September 2, 2024

Mr. John Schindler
Secretary General
Financial Stability Board (FSB)
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland
(Submitted electronically)

Re: Evaluation of the Effects of the G20 Financial Regulatory Reforms on Securitisation: Consultation Report

Dear Mr. Schindler:

The Institute of International Finance (IIF) and its members welcome the opportunity to provide feedback to the Financial Stability Board (FSB) on its consultation report on the Evaluation of the Effects of the G20 Financial Regulatory Reforms on Securitisation. We welcome the work being undertaken by the FSB in what is an important area of financial intermediation.

In our submission we provide a number of key observations and then we address selected questions set out in the FSB consultative report as well as providing additional feedback and further observations about this important topic.

<u>Key observations</u>

Report Focus, Approach and Scope

- We observe that the focus of the report is through the lens of global financial stability. While we understand that this is the primary mandate of the FSB, we believe that this exclusive focus on stability narrows the analysis and limits the opportunity to appropriately consider numerous other factors that impact securitisation activity and markets and which are pertinent to its current state and the contribution this financing option makes to broader financial markets and the economy.
- We also consider that the report does not adequately take into account broader factors which also contribute to financial stability. These include market depth, liquidity and the broader pool of financing options and tools. Financial stability should not only be considered through reduced incidence of default and eliminating any risk of financial stress. Broader, deeper, more liquid and more efficient financing markets contribute to financial stability. Further, these factors enhance economic growth and stability which in turn supports financial stability. Smaller or shrinking markets should not be confused with stable markets.
- The report explains that the focus of the analysis is somewhat narrow, examining only the more significant markets of RMBS and CLOs. While we acknowledge the data advantages of these larger markets, and the data limitations of other securitisation classes, we believe that excluding other classes limits the benefits of this evaluation work and the quality of the conclusions. ABS issuance is material in some markets, and in particular this class offers potential for reinvigoration and growth of securitisation, especially as it could provide avenues for facilitating financing in emerging risk/financing arenas (e.g. sustainable finance). This area of securitisation could also generate opportunities for

greater term issuance, one feature that would be of great interest to certain investor classes such as insurance companies. At the very least, further work should analyse the reform impacts on these other classes, and any regulatory constraints to greater ABS issuance.

- The industry supports the work done by regulatory authorities to enhance resilience and financial stability in the wake of the GFC, and specifically with regard to securitisation in recognition of the many inappropriately risky structures and transactions which took place leading up to the GFC. However, while those issues have been more than adequately addressed, it could be argued that the authorities have now over-achieved in terms of minimising risk and financial stability concerns with regard to securitisation.

Trends, State of the Securitisation Market and Impact of the Reforms on Participation

- Despite the contention in the report that the G20 reforms have not constrained securitisation activity, the data presented in the report tends to support the view that securitisation markets remain relatively subdued and in some markets quite markedly so. While the report suggests that it is inappropriate to compare activity in this sector to pre-GFC levels, comparisons to activity levels of approximately 10 years ago, which is when many of the G20 reforms were in train and being developed and socialised, and which is many years after the GFC, demonstrate that many areas of securitisation remain lower. For example, the data in the report shows that cash securitisation volumes outstanding in the EU and the UK are in the order of 30% to 40% lower than approximately 10 years ago
- The report references the prudential treatment and the implications of the capital and liquidity rules but largely points to the challenges of drawing conclusions as to cause and effect. While we understand the challenges, we do not believe that this should lead to a dismissal of the relevance of the impact of conservative capital requirements or structural shortcomings of the liquidity rules on securitisation activity and markets. In addition, the report is generally dismissive of regional implementation factors, stating that these are not pertinent to the global focus of the FSB or the G20 reforms. But these regional requirements are in many cases simply jurisdictional implementation of the global rules and are therefore within the mandate of an evaluation of the impact of G20 reforms. Any future detailed analysis and evaluation should take such regional implementation factors into account, otherwise the evaluation and analysis of the true extent of the impact of the G20 reforms risk becoming exclusively academic and ultimately ineffective.
- We also believe that there are other factors which are proving detrimental to securitisation markets and are worthy of in-depth analysis which are not considered in detail in the report. The report does touch on reduced activity, but tends to dismiss this as being due to a lack of interest or investment appeal. We believe this to be a somewhat narrow consideration that does not delve deeper into the reasons behind this trend. One element is the decline in capacity or capability of securitisation market participants due to the progressive impact of the constraining factors. We would contend that there has been a progressive decline in the skill-base and experience of securitisation stakeholders, particularly among traditional investor segments. The steep decline in activity following the GFC, combined with the restricted incentives due to the progressively introduced regulatory requirements, have led many formerly active institutions to wind back their operations in this area, leaving them with significantly reduced capacity and capability to deal with potential opportunities in the sector.
- Related to this is the fact that some formerly active participants, including many in the insurance sector, have increasingly withdrawn from this market. Rather than dismiss this trend as simply being

a prospect of more attractive alternatives elsewhere, we consider deeper analysis and evaluation of this trend would be worthwhile. For example, it would be beneficial to conduct further analysis on the impact of regulations on the propensity of certain investors to invest in securitizations, such as the impact of Solvency II on insurance companies in the EU. If many investors have left the market, it would be beneficial to understand more clearly why they have done so. This would provide more informed insights into the possible impact of the G20 reforms in perhaps exacerbating this negative trend.

