the only source of funding.

- Do the principles set out in Box 3 seem broadly sensible given the objective of encouraging a set of securitisations that are more amenable to risk assessment? Are there any obvious unintended consequences?

The two main risks of a “qualifying”/”other” approach are 1) watering down of the qualifying criteria, making them hardly discriminating and 2) cliff-effects. So we would generally favour a strict definition of “qualifying” combined with realistic requirements for “other” transactions, which would not unduly threaten the existence of these “other” securitisation products.