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

Response to Consultation

Paris Europlace

1. **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?**

   Paris Europlace represents Paris international financial centre's market players, including banks, insurance companies, asset managers, financial intermediaries, international corporates, and other financial services providers. Paris Europlace ambitions include making the European Union more resilient and attractive to better fund the twin transition.

   Paris Europlace has a dedicated Securitisation Committee (SC), under its European Financial Regulation Committee, which adopts an international approach when analysing the ongoing financial and prudential regulation in the EU and other jurisdictions (primarily the United States and the United Kingdom).

   Members of Paris Europlace SC are securitisation specialists, often with decades of practice in this market, and working both on the issuing and investing sides, but also on transaction structuring, labelling, rating, servicing, thereby Paris Europlace is uniquely qualified to provide fact-based feedback to European policy makers, considering the overall securitisation ecosystem. Paris Europlace Securitisation Committee welcomes the FSB invitation to comment on this consultation report and the questions set out below.

   Paris Europlace notes that this consultation report presents the preliminary results of the evaluation of the effects of the G20 financial regulatory reforms on securitisation that have been implemented to date. The evaluation focuses, in terms of reforms, on the International Organization of Securities Commissions (IOSCO) minimum retention recommendations and the Basel Committee on Banking Supervision (BCBS) revisions to prudential requirements for banks' securitisation-related exposures; and in terms of scope, on the collateralised debt/loan obligation (CDO/CLO) and the non-government-guaranteed part of the residential mortgage-backed securities (RMBS) market segments.

   Paris Europlace regrets that the FSB chose to reduce the scope of the report to a narrow set of asset classes and a narrow set of policies. This choice leaves major aspects of the securitisation market unaddressed, although they also contribute to the financing of the economy, be it through Asset-Backed Commercial Paper, Consumer credit ABS or SRT

synthetic securitisation, among others. It also disregards the impact of reporting, disclosure and due diligence rules, as well as rules impacting (re)insurers as investors or risk takers, credit rating agencies, and structuring requirements other than retention rules, such as restrictions in re-securitisation, limits in relative size and maturity profiles applying to UCITS, etc…

Paris Europlace strongly encourages the FSB to broaden its analysis to provide with a more holistic assessment, as the FSB intends to continue its analysis of the reforms, including through empirical work, and to publish its final report at the end of 2024.

Paris Europlace also understands that this FSB evaluation work is part of a broader evaluation program launched in 2017 . This ex-post evaluation framework has been applied successively to various aspects of the financial markets post Global Financial Crisis (GFC) reforms, namely Infrastructure Finance and Central Clearing of Derivatives in 2018, SME financing in 2020, too-big-to-fail reforms in 2021. As far as Paris Europlace members, involved in most of those consultations, have experienced, all those reports have concluded that reforms had achieved their purpose, without measurable negative consequences on the economy. This outcome is disappointing and suggests that the analytical framework and/or the governance of the process may result in missed opportunities to address unintended consequences, putting into question the very purpose of the evaluation program. As then FSB Chairman Randal Quarles stated:

“In any system as complex and consequential as the body of post-crisis financial regulations, there will always be aspects-and sometimes material aspects-that can be improved on the basis of experience and analysis. A credible review process that is both rigorous and dispassionate will find a few.”

Paris Europlace urges the FSB to finalize its analysis in a truly open mindset, as recommended by former Chair Quarles, recognizing specific areas of over-shooting and recommending concrete, targeted improvements or revisions to standard setters. The case of securitisation is clearly in such a situation where, in particular in the European Union (EU), the functioning of the market has been significantly hampered by many reforms, as shown by multiple recent reports . Therefore, ending this evaluation without any substantial action plan to be implemented by IOSCO, BCBS and/or key jurisdictions could raise questions as to the credibility of the overall FSB evaluation framework, at a time when financing needs to address the twin transition are huge.

Paris Europlace agrees that the main objective of the reforms was to reduce misaligned incentives and moral hazard, and thereby limit systemic risk. There is no doubt that US securitisation has represented a major systemic risk during the GFC, as a factor of contagion across various types of market participants and across geographies. However, it should be noted that:

- The European securitisation market performed much better during the GFC and did not contribute to the crisis in any significant way.

- At the time, the US « originate and distribute » framework represented a significant moral hazard issue, which has since been solved in particular by the retention rules, which ensure « skin in the game » by the originator, as implemented in Dodd Frank and in the EU

Securitisation Regulation. Such measures have allowed to significantly reduce the systemic risk that had materialized during the GFC, subject to proper implementation by jurisdictions, and appropriate supervisory scrutiny, ensuring that rules are not circumvented.

At the same time, prudential rules have become extremely conservative for banks and insurance companies, notably in Europe, which has driven a significant shrinkage of the EU securitization market, with low supply by issuers and low demand from investors. Looking at current issuance volumes in the EU, it is clear that securitisation does not have the scale that may generate a systemic risk, and would have considerable room for growth before reaching a potentially worrying level.