Availability of Financing, Substitution Effects

- Another area of concern relates to the statements in the report questioning whether the decline in securitisation activity overall has had any negative impact on the capacity of market participants to obtain funding. The report highlights as proof of lack of negative impact the overall current levels of indebtedness (which at the threshold we would question as a sound metric to consider, especially from a financial stability perspective) but the report does not consider the implications of the sources of the alternative funding options. Indeed, while the report does mention briefly that the FSB undertaking work on resilience in the NBFI sector, we note that there is no detailed consideration of the relative risk exposure to the financial system and to stability of these alternative sources of funding. The FSB should conduct more direct and detailed consideration of this substitution effect and its implications, to ensure that securitisation reforms have not caused a shift to riskier alternatives, thus making the overall financial system less stable.

The Way Forward and Future Work on Securitisation

- Proportionality is now a key consideration in any comprehensive review of the current state of securitisation markets and of the effectiveness and efficiency of securitisation reforms. Given the significant reduction in risk and the consequent, and acknowledged, profound increase in stability of securitisation, the industry believes that many of the regulatory measures and requirements which have impacted the securitisation markets are now disproportionate to the inherent risk of many of those transactions.
- We believe that it is indeed timely to re-evaluate whether those measures, and in particular the current design and calibration, remain appropriate. We also note that the EU Authorities are similarly concerned that the regulatory requirements are constraining markets and activity and consequently are proposing to undertake a comprehensive and wide-ranging review of securitisation, including the impact of the prudential framework, which we expect to be launched in coming weeks. The very fact that the European Commission is undertaking such a comprehensive review supports our belief that the sector is worthy of detailed evaluation and in particular detailed evaluation and consideration of the impact of particular regulatory requirements.
- The industry would recommend the FSB and peer authorities to consider further in-depth and granular analysis of this sector. As stated, we understand that the focus of the FSB is global financial stability, while many of the issues impacting on the sector are banking prudential factors. We therefore would welcome the FSB encouraging the BCBS to undertake a detailed analysis of the impact of the Basel regulatory framework on securitisation activity and markets. The profound reduction in risk and the constrained levels of activity would suggest that it is indeed timely to consider whether the requirements remain appropriate and proportionate relative to the underlying risk.
- Indeed, with the US soon to finalise its Basel III rules, and the EU authorities undertaking a comprehensive review and evaluation of the securitisation reforms and markets, a globally focused

review by the BCBS would help to ensure any developments in respect of the securitisation reforms are managed at the global level thus avoiding any undesirable fragmentation.

- Work to reinvigorate important securitisation markets needs to be a collaborative effort. Therefore, we and our members remain ready to engage with the FSB and peer authorities in analysing and evaluating in depth this important segment of the financial markets.

In the balance of this letter we submit answers to questions included in the Consultative Document. Note that we have only submitted answers to questions where we have material comment. We also provide in an Appendix further elaboration of key points made in the body of certain questions. This Appendix material incorporates relevant discussion of requirements in the EU in particular, which, in accordance with our points above, is relevant to this evaluation process and can help to constructively inform future work in this area, particularly by peer authorities such as the BCBS.

<u>Responses to specific questions in the consultation report</u>

Q1 Preliminary findings: Does the report draw the appropriate inferences about the extent to which the securitisation reforms have achieved their objectives? Is there other evidence on the effects of the reforms to complement the preliminary findings of the report?

We assume that the objectives referred to are the initial objectives of the G20, given that this report is about evaluation of the G20 reforms. Those initial objectives were high-level and the key objective for securitisation, under the broader banner of shadow banking reform, was to assess and align incentives of lenders/issuers and buyers in securitisation. This included changing the profile of 'skin-in-the game' for issuing organisations. Later reform measures related to enhanced disclosure requirements and strengthened supervisory practices related to investment in structured products (including securitisation).

It is difficult to confirm if the securitization reforms have achieved their goals in terms of reducing misaligned incentives and moral hazard, because as the report acknowledges "*systemic risk and moral hazard are not directly observable*". Also, as the report acknowledges, there are significant data limitations and also challenges in determining cause and effect in regard to the impact of the reforms on the securitisation market, given multiple factors and variables involved.

