European Commission Consultation Document "Capital Markets Union Mid-Term Review 2017"

This document provides the response of the Dutch Securitisation Association ("DSA") on the EC Consultation dated 20 January 2017.
We welcome the opportunity to respond on this Consultation Document.

DSA Background

The Dutch Securitisation Association was established in 2012 as representative body of the Dutch securitisation industry. Our membership includes issuers of securitisations both from the insurance and banking industry, and we are operating in close cooperation with the Dutch investor community.
Our purpose is to create a healthy and well-functioning Dutch securitisation market.
We try to achieve this i.a. by providing a standard for documentation and reporting of Dutch RMBS 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 respond, on behalf of all Dutch issuers joined in the DSA, on action point 5 of the Consultation Document, "Strengthening Banking Capacity To Support The Wider Economy".

Our comments

As action point 5 states, "Securitisation can increase the availability of bank credit, reduce the cost of funding, contribute to a well-diversified funding base and act as an important risk-transfer tool to improve capital efficiency and allocate risk to match demand".
In that respect we welcome the progress on the proposal on STS securitisation and the associated revision of the capital calibrations for banks.
The DSA remains very concerned about capital charges for STS securitisation in the proposed amendments to the CRR. While there is a common belief among the European regulatory community that the capital charges for STS securitisation will decrease, the fact is that the STS proposal contains a significant increase in capital charges based on calibrations that reflect the poor performance of US subprime assets rather than the performance of European assets. This should be rectified, but we have the impression that between the EC, the Council and the Parliament, not much priority is given to this rectification.
In addition, we would like to point to the urgency of the following actions to be taken as soon as possible after the completion of the STS Securitisation Regulation:
1) Revision of the Solvency II capital charges for investing in securitisations
2) Reclassification of STS securitisations in the LCR framework

Solvency II

The Solvency II regulation (Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) became effective in 2016 and introduced capital charges depending on the credit quality score (rating) and duration.

For a 5 year AAA tranche of type 1 (comparable but not identical to STS) securitisation the capital charge is 2.1% per year of duration, so 10.5% for a 5 year bond.

These capital charges are a multiple of capital charges allocated to other products (like Covered Bonds or unsecured bonds) or even the capital charges for securitisation under the CRR: for a 5 year AAA unsecured bond the Solvency II capital charge would be 4.5%, for a 5 year/AAA Covered Bond 3.5% and for an STS AAA RMBS up to 5 years (if the 10% RW floor applies) 0.8%.

As a consequence, investment in securitisations dropped to extremely low levels: no numbers are publicly available (but market regulators should be able to provide them), but based on informal feedback from investment banks, it has become clear that investor participation in new securitisations issued is zero up to at best a few percent.

The traditional main groups investing in securitisations are Pension Funds, Insurance Companies, Asset Managers and Banks. So one important investor group has virtually disappeared, and will only come back to the market after a substantial reduction of the Solvency II capital charges.

LCR

Banks have also been a traditional investor in securitisations, especially for their liquidity portfolio. With the introduction of the Liquidity Coverage Ratio in the CRR (Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No 575/2014 of the European Parliament and the Council with regard to liquidity coverage requirements for Credit Institutions), part of the framework for liquidity management (the other part being the Net Stable Funding Ratio) was created.

From 2018 onwards, banks have to comply 100% with the LCR.

Securitisations that meet certain requirements that are neither identical to the STS requirements nor the Solvency II level 1 criteria, but comparable to both, would qualify as level 2B liquid assets. Level 2B can only account for 15% of total liquid assets, and the securitisations will be subject to a haircut of at least 25% (for RMBS and auto ABS).

This makes securitisations considerably less attractive compared to Covered Bonds (level 1 or 2A) and corporate bonds (level 2A or 2B) both in terms of maximum share in the total pool of liquid assets and in terms of haircuts (level 2A: max. 55%, haircut 15%).

So while the LCR will most likely increase the bank holdings of liquid assets, the composition of het levels and haircuts makes securitisation once again an unattractive investment category. Only when STS securitisations will be included in at least the level 2A, banks will have an incentive to substantially invest in securitisations as part of their liquidity portfolio.

We foresee no implementation challenges, assuming urgent attention and cooperation of the Council, the Parliament, EIOPA (for Solvency II) and EBA (for the LCR).