In the US, where retention rules have been implemented, but where the prudential treatment has remained basically local, as BCBS reforms (STC and prudential rules) have not been implemented, the market promptly restarted after the GFC, and is now much bigger compared to pre GFC levels, without having generated any systemic risk concern during the recent episodes of turmoil, linked to COVID-19, the US Treasury market issues, the Russian war in Ukraine, or the recent regional banks failures.

While comparing how the international standards have been implemented across jurisdictions, we would welcome that the FSB encourages the EU to remove some of the gold-plating, for example, in the extremely prescriptive and narrow definition of STS compared to STC, or in the very intrusive and burdensome interpretation of the principle-based notion of “Significant Risk Transfer”.

2. Analytical approach: Are the descriptive analyses used to evaluate the effects of the securitisation reforms appropriate? Are there other such analyses to consider? What types of empirical analysis based on available data could inform the evaluation?

Paris Europlace agrees with the aspects studied by the FSB, including the complexity and opaqueness of structures; credit enhancement; changes in the investor base; credit quality of underlying loans and credit performance; pricing of securitised assets; and the robustness of these markets during recent episodes of stress and in hypothetical adverse scenario analyses.

Paris Europlace also welcomes that the FSB has excluded US agency securitisations, such as those of Fanny Mae in the US, from the analysis. The US agency market is so different in its dynamics and rationale, that incorporating it in an analysis of securitisation would have been misleading. In the same vein, Paris Europlace strongly recommends that the FSB also excludes the retained securitisation transactions, which in our view are not part of the securitisation market, but are structured for pure liquidity and collateral management. Incorporating them in any analytical work inaccurately flatters the size of the European market. Indeed, the distorting impact of including them is well illustrated by a graph that appears in the FSB report (see graph 6 on page 21). Adjusting for the retained transactions (where, by construction, neither retention rules not prudential rules play a role) would provide a much more realistic assessment of the persistently subdued European securitisation market, despite the expected benefit of introducing the STS framework.

3. Trends: Are the securitisation market trends presented in this report adequate given the scope of the evaluation? Are there other important trends that should be included and, if so, what additional data sources could be used for this purpose?

As regards the chapter presenting market trends, as explained above, it would be more relevant to exclude from the comparisons the retained transactions, which are not market transactions.

It would also be useful, in addition to the horizontal analysis, to explain separately the trends for each of the major geographies, which would help understanding the drivers behind the figures, and subsequently exploring potential recommendations.

In Europe, the securitisation market has collapsed since the GFC, particularly the segment of publicly placed issuances. Between 2007 and 2023, total annual issuance volumes of securitised assets dropped in Europe from EUR407bn to EUR213bn according to AFME data, a decrease of 48%, a trend which was not observed in other jurisdictions. In addition, the ratio of the European to the US issuance has remained below 20% since 2012, while it reached 85% in 2008 . According to the latest AFME CMU report , EU securitisation issuance adjusted by GDP continues to languish far behind global competitors. In 2023, EU issuance was equal to 0.4% of EU GDP which compares with 0.9% in the UK, 1.1% in the US (excluding issuance guaranteed by the government agencies), 2.4% in Australia, 1.0% in Japan and 1.5% in China, as AFME data also show.

A reverse trend has been noticed in synthetic SRT transactions, with a growing volume of securitized assets year after year, from a low base, and as SRT securitisation became progressively recognised as a reliable tool in bank's capital management toolkit, also in the wake of ongoing increases in the prudential regulatory and supervisory pressure on the overall balance sheet, which has taken place since the Global Financial Crisis. In 2023, at global level, banks executed synthetic SRT transactions on EUR 207bn of loans, covered by EUR18.5bn (close to 9%) of tranches attaching generally at 0%. EU banks executed SRT transactions on EUR 107bn of loans.

Whether the underdevelopment of the securitisation market in Europe is driven by a lack of offer or a lack of demand is often debated in policy circles, to focus potential regulatory adjustments on the most binding constraints. Paris Europlace considers that the securitisation market must be looked at as an ecosystem, and that the instrument must make sense both for the issuers and the investors. A decade ago, the post-crisis regulatory agenda implemented a very conservative framework probably aiming at disincentivising the use of securitisation, both from the issuers and investors standpoints, the (expected) outcome has been to discourage both regulated issuers and regulated investors.

On the supply side, while banks would be natural users of securitisation in their funding and capital strategies, their share in placed securitisation issuance has constantly reduced, while non-banks' share has increased, whether corporates, credit funds, digital lending platforms, etc. Indeed, securitisation is today an expensive option for banks, used mostly at the margin, to diversify funding sources or transfer some risks, with high costs and discouraging barriers to entry for many medium size banks.

Actually, the prudential framework for banks was calibrated at a very conservative level, disconnected from the economic risks, thus creating a significant 'non-neutrality' in the framework (i.e., the capital requirement after securitisation is higher than before securitisation, sometimes a multiple of the capital requirement of the underlying pool).