However, given the overwhelming focus on financial stability which permeates the report, it could be argued that the significant reduction in risk in securitisation transactions, which is discussed and highlighted in the report, has therefore achieved the objectives of the G20 in terms of financial stability implications of securitisation.

However, one key concept used in the initial G20 objectives is 'incentives' and the industry is concerned that the regulatory reform framework which impacts securitisation provides disincentives to both issuers and investors. Overly conservative prudential treatment, constraining liquidity mechanisms and disproportionately burdensome due diligence and reporting requirements present challenges to the sound growth of the sector.

Further, while the particular impacts of certain of these reforms is not readily observable, what is observable are the market trends and market data, and the different behaviours of market participants in different jurisdictions. The data provided in the report shows that securitisation volumes in many markets

have declined significantly, and in many markets, such as the EU and the UK in particular, remain significantly below levels of approximately 10 years ago, many years after the GFC.

The report references the FSB's "*Framework for Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms*" published in 2017 and this evaluation notes that such evaluations should help to identify any material unintended consequences: "*Evaluating the effects of reforms (particularly the overall effects) involves the estimation of benefits and costs. Such evaluations should focus on assessing the social benefits and costs.*"

The evaluation framework goes on to say that social costs include "*potential knock-on effects on economic growth caused by possible (temporary or permanent) reductions in the availability of financial intermediation*." Therefore, have the reforms led to unintended consequences in that, in trying to eliminate or significantly reduce riskiness in this sector, have the reforms had the unintended consequence of constraining activity and market growth, disincentivised activity and/or narrowed the potential investor base? We do not believe that the report adequately addresses this element of the impact of the reforms on securitisation, in the context of the FSB's own evaluation framework.

Q5 Other reforms: Does the report accurately identify other G20 and domestic financial reforms that are most relevant for securitisation markets? Are there other reforms that should be considered in terms of their impact on market participants?

The report references concerns about the impact of Solvency II reforms on investor demand *"even though … they were not part of the G20 reform agenda"*. However, these reforms are relevant and have impacted the securitisation market. Insurance companies have been important stakeholders in securitisation and these reforms and related regulations significantly impact their capacity and incentive to participate in transactions. Also, Section 3.1.1 of the 2011 BCBS report on securitisation[1] explicitly links Solvency II changes on securitisation to the G20's 2009 statements on post-crisis reform. Therefore, this reform is specifically relevant, and should not be dismissed should the FSB wish to fully evaluate the implications and impacts of regulatory reforms on securitisation.

The FSB could also further consider the impact of U.S. regulatory and prudential reforms, such as: changes to disclosure requirements under Regulation AB2, which have significantly changed disclosure requirements for ABS in the U.S., with a resulting impact on issuance.

IFRS 9, which replaced IAS 39, is a reform that has impacted the securitisation market. The reason for that is that IFRS 9 restricts the types of securities that the holder can measure at amortised cost. Essentially those tranches that have a higher credit risk than the underlying portfolio are now required to always be measured at fair value: (IFRS 9 BC 4.35 (f)) "measure at fair value any issued instrument whose exposure to credit risk in the underlying pool of financial instruments is greater than the exposure to credit risk of the underlying pool of financial instruments". Previously (under IAS 39 and accounting directives), if the intention was to hold those securities until final maturity, they could be measured at amortised cost.

(See also The Appendix for discussion of the implications and impacts on securitisation of certain measures implemented in the EU).

[1] https://www.bis.org/publ/joint26.pdf

Q7 Resilience metrics for the CLO market: Does the report accurately describe the evolution of resilience indicators for the CLO market? To what extent can the evolution of these indicators be attributed to the reforms?

AND

Q8 Risk retention in CLOs: Does the report accurately describe risk retention practices in the CLO market before and after the reforms? What additional analysis could be included to assess the effectiveness of risk retention in CLOs across FSB jurisdictions, including on how financing of risk retention deals by third party investors impacts effectiveness?

With respect to the report's consideration and discussion of the CLO market, we address the two CLO questions together. On this section of the report we have a number of specific concerns as follows:

Section 4.2, p.40. The report states: *"Market conditions sometimes favour the reset or reissuance of outstanding CLOs, making it difficult to predict expected losses of CLO tranches over longer periods."* We do not believe that it is correct to consider this as a factor that makes default rate of CLO tranches low. By definition the tranche is crystallising no loss at the time of the refinance/reset, since the original tranche is repaid in full by new money.

Section 4.2, p.42: In this discussion the report fails to take into account the fact that sustained elevated interest rates across the global economies put additional stress on corporates, particularly when borrowing costs (floating rate for loans) were originally locked in during prior economic periods when base rates were historically low. This led to deteriorating interest coverage ratios and free cash flow generation without any active underlying revenue performance deterioration. In other words, defaults can spike not just by underperformance but also by macro-economic policy and conditions.

Section 4.2, p.43: *"If test levels fall below their trigger levels, cash flows from loan interest and principal payments are diverted away from equity and mezzanine tranches, and these cash flows are used to pay down the liabilities in order of seniority to deleverage the CLO and bring tests back into compliance."* The reference to cash flow diversion mechanics is correct but we would point out that this is not a new feature enacted post 2008.

Section 4.2, p.44: *"Larger average deal or tranche volumes tend to increase the complexity in securitisation, as they represent more loans, underlying collateral, and geographic dispersions."* We do not necessarily agree with this conclusion, as often a larger deal simply means pro rata larger individual position sizes. Also, greater diversity in the pool is credit-positive for senior CLO debt holders.

Section 4.2, p.46, final para. We note that the report does state that the literature is not conclusive on this point. However, the paper fails to acknowledge that an important factor for risk retention is in relation to the size of capital commitment and the cost of such capital (i.e. the target return the CLO manager needs to provide to the people from which this capital has been raised). Indeed, if holding horizontal, the return on the risk retention interests will be greater, but needing a greater usage of such permanent capital in terms of absolute amount.

Section 4.2, p.47: *"However, subordination levels increased somewhat since 2018 and until recently, which would be consistent with the hypothesis that investors in non-retention deals require higher subordination for AAA-rated tranches.". "During the pandemic, newly issued CLO deals in the US with voluntary risk retention exhibited a slightly higher share of lower-rated loans compared to deals without risk retention (see Graph 20), which is consistent with some of the literature on this topic."*

We would question some of the conclusions drawn here in the report. Any increase in subordination level has been driven rather by market dynamic factors such as heightened default concerns / outlook from COVID and then elevated base rates. We think it is challenging to believe in an active relationship between risk retention and initial share of CCC.

Section 4.2, p.48: We believe that the report should also consider and discuss another important factor that is credit positive: Having a dedicated CLO Manager who is actively selecting the inclusion of exposures into the CLO. It is an inherent quality control where incentives are appropriately aligned to encourage the CLO manager to do their job well, e.g. through performance fees and desire to continue to raise fee generating CLO vehicles from prospective investors in the future as well.

Q11 Effectiveness of BCBS securitisation reforms: Does the report accurately describe the changes in bank behaviour following the implementation of the BCBS securitisation framework reforms? To what extent can the effects of these reforms be disentangled from the broader Basel III framework, other reforms and confounding factors?

In discussing the effectiveness of the reforms, the report particularly focuses on riskiness, default rates, complexity and transparency, and generally concludes that, again through the lens of financial stability, the reforms are achieving their objectives. However, the industry believes that a key consideration, which the report does not adequately address, is whether the reforms are proportionate to the risk.

The enhanced risk mitigation structures, increased risk retention, improved transparency and risk management frameworks around transactions have all contributed to the performance of the securitisation sector, and profound reduction in systemic and moral hazard risks.

However, if the objective of the securitisation reforms has been to further mitigate any prospect of securitisation causing financial stress, then it could be argued that the reforms have overachieved this objective, and has led to a suboptimal framework for securitisation as a whole.

And it is noteworthy that regulatory studies of the securitisation market have acknowledged that the regulatory frameworks have failed to encourage the amount of increased activity and issuance in the sector as was originally hoped for or intended.

In December 2021 HM Treasury of the UK (HMT) published the report "*Review of the securitisation regulation"*.[2] While the report was a summary of industry responses to a call for evidence, the report did acknowledge that the impact of prudential regulations was a priority area for the industry. The report also noted the consistency of responses in highlighting particular regulations as limiting the efficiency of the market. And with respect to the constraining impact the regulations may have had on the sector, the HMT Report states: *"….there are some indications that the Sec Reg has not boosted securitisation issuance or broadened the investor base as much as it could have.*"

[2] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1040038/Securitisation_Regulation_Review.pdf

In December 2022 the Joint Committee of the European Supervisory Authorities (the JC) published the paper: "*Joint Committee advice on the review of the securitisation prudential framework (banking)*".[3] In considering whether the securitisation reforms had helped to achieve the intended increase in activity and improvements in the market, the paper stated: "*However, the JC considers that the introduction of the SECR and the amendments to Chapter 5 of the CRR in 2019 has not yet produced all the expected results as development of the market has been limited against the original objectives to generate between EUR 100-150bn in additional funding for the economy.*"

The issue of proportionality can be particularly considered with respect to prudential factors related to securitisation. While we acknowledge, as stated in the report, that it is often challenging to draw direct conclusions between specific regulatory requirements and the impact on the securitisation market, we do consider that it is important in any evaluation of the market, and in particular to address potential unintended consequences (as per the FSB's evaluation framework), that such factors are considered and analysed in depth.

Capital requirements are a significant factor affecting all participants - originators, sponsors and investors. However, despite the profound improvements in riskiness of securitisation transactions since the GFC and the clearly enhanced performance of the sector, capital regulations for securitisations appear to be over-conservative, and not reflective of the underlying risk. Capital required across all securitisation tranches issued in a specific deal should not exceed the capital required by the underlying portfolio before securitisation. For example, in the EU the conservative application of the p-factor has a very significant impact. Pro-forma RWA calculations on existing positions demonstrate the supervisory assertions that the increase in the p-factor would be largely offset by, in many cases, a decrease in the capital requirement (i.e., KG) on the underlying were incorrect. In addition, while the U.S. banking agencies' recently proposed amendments to adopt the 2017 Basel Committee on Banking Supervision (BCBS) international capital standards include the same p-factor as the BCBS standards, that p-factor is calibrated relative to BCBS risk weights and not the higher risk weights of the U.S. proposal. As a result, it likely overstates the risks associated with securitisations. Our members would welcome a comprehensive review of the securitisation framework where the overly conservative and restrictive requirements, in particular the calibration of the p-factor, could be addressed so that the proportionality concern is addressed.

Another reform area which is impacting on securitisation is disclosure. The report essentially just lists the many elements of enhanced disclosure included in the G20 reforms, and highlights how these requirements have significantly increased transparency**.** However, apart from stating that market participants have highlighted how concerns over the extent of the disclosure requirements, there is no discussion of whether they are appropriate or proportionate nor is there any evaluation of the impact or implications of these reforms

The requirements for disclosure are in many cases excessive, overly burdensome and a disincentive to the market. Disclosure requirements should be reasonable and proportionate to the complexity of the underlying transaction. We note that some jurisdictions have recognized that these requirements have become too onerous and act as a disincentive and we welcome initiatives such as the current review by the

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[3] https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Other%20publications/2022/Joint%20advice%20to%20the%20EU%20Commission%20on%20the%20review%20of%20the%20securitisation%20prudential%20framework/1045321/JC%202022%2066%20-%20JC%20Advice%20on%20the%20review%20of%20the%20securitisation%20prudential%20framework%20%20-%20Banking.pdf

European authorities aimed at a simplification of the reporting requirements. Disclosure requirements and templates across all jurisdictions should ensure proportionate transparency requirements mirroring investors' and supervisors' information needs, particularly in the case of private transactions.

From an investor perspective, the prudential treatment of securitised assets is also proving to be a significant obstacle. For banks as investors, eligibility of senior STS and non-STS tranches in the LCR ratio is currently too restrictive and should be reviewed. A review of the eligibility rules for the HQLA of the Liquidity Coverage Ratio (LCR) for both Asset Backed Securities (ABS) and Asset-backed commercial paper (ABCP) should be envisaged to further support the securitisation market. High quality, highly rated ABS have liquidity features comparable to Covered Bonds but are subject to a less favourable LCR treatment.

For insurers, regulatory frameworks impose a punitive capital treatment on securitisation exposures and have led to a disincentive to invest in securitisation transactions. For example, in Europe under the Solvency II regulation it is much more attractive for insurance companies to invest in a whole loan portfolio than in the AAA tranche of a securitisation of similar loan collateral.

And from a global perspective, across all investors, the disclosure requirements in some jurisdictions are excessively restrictive – as noted above, the disclosure requirements for European investors are particularly onerous, and make it almost impossible to undertake third-country investments. Such differing international requirements and restrictions are not consistent with a level playing field or an efficient global financial market and consideration should be given to harmonizing such requirements, or establishing appropriate equivalence regimes.

The report identifies the challenges in identifying cause and effect in this market, and the difficulties in isolating particular reforms and their impact on activity and the market. However, the report does identify at least one scenario where it was possible to isolate and assess the impact of prudential requirements on insurers' holdings of RMBS, concluding that the evidence *"corroborates the interpretation that capital requirements are a key driver for insurers' differential trading behaviour across asset classes".* So it is not unreasonable to assume that this could also be true of BCBS and Solvency II reforms as well. Further this is an area that deserves deeper analysis – including investigating why US insurers continue to invest significantly in securitisation but EU ones have reduced their activity (as the FSB's report identifies.) Understanding why investors have reduced activity or withdrawn completely would provide excellent insights into the factors impacting the market.

While the report cites recent studies concluding that "non-regulatory" factors constrain the growth of the EU securitisation market. …. low supply and weak demand due to a lack of inherent interest from both sides. The footnote supporting this (no.129) notes that *"On the originator side there are other cheaper funding sources such as covered bonds, deposits and ECB repos; and on the investor side there remains a perception of securitisation as a complex product with extensive due diligence requirements."* (See also page 38 – *"some market participants note that securitisations continue to require more documentation and due diligence than other debt products"*). However, as the report notes elsewhere, the tighter due diligence requirements are, at least in large part, a regulatory factor. Therefore, once again, the key consideration is whether these requirements are proportionate to the risk or in comparison with the requirements for those alternative asset classes.

(See also The Appendix for discussion of the implications and impacts on securitisation of certain measures, and particularly Basel III reforms, implemented in the EU).

Q12 Simple, transparent and comparable (STC) securitisations: Does the report accurately describe the impact of the introduction of the STC framework on the securitisation market? To what extent has the reform met its objectives?

The report details the design features of the STC securitisations and the intention behind it. The report suggests that this framework has promoted greater transparency and reduced complexity. However there is little detailed evaluation on the actual impact of the reforms, and more specifically whether the design as implemented is appropriate and proportionate, or any detailed consideration of whether the original objectives in terms of market growth have been achieved.

Industry generally supports the concept behind the STC framework for securitisations proposed by the BCBS. However, the regional adoption of this framework has often seen more challenging requirements imposed. For example, the Simple, Transparent and Standardised (STS) framework for securitisations in Europe has become excessively complex and too onerous for many otherwise valid securitisations to meet the very stringent STS requirements. We note that a number of jurisdictions have chosen not to adopt the STC framework as currently designed. We would recommend that the FSB include further detailed evaluation of this segment and its adoption in different jurisdictions, and to consider a recommendation to simplify and streamline the frameworks, such as the STS criteria, and in other jurisdictions as appropriate. This would also lead to greater consistency in the global adoption of the STC approach.

Given the very stringent qualification requirements, a large number of otherwise appropriate securitisation transactions will be unable to meet the 100+ STS criteria. As a consequence, even if appropriate prudential improvements are made for STS securitisations, very significant and important segments of the potential scope for securitisations will remain excluded. Both cash and synthetic non-STS securitisations add value and provide stable financing for the economy both by enhancing capital allocation efficiency and by diversifying funding sources for segments of retail and non-retail markets that otherwise are not able to access traditional bank lending. In evaluating the impact of stringent capital requirements on the securitisation sector and the market, it is therefore appropriate to also consider a more proportionate and appropriate prudential treatment for non-STS securitisations.

(See also discussion of regulatory impacts on STS securitisation in the EU in the Appendix).

Q13 Effects on financing the economy: Does the report accurately describe the main effects of the reforms on financing the economy? Is there additional analysis that could be undertaken to estimate the benefits and costs of these reforms and to assess their impact on securitisation as a financing tool?

The report briefly considers the impact on financing for the economy and points out that generally funding has been readily available during the period considered, so that constrained securitisation conditions did not affect financing to the broader economy. However, this period of course was the most accommodative monetary policy period in the modern era, and we note that the report does at least acknowledge the accommodative policy environment.

The regulatory framework is having a constraining effect on the securitisation market, and has actually led to a contraction in some jurisdictions in recent years. In July 2022, the European Systemic Risk Board (ESRB) published a report "*Monitoring systemic risks in the EU securitisation market*".1 In discussing recent trends in the EU market, the report stated: *"Over the past ten years the EU securitisation market has shrunk by around 40% (from €1.2 trillion in 2012). This is also reflected in the size of new issuances before and after the GFC, which were as high as €819 billion in 2008 compared with €181 billion in 2013. By the second*

quarter of 2021 new issuances amounted (on an annualised basis) to €171 billion. Compared with the total assets of the EU banking system, which is the main source of origination for EU securitisations, the size of the EU securitisation market is small at around 2% in the second quarter of 2021."

Due to the impact of the issues listed above (under Q.11), securitisation is not providing the funding, liquidity and financial stability benefits to the real economy to the extent that would be possible under a more appropriately calibrated regulatory framework.

The report lists some of these factors as having been raised by market participants in the past, but is generally dismissive of these factors. The report goes on to say that the investor market may have been broadened due to increased confidence and trust generated by the implementation of the reforms. We see little evidence in support of this claim and, while the enhancements in risk profiles and increased transparency and simplicity has been welcomed, the suggestion that this has therefore broadened and deepened the investor market does not reflect the experience of our members. A proportionate bank prudential capital framework is a prerequisite for securitization transactions becoming economically viable. For example, banks and insurers in the EU have been disincentivized from securitization because of reforms to their prudential frameworks. For many investors the regulatory cost of compliance in the EU outweighs the benefits of investing.