Another factor often cited to explain the decline in public securitisation issuance by banks is the abundant liquidity provided by central banks. Although this may have played a role in cash securitisation, it has no impact on synthetic transactions aiming at risk transfer. And even in cash transactions, we have observed only limited improvement with the more restrictive monetary policy recently implemented. It should be observed that other jurisdictions also provided abundant liquidity to banks over the last decade, but their securitisation market continued to experience solid growth.

From an issuer perspective, the decision to securitise a portfolio must be value creating, which means that the cost of securitisation must be compensated by a commensurate capital saving, otherwise the transaction is value destroying, and just does not happen.

In the EU, banks are the main source of funding to the economy, and therefore should be recognised as the natural and main source of, or transmission channel for, assets to be securitised. However, the existing prudential framework entails undue disincentives for banks to issue securitisation, stemming from the excessive 'capital non-neutrality', i.e., the fact that capital attached to securitised portfolio significantly exceeds the capital attached to the portfolio before securitisation.

This capital non-neutrality is driven by two distinct prudential rules:

- the 'p-factor' which distributes the capital across securitisation tranches,
- the risk weight floor applied to the most senior tranche.

Investors on publicly placed senior tranches are clearly not enough in number and volume, even in the current low level of issuance, especially since the ECB has discontinued its assets purchase program. It is basically limited to 20-30 bank investors, asset managers and public institutions. Not only the number of investors in these tranches has significantly reduced over the years, but also order sizes (especially with asset managers) can be quite small (while much larger for covered bonds), placing reliance on a handful of anchor investors.

According to its 2022 report on Monitoring systemic risks in the EU securitisation market , the European Systemic Risk Board (ESRB) stated: "EU banks remain the main holders of EU securitisations. Nonetheless, EU banks retain securitisations mostly for use as collateral in central bank operations. In the second quarter of 2021 euro area banks held 84% of the total market value of euro area securitisations. Of these, 40% of true sale securitisations held by euro area banks had an AAA external credit rating. This apparent large share of banks does not show a dynamic market, as in the case of retained transactions, the bank only transforms illiquid portfolios into collateral eligible to the ECB, which does not create any room for new lending."

In the FSB report, the Graph 6 showing the proportion of securitisation assets held by banks, where banks are originator or sponsor, provides an interesting angle. It shows that European banks predominantly use securitisation as an instrument closely linked to their own credit origination strategy, contrary to other regions, in particular the Americas, where most bank holdings of securitisation tranches are for investment purposes. Once corrected by removing retained tranches (according to Table 1, and generally used data, about 50% of the outstanding), this pattern would deserve to be examined more closely. It can be interpreted in the following ways:

- European banks have been crowded out of the securitisation market as investors. This may be due to the punitive treatment of securitisation in the LCR, especially compared with covered bonds.

- European banks are more affected by prudential rules determining the capital relief applied to Significant Risk Transfer transactions.

- With such low level of investments, there is less contagion risks than in other regions.

- On most of their securitisation portfolios, there is no or very limited agency risks, given the underlying has been originated or sponsored by the bank, according to strict loan origination and monitoring guidelines, and therefore the justification of capital non-neutrality with agency risk arguments does not hold.

This is a good example of why it would be essential to have a regional approach as regards market trends and potential regulatory impacts, even if the securitisation market should be a global market.

Other important trends are missing, especially on SRT transactions:

• The growing participation of regional/local banks, both in the EU and US. This implies that any review of calibrations should not only focus on IRB banks, but also Standardized approaches (which will also impact IRB banks with the implementation of the Basel III output floor).

• The involvement of non-life insurers on the liability side in Europe, and their role in the US non-agency RMBS. Non-life insurers have the potential to contribute to the robustness of the market, as most of their risks are largely decorrelated from credit risk.

• The differences between the emerging US and the current European SRT markets, from both an issuer and an investor perspective, mostly due to differences in banks' prudential regulations: If local prudential regulations require higher RWA on similar assets, local banks have to protect thicker tranches to enable capital release. However, if the thickness of the protected tranches largely exceeds the cumulated expected and unexpected losses on the underlying loan pool, such thick tranches would not be priced at a level commensurate with investors target risk/return, which may incentivize them to consider leveraging their investment. This example illustrates that regulatory differences, or insufficient risk sensitivity, can be a source of arbitrage or leverage, which can disrupt the market and increase the risk of contagion in a crisis situation.

• The collected information covers a period of weak demand for credit, due to multiple crises. However, the huge investments needed for the digital and environmental transition, combined with the impact of deglobalization, can change rapidly the credit demand and reported behaviours. Non-bank lending is growing, together with banks' need to securitize so that most of the credit market remains delivered and service by regulated entities.