Further, the report suggests that a counterfactual evaluation would be the best way to evaluate the impact of the reforms but remains silent beyond that. However, there are certain counterfactual examples available for consideration. The report highlights growth in certain segments of securitisation in Australia and the USA as evidence that the reforms have not constrained the market. However, Australia chose not to implement the mandatory risk retention recommendations proposed by IOSCO and both the USA and Australia have not adopted the STC framework. Consequently, two jurisdictions which have been put forward as positive growth stories for the sector have taken a pragmatic and selective approach to adoption of the relevant G20 reforms. This should suggest that more detailed review of the proportionality and effectiveness of the reforms is warranted.

And this is an opportune time to undertake a comprehensive review of securitisation regulation and markets, as the world is facing more challenged economic circumstances. Further, emerging risk classes (including sustainable financing and digital financing) will create significant funding requirements which could benefit greatly from an appropriately calibrated securitisation framework.

Q14 Effects on financial system structure and resilience: Does the report accurately describe the extent to which there has been a redistribution of risk from the banking to the non-bank financial intermediation sector? What role did the reforms play in this process and what are the main benefits and risks from a system-wide perspective? How have the reforms impacted the demand and supply of liquidity in securitisation markets?

For a rounded financial stability assessment it is necessary not only to look at e.g. credit quality and performance in the securitisation market, but also whether the market is fulfilling the function it can serve to reduce financial stability risks – that is, transferring risk to those who are best place to bear it, or, for example, offering more stable long-term funding than the alternative of deposit funding. And the securitisation market will fulfil these functions most effectively if it is liquid. So, if, for example, prudential requirements are not proportionate, it would suppress demand or supply, and liquidity, and financial stability benefits of securitisation would be lost.

The report does not clearly address the interaction between the securitisation markets and other forms of financing and whether that financing is substitutive or additional. For example, are investor bases for funding to the real economy more concentrated with less risk dispersal.

This corresponds with the broader trend of financing & risk moving from banks to NBFI, while that latter sector is less regulated and prone to exhibit volatility and liquidity risks, particularly during periods of systemic stress, given the sometimes higher degree of interconnectedness.

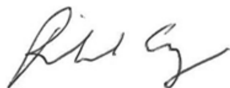
The report doesn't handle whether other forms of financing provide capacity with similar or lower levels of systemic risk attached. What the report is weaker on is whether the reforms have stymied broader expansion of securitisation markets by geography (i.e., use beyond the main financial centres), or whether there an inverse correlation in established markets where (more opaque, possibly less stable) financing is now being used as an alternative funding source. For example, how much has the growth in private credit markets now substitutes for securitisation-based financing, given that private credit has been flagged as an emerging risk by the FSB.

Conclusion

The IIF and our members appreciate the work being done by the FSB in this very important area of securitisation. We would strongly support further and deeper analysis and evaluation of this crucial form of financial intermediation by the FSB. We trust that our constructive suggestions in this letter will help to inform further work.

In response to the industry interest in this area, we would also strongly support initiatives by the FSB to encourage the Basel Committee to undertake a programme of work to evaluate the implications and impact of the bank prudential reforms on securitisation. We welcome questions on this letter and we remain ready to support all initiatives by the FSB and peer authorities on securitisation.

Sincerely,



Richard Gray
Director
Regulatory Affairs

APPENDIX

The following summarizes some key impacts in the EU market of the implementation of the G20 and other reforms, particularly the bank prudential reforms. We have included the information in this Appendix because it is clearly more directly focused on the EU securitisation market, and the report makes it clear that it, and the questions, are more focused on the global G20 reforms.

However, although the details are very focused on the EU market and a number of these measures are specific to the EU, we have included this information below because in many instances they also reflect the jurisdictional implementation of the G20 measures and the Basel framework and highlight the constraints these measures are having on the securitisation market and the challenges faced in this market. Consideration of these impacts can inform an insightful review of the current appropriateness, proportionality and efficiency of the reforms, and could prove particularly helpful in any specific evaluation by other authorities, such as the BCBS, of the impacts of the prudential framework on securitisation.

Although the EU Securitization Regulation (SECR) and the EU banking capital regulation 2024/1623 (CRR) have contributed to reducing systemic risks in Europe, they have also limited the development of the EU securitization market due to a conservative and complex regulatory framework. This makes securitization transactions complex, burdensome and costly, constraining SMEs' access to this financing tool and discouraging investment by institutional investors, insurance companies and small credit institutions.

Impact of the Liquidity Coverage Ratio (LCR) on Securitisation

The regulatory treatment of liquid assets for LCR purposes is defined in Delegated Regulation 2015/61. Level 1 assets are defined in Article 10. Unlike other instruments such as bonds/mortgage covered bonds that meet a series of requirements, holdings of securitization instruments issued by other entities are not admissible as Level 1 assets for the LCR, but are instead considered as Level 2B assets.

The eligibility of securitizations for LCR purposes is limited to AAA-rated bonds only. It is important to note that in some countries, such as Spain or Italy, there are some rating agencies that still maintain a rating ceiling at AA, which prevents certain peripheral countries from having their securitization bonds eligible for LCR purposes.

Despite the fact that the demand in the market and with the current prudential treatment is not the same as other instruments included in the LCR level 1 assets, such as covered bonds that meet a series of conditions in terms of liquidity and credit quality, the discount that the ECB would apply in the liquidity window would be the same, therefore, in a stress scenario, the liquidity obtained in the ECB for these securities would be equivalent to many of the assets included in the LCR level 1. It would be worthwhile to undertake a review of the implications of the LCR for securitisation transactions and markets.

Increasing risk sensitivity within the bank prudential framework

The EU regulatory framework for both STS and non-STS securitisations is very rigorous and more stringent than the Basel III standards in many respects. Some measures in the EU banking capital regulation 2024/1623 (CRR), (halving the p-factor parameter and lowering the RW floor) have been taken regarding both simple, transparent, and standardised (STS) securitisations and non-STS, but only for the calculation of the output floor (SEC-SA) and only on a temporary basis. As discussed, securitisation transactions are far

more transparent and now have a profoundly enhanced risk profile. It would therefore be timely to analyse and evaluate the appropriateness, proportionality and calibration of the prudential measures that impact securitisation. In the EU context, evaluation of elements such as the calibration of the p-factor and the output floor could form part of that evaluation, and may provide simple avenues for reducing the constraints and providing more appropriate incentives for securitisation activity. A comprehensive evaluation by the BCBS would help to identify and address similar constraints at the global level.

Disclosure requirements

The SECR imposes extensive reporting requirements on originators. It would be beneficial to consider a more proportional and efficient approach to disclosure, including analysing the burdensome regulatory reporting on private securitisations and perhaps considering the introduction of a dedicated template addressing supervisors' needs, and also addressing the compliance challenges faced by EU investors when seeking to invest in third country securitisations.

Specific measures that could be considered include targeted changes to disclosure templates – for example, by replacing unnecessary loan-by-loan reporting for certain highly granular and revolving asset classes, such as credit card receivables and by making certain other targeted improvements on the field-by-field review of the reporting templates. Not only would some reforms result in a more proportionate approach, but it would help to incentivize participation in these markets.

Significant Risk Transfer Process

The ECB has a period of 3 months to authorize a securitization scheme (it also requires one month's notice); this period can be extended if the ECB makes any additional information request; the Spanish CNMV has 1 month to approve the issue. These deadlines provide entities with very little margin.

The guidelines published by the ECB "Public guidance on the recognition of significant credit risk transfer" detail the process for obtaining significant risk transfer validation, as well as the information package that institutions have to submit to their inspection teams (JSTs). Although all the guidelines published by the supervisor are welcome as they provide visibility on the course of the authorization process, we consider that these deadlines are too long considering that the schemes used by institutions to securitise portfolios are characterized by their recurrent standardization.

The supervisory review process is very complex and time consuming, and evaluation of more streamlined approaches to certain transactions would remove the disincentive faced by participants.

Although the above-mentioned ECB guidelines detail the process, as well as the documentation to be submitted, we note that the criteria for receiving a positive assessment of significant risk transfer are unclear and potentially may not be homogeneous across entities to the extent that they depend in part on the supervisory judgement of the JSTs. Measures could be evaluated aimed at increasing clarity and transparency regarding the requirements needed to obtain a positive assessment of significant risk transfer (SRT), such as creating of a specialized horizontal team at the ECB intended to harmonize and speed up the authorization processes.

Due diligence obligations and STS requirements

Regulation 2017/2402 establishing a general framework for securitization and creating a specific framework for simple, transparent and standardized (STS) securitization establishes a series of requirements for

investors in this type of asset class to ensure that they are aware of the general characteristics of the instruments they are acquiring.

Within these requirements, obligations are established to carry out a due diligence process in order to guarantee that the risks derived from all types of securitizations are adequately assessed for the benefit of the final investors and to give confidence to the market. In this sense, they have been obliged to carry out an informed assessment of the credit quality of the securitization instruments. Article 5 of the EU Securitization Regulation (SECR) establishes the due diligence requirements for institutional investors. The performance of these exercises entails costs which, in the most senior tranches, do not justify the returns offered by the securities.

A more proportionate approach could be evaluated, which provides the necessary legal clarity and certainty to investors, while taking their actual needs and own expertise into account.

The bureaucratic burden in relation to due diligence obligations imposed on securitizations (that are not required for other security investments, for example when buying a bond) should be analysed and reconsidered and should be proportional (for example, reduced requirements when investing in a senior tranche). While the requirements can be justified in relation to subordinated tranches, they are disproportionate for investment in senior tranches with a strong rating.