4. **Relevant reforms: Does the report appropriately describe the key aspects of the design and jurisdictional implementation of the BCBS and IOSCO reforms for analysing their impact on securitisation markets? Are there other important aspects of these reforms that should be considered for inclusion?**

Paris Europlace fully supports the report statement that "The risk sensitivity of the prudential framework is one of the drivers of a sustainable securitisation market that can support financing to the economy. Such a framework, by ensuring that capital charges are commensurate with the risks, enables banks to contribute to a proper functioning of the market and to channel lending to the real economy." Indeed, we strong believe that a correct, risk-based calibration is a public good, the only way to avoid regulatory arbitrage, unlevel playing field, and build-up of risks in the least regulated area.

The FSB consultation report also states that "the Basel III reforms increased overall capital charges for securitisation exposures and generally made them more risk sensitive. This was one of the intended effects of the reforms to enhance the resilience of the banking sector and promote a sound securitisation market. However, analysis of the appropriate specification and calibration of the prudential standards – in terms of the approaches, factors and risk weight formulae used – is beyond the scope of this evaluation, although authorities in some member jurisdictions have examined the framework risk sensitivity as part of their securitisation reforms evaluation (see p35)."

The FSB decision to exclude the analysis of the commensurateness of the prudential standards from the scope of its evaluation is in our view a negation of the very purpose of the evaluation, and should be revisited, if the FSB intends to table a report that would bring added value to the policy community.

As regards the BCBS reforms, Paris Europlace considers that the description is insufficiently detailed, and in some cases biased.

For example, the report recognizes that the December 2014 reforms 'also included a capital non-neutral approach. Capital "non-neutrality" refers to the fact that under the Basel III reforms the total capital required for a securitisation (i.e. the sum of the capital required for all securitisation tranches) is greater than the amount of capital required for the underlying assets. This non-neutrality was introduced to address structural risks such as model and agency risks." However, the report falls short of quantifying the non-neutrality, which in our experience can easily reach a factor of 2, a level that can certainly not be justified by model and agency risks, especially when banks are originators or sponsors. Such an analysis of the degree of non-neutrality, which has never been made public by the BCBS, would be a significant value added for the report. It would show how the framework (and notably the so-called p-factor") behaves, as a function of asset classes.

Another example is the description of the look-through approach. The report justifies this feature by stating that “While the capital requirements were significantly increased, maximum risk weights for senior tranches based on a “look-through” approach were introduced. The “look-through” approach promotes consistency with the credit risk of the underlying pool of exposures and does not disincentivise securitisations of low credit risk exposures.” Actually, the look-through approach (which means that the RW of a senior tranche cannot be higher than the risk weight of the securitisation pool) does work as a powerful disincentive to securitize. If a bank gets the same RW on the senior tranche, after having sold the junior tranches at a high cost, as the RW before securitisation, there is no capital relief, and the transaction is value destroying. Consequently, it just does not happen. We encourage the FSB to develop a case study to assess this simple rule and show that the look-through approach is actually not risk-sensitive. A more risk-sensitive approach to assess the RW of the senior tranche, taking into account the risk of underlying assets, to avoid disincentivizing the securitisation of low-risk portfolios, would be to implement the “Risk-sensitive Risk Weight Floor” as proposed in our report .

Overall, these examples show that the prudential framework lacks true risk-sensitivity, contrary to the stated goal.

Paris Europlace welcomes that the report refers, in Box 3, to EU and UK recent analyses on the securitisation framework. Indeed, in 2022, the European Supervisory Authorities (ESAs) reviewed the securitisation prudential framework for banking in the EU against the framework’s original objective of contributing to the sound revival of the EU securitisation market on a prudent basis. In their report to the EC, the Joint Committee (JC) of the ESAs identified certain concerns about the framework’s risk sensitivity.

However, Paris Europlace disagrees with the FSB’s choice to quote that “the JC concluded that re-calibrating the securitisation prudential framework would not be a solution that would ensure the revival of the securitisation market.” Actually, the Joint Committee itself stated that “This advice includes targeted recommendations to support the securitisation market in a prudent manner and to promote the issuance of resilient securitisations qualifying for a more beneficial capital treatment, without jeopardizing investor protection and financial stability.” Paris-Europlace urges the FSB to adopt a more open-minded approach in referring to the Joint Committee report, to make the evaluation work both credible and constructive.

Later in the consultation report, the FSB describes only superficially the Joint Committee work by quoting: “The JC noted that it is possible to increase the risk sensitivity of the framework, but this would require a more fundamental and comprehensive review before conclusive opinions can be formed. Work is ongoing by the ESAs on this issue as part of a follow-up review under Capital Requirements Regulation (CRR) and the Securitisation Regulation.”

It is extremely disappointing that the FSB does not leverage in a more granular fashion on this important work. Actually, the Joint Committee “makes the following recommendations with respect to the prudential framework for banks:

• Technical fixes to the prudential framework aiming at improving its consistency and clarity in the framework [see section 3.2 of the advice on banking].

• A more substantial, but still targeted, recommendation aimed at improving the risk sensitiveness of the framework by recognising the reduced model and agency risk associated to originators [see Section 3.3.1. of the advice on banking]. The JC advice elaborates on why a reduction of the risk weight floor for senior tranches retained by originators may support further growth in the SRT market in a prudent manner, if accompanied by a set of appropriate safeguards. This would in particular promote the issuance of resilient securitisations, which can qualify for a more beneficial capital treatment, without jeopardising financial stability.

• General issues on the securitisation risk weight formulas that underpin the framework [see section 3.3.2 of advice on banking]. These however require further work which should be potentially brought for discussion to the Basel Committee on Banking Supervision (BCBS)."

Paris Europlace believes that this call by the EU regulatory agencies to the BCBS to review the securitisation framework should be echoed explicitly by the FSB in its final report, as it would otherwise be an important missed opportunity to reduce the current market fragmentation.

As regards the STC framework, the BCBS framework is principles-based. However, the STS framework as implemented in Europe is much more prescriptive. A detailed comparison between the two frameworks would be extremely helpful to better assess the impact the STS had on the EU securitisation market, and the fragmentation it generated, crowding out EU banks and investors from sponsoring or investing in non-EU securitisation. Indeed, EU-based institutional investors face specific difficulties investing in non-EU securitisation transactions as non-EU reporting entities cannot or are not willing to provide EU investors with the full article 7 template disclosure. The FSB should encourage convergence and proportionality in disclosure and due diligence requirement to reduce market fragmentation. Similarly, EU banks involved in sponsoring or structuring securitisation on behalf of financial or corporate clients, are unable to compete in global markets, including accompanying their EU clients in their non-EU securitisation programs. Accessing the large US and Asian securitisation markets is also a pre-requisite for these EU banks to have the scale allowing them to maintain dedicated expert resources, and develop a viable business model.

More generally, jurisdictional differences are not analysed in sufficient details. The qualification that the US framework is "largely in line with the Basel III framework except for some parameters" is only detailed in a footnote stating that "Key differences between SSFA under the current US capital rule and the SEC-SA rule include lower p factor (0.5 compared to 1.0 in the Basel framework), a higher risk weight floor of 20%, a lack of specific treatment for non-performing exposures. See Annex 1 for a description for more details on the Basel approaches and the relevance of the p factor." The significance of those differences is not qualified.

5. 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?

Another key reform which would deserve a more in-depth analysis is the LCR. On this subject, the FSB report notes that "The EU has also provided further incentives by

recognising certain STC securitisations as a type of high-quality liquid asset (HQLA) for the LCR."

But actually, this recognition is accompanied with a punitive haircut (25%-35%), even for senior STS transactions. Indeed, these haircuts are totally dissuasive, and according to EBA Risk Dashboard, Level 2A and 2B combined (the most granular figure published by EBA, which includes STS securitisation), represent on average only 4% of the Total HQLA portfolio for European banks, which amounts to EUR5.5tr.

Consequently, while banks could be legitimate and sizeable investors in senior tranches of third-party securitisations, as part of their High-Quality Liquid Assets buffer, they were crowded out of the market.

Indeed, banks, even when buying STS tranches, are penalised with a significant haircut, higher than covered bonds, which makes them too onerous to play a role in the management of the liquidity buffer (LCR). It should also be noted that LCR eligibility is an important investment criterion for the banks but also for non-bank investors, who take this liquidity aspect into account in their investment decision.

6. **Conceptual framework: Does the report adequately explain the objectives, transmission channels and expected outcomes of the securitisation reforms? What other metrics to assess the impact of the reforms should be considered?**

To report on transmission channels, the FSB should consider analysing the entire chains of risk transfer from loan origination to ultimate investors. These chains can be very simple for bilateral transactions developed in partnership between banks and ultimate long-term investors, but become more complex, involving different steps of transformation and new transmission channels, if tranches are not directly protected by the ultimate investors. The report would be enhanced by identifying the various transmission channels and their factors of sensitivity along the most common chains of risk transfer.

7. **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?**

As indicated in the report (p 56), "the period immediately prior to the GFC was characterised by 1) excessive risk taking and 2) the unsustainable build-up of leverage by the private sector". The GFC was actually triggered by mortgage brokers developing a large non-prime mortgage business that did not exist before, for the sole purpose of satisfying the demand of a new community of leveraged traders and investors relying on market prices and liquidity.

The FSB has primarily chosen the resilience of the underlying assets as proxy for securitisation resilience. Paris Europlace believes that this metric is not appropriate. Indeed, the purpose of securitisation is to transfer risk. Risk implies that the investor has a probability to incur some losses, in line with the seniority of the tranche. Securitisation can be used to transfer risk on any type of portfolio, from low risk through higher risk portfolios, and even NPLs. This is not an issue, as long as the portfolio's risk is transparent, and that risk characteristics are assessed following a rigorous credit and portfolio analysis.

Consequently, the FSB measure of resilience should rather be whether the observed defaults and migration of the tranches are in line with their stated initial risk.

More broadly, market resilience requires to assess:

1) at issuer level, stability in issuance of regular volumes of securitisations on assets originated from banks' core lending book, and not assets which exceed their risk appetite,

2) at investor level, stability in investment strategies, enabling to develop through-the-cycle experience of credit losses per asset class and region.

Therefore, we believe that the final report would be enhanced by analysing vintages of issuance on all asset classes to identify changes in issuers and investors strategies per (sub)asset class, and to understand the nature of the relationship between issuers and investors. This can be achieved by establishing transparency on the risk transfer chain between lenders and ultimate owners of risk, which can be either bilateral and based on long-term partnership, or separated by several steps of risk transformation and leverage sensitive to changes in market prices and liquidity, but enabling scalability in a non-stress financial context.

8. 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?

As a preliminary remark, we note that most CLO managers essentially operate as asset managers, with light balance sheets, the only significant difference being that they raise funding in the form of tranched debt securities rather than equity or bonds investment in funds. As such, they may hold the assets they invest in through SPVs, funds and other vehicles.

Unlike other securitisation transactions, CLOs acquire loan assets that were not granted by the original lender with a view to being securitised, but rather, for the purpose of being distributed on the syndication market. CLOs invest in these loans as would any other participant to the syndication market, including in particular, credit institutions and other debt funds.

The FSB report focuses on CLOs using third party originators, which also act as retaining entity, while this does not reflect the only structuring option commonly used in the market: certain CLO managers hold the retention piece directly on their balance sheet and fund this holding by means of secured financing or repos.

The report is questioning whether a third-party originator can validly ensure an alignment of interest with the investors in the CLO, in particular because the entity acting as third-party originator is generally an SPV or a fund managed by the CLO manager but not necessarily affiliated to it. In practice, it usually issues notes or units held by third party investors. The report therefore seems to consider that the assets assigned to the CLO are originated by

the CLO manager, whereas the SPV or fund is retaining the risk on behalf of such third-party investors.

This view is based on the two following assumptions:

- the actual originator would be the CLO manager rather than the “third party originator” (and the third-party originator would hold the asset on behalf of the CLO manager; and

- the “third party originator” would not be a substantive entity and the risk should be deemed to be borne by its investors.

According to this view, the third-party investors would bear the risk for the benefit of the CLO manager.

We do not consider these assumptions appropriate for the following reasons:

- CLO managers that use third party originator usually create a substantive vehicle, whether in the form of a debt issuing entity or a fund, which is intended to be used on the long term to acquire loan assets on an on-going basis: these asset acquisitions are financed in different ways, which include debt or unit issuance, borrowing, and when the conditions are met, sale of sub-portfolios to CLOs established by the CLO manager; the third party originator is therefore taking the risk that the conditions to gather an appropriate sub-portfolio and to establish a new CLO may not be met, in which case it would remain exposed to the whole portfolio, both in market and credit terms;

- In order to be an eligible originator, the third-party originator must have originated more than 50% of the assets acquired by the CLO: in practice, this means that the third-party originator would have to be the most significant medium used by the CLO manager to originate loan assets;

- the investment by the third-party originator in loan assets is subject to a pre-established investment strategy, operated by a substantive credit business, involving a substantive corporate governance and credit and investment organisation;

- this investment strategy is defined in agreement with core investors holding the debt securities or units issued by the entity, with a view to establishing such investment strategy on the long term;

- the CLO manager is not necessarily expected to invest directly in these securities or units, but rather acts as an investment and management service provider to the originator, who is actually running the origination business: should the CLO manager disappear or fail to provide satisfactory services, the originator would have to seek to appoint another service provider to substitute the CLO manager to keep running its business.

The fact that the third-party originator is not part of the CLO manager’s group is not relevant because the latter is rather acting as a service provider to the former. And the fact that the investors in the third-party originator are not affiliates of the CLO manager or the originator does not differ from any stockholders in any substantive company.

This analysis relies on the substance of the origination business of the third-party originator, based on:

- an actual investment strategy involving the purchase of loan assets on the long term, operated by means of an effective operating organisation; and

- the actual holding of a significant pool of assets on an on-going basis, such that the transfer of sub-portfolios to CLOs does not mechanically result in the liquidation of the whole portfolio, but leaves the originator with a substantive origination business and significant resources.

The analysis would likely be different with a proper SPV used to season assets warehoused for the sole purpose of establishing one single CLO, or that would not bear any risk itself, i.e. acting on a pure pass-through basis.

More broadly, we understand that some market participants maybe arguing that retention rules are not relevant in the case of CLOs

Paris Europlace strongly disagrees with an approach that would single out a specific type of issuers. The principle “same risk, same regulation” must be maintained and broadened where not yet implemented. We see no compelling reason why CLO’s may be treated differently from banks securitisation of corporate or leveraged loans. Certainly, the quality of origination of banks cannot be considered as less robust, given the close supervisory scrutiny, which does not exist in the case of CLOs. For example, in the EU, banks are subject to strict Loan Origination and Monitoring guidelines, and Supervisory guidelines on leveraged loans that are currently being reviewed. The argument that CLOs are exclusively distributed to institutional investors is not either a specificity of CLOs. Most if not all securitisation issued by banks and by corporates (such as ABCPs) are also distributed to institutional investors.

As noted in the FSB report, retention rules have been a backbone in the post GFC securitisation reforms. They are now a well-accepted market practice, and it is doubtful that removing them would unlock significant market growth.

One argument could be that retention may be a bilateral contractual discussion between the issuer and the investor, rather than a one-size fits all rule. Paris Europlace warns that in this case, large experienced investors may have the market power to impose retention rules to issuers, but smaller investors may not be in a position to influence. This would translate in either a concentration of the risk in a smaller number of very large investors, or a lack of investor protection for smaller investor.

Instead of watering down retention rules, Paris Europlace believes that reporting and due diligence requirements should be reviewed to be more proportionate to the needs of investors.

9. Resilience metrics for the non-agency RMBS market: Does the report accurately describe the evolution of resilience indicators for the RMBS market? To what extent can the evolution of these indicators be attributed to the reforms?

As indicated in the report (p 56), “the period immediately prior to the GFC was characterised by 1) excessive risk taking and 2) the unsustainable build-up of leverage by the private sector”. The GFC was actually triggered by banks developing a large non-prime mortgage business that did not exist before, for the sole purpose of satisfying the demand of a new community of leveraged traders and investors relying on market prices and liquidity.

Market resilience requires therefore:

1) at issuer level, stability in issuance of regular volumes of securitisations on assets originated from banks’ core lending book, and not assets which exceed their risk appetite,

2) at investor level, stability in investment strategies, enabling to develop through-the-cycle experience of credit losses per asset class and region.

Therefore, we believe that the final report would be enhanced by analysing vintages of issuance on all asset classes to identify changes in issuers and investors strategies per (sub)asset class, and to understand the nature of the relationship between issuers and investors. This can be achieved by establishing transparency on the risk transfer chain between lenders and ultimate owners of risk, which can be either bilateral and based on long-term partnership, or separated by several steps of risk transformation and leverage sensitive to changes in market prices and liquidity, but enabling scalability in a non-stress financial context.

10. Risk retention in RMBS: Does the report accurately describe risk retention practices in the RMBS market before and after the reforms? What additional analyses could be included to assess the effectiveness of risk retention in RMBS across FSB jurisdictions?

11. 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?

Paris Europlace considers that the FSB analysis of the impact of the BCBS securitisation framework on banks’ behaviours is very superficial and would deserve more consideration. This analysis should be informed by a deeper and more structured dialogue with banks, to better understand the banks’ decision-making process as regards securitisation purpose, issuance, structuring, and investment strategies.

The BCBS securitisation reforms has had a direct impact on the viability of issuance for banks, and on banks as investors in 3rd party transactions. These impacts were largely disconnected from the broader initial Basel III impacts. On the contrary, the increasing pressure on banks’ capital should have translated into a larger use of securitisation to compensate some of this pressure. Given the excessive conservativeness of the BCBS securitisation framework, securitisation was unable to play its role in contributing to alleviate the capital pressure on banks, and banks had to limit the growth of their balance-sheets and lending origination instead.

While banks would be natural users of securitisation in their funding and capital strategies, their share in placed securitisation issuance has constantly reduced, while non-banks have increased, whether corporates, credit funds, digital lending platforms, etc. Indeed, securitisation is today an expensive option for retail banks, used mostly at the margin, to diversify funding sources or transfer some risks, with high costs and barriers to entry.

Actually, the prudential framework for banks was calibrated at a very conservative level, disconnected from the risks, creating a significant 'non-neutrality' in the framework (i.e., the capital requirement after securitisation is higher than before securitisation, sometimes a multiple of the capital requirement of the underlying pool).

From an issuer perspective, the decision to securitise a portfolio must be value creating, which means that the cost of securitisation must be compensated by a commensurate capital saving, otherwise the transaction is value destroying, and just does not happen.

In the EU, banks are the main source of funding to the economy, and therefore should be recognised as the natural and main source of, or transmission channel for, assets to be securitised. However, the existing prudential framework entails undue disincentives for banks to issue securitisation, stemming from the excessive 'capital non-neutrality', i.e., the fact that capital attached to securitised portfolio significantly exceeds the capital attached to the portfolio before securitisation.

This capital non-neutrality is driven by two distinct prudential rules:

- the 'p-factor' which distributes the capital across securitisation tranches (see Section 2.2),

- the risk weight floor applied to the most senior tranche (see Section 2.3).

Recently, and in particular after the possibility was given for synthetic transactions to be eligible to the STS label, the synthetic market has grown. However, given current calibration, only a limited portion of the banks' portfolios can be securitised in a value creating mode. Assuming that the quantitative issues are rectified, it will be important to also start thinking on how to further streamline the SRT assessment process, while making it more risk-sensitive.

Finally, in prudential reforms applicable to IRB banks, the report did not evaluate the combined impact of the RWA increase on the underlying assets and the output floor on retained senior tranches of SRT transactions.

12. 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?

Beyond the prudential issues faced by issuers and investors, the scale-up of the securitisation market also requires a true market to develop, both primary and secondary. For this ecosystem to develop, the market should be open to a broader range of issuers and investors, including UCITS funds, to increase volumes, which requires reducing existing barriers to entry and unnecessary regulatory burden for issuers and investors. Policy makers should introduce proportionality in due diligence and reporting requirements, notably as

regards senior high-grade transactions, private transactions, and involvement of EU players in third-country transactions.

Policy makers should review the current disclosure and due diligence requirements in order to more accurately meet the supervisors' and investors' needs, while limiting the burden of completing the regulatory disclosure to what is actually necessary.

Simplifying the reporting process would also benefit less frequent European bank issuers, and to that end, one could explore the consolidation of the multiple reporting formats and obligations currently affecting issuers and investors into an integrated due diligence and disclosure framework, which would allow for proportionality as a function of the type of transaction, based on different criteria.

Indeed, it is essential to differentiate the due diligence obligations and disclosure templates according to different categories of issuers and investors, based on the different asset classes, types of transaction and types of placement, with a view to adapting the nature and extent of information disclosure and due diligence requirements to these different situations.

The prescriptive templates produced by ESMA for the purposes of the disclosure under Article 7 SECR ("ESMA Templates") have been largely discussed among the different market participants. Some question the relevance of such templates, as opposed to a principle-based approach, while other question the appropriateness of the format of the ESMA Templates as they stand.

While we understand that a certain degree of standardisation is required for supervision purposes, we believe there is a consensus about the fact that the current templates are too detailed and that neither the investors nor the regulators need such level of details. While transparency is key for investors, any overdetailed disclosure reporting is in our view an obstacle to the development of the securitisation market and a comprehensive review would therefore be highly necessary.

We, therefore, believe that the current templates should be reviewed in order to more accurately meet the regulators' and investors' needs, while limiting the burden of completing the disclosure to what is actually necessary. Simplifying the report process would also benefit less frequent European bank issuers, and to that end, one could explore the consolidation of the multiple reporting formats and obligations currently affecting issuers and investors into a single reporting document format.

A debate has been taking place as to whether the same template (or format) of reporting should apply to public and private securitisations. This debate has raised the question of the definition of public versus private transactions (which currently depends on whether a prospectus has been established or not), but the answer to this question has proved to be complex and raise other issues.

We thus think that this criterion should not be the only one taken into account to determine the reporting regime, and that there should be a gradation of reporting depending on a more nuanced list of categories of transactions.

While transactions for which a prospectus has been established would always be subject to the full ESMA Templates reporting, other transactions would be subject to a proportionate reporting format depending on (i) the granularity of the securitised assets, (ii) the type of investors (regulated or not, subject to other reporting obligations or not), (iii) the existence of a secondary market (which make more unlikely the existence of a direct relationship and disclosure channel between the originator and the investors, and may result in the transfer to non-regulated investors), and finally (iv) the existence of confidentiality issues (which may impose the privacy of a detailed disclosure).

These different criteria could determine (a) where a loan-by-loan disclosure is both useful and practical (e.g. for public transactions, or for securitisation of certain categories of assets), (b) where the investors would rely mainly on a standardised disclosure (e.g. in respect of securitisation for which an active secondary market exists, and investors need to process a due diligence on automated and comparable basis), or where the relevant ESMA Templates would be in priority for supervisory purposes, and therefore (c) whether the regulatory disclosure should be publicly available or limited to either (i) the supervisors and/or (ii) the relevant investors.

While a detailed and standardised loan-level reporting may be required for public securitisations or securitisations of certain categories of assets, for which an active secondary market exists, subject always to warrantying the necessary level of confidentiality, this is not the case in other situations; for instance:

- certain categories of investors do not rely on the ESMA Templates to carry on their own due diligence and monitoring, and agree directly with the originator upon the type of disclosure they need;

- regulators do not review detailed loan-by-loan data, but instead process aggregated reporting based on the existing reporting used for ABCP transactions;

- in any event, originators would have the option to use a more detailed reporting template if they deem it appropriate.

All in all, such gradation of the disclosure would allow for more adequate and proportionate due diligence requirements. On the one hand, whilst standardised disclosure would allow investors in tradable asset-backed securities to implement automated or formatted due diligence, more sophisticated investors in tailor-made transactions, based on a more direct and ongoing relationship with the originator, would be authorised to determine the extent and the nature of information and reporting process and format best adapted to their needs, while ensuring (i) processable reporting for supervision purposes and (ii) confidentiality of the disclosed information where needed for commercial or legal reasons. On the other hand, the type of disclosure, whether on a loan by loan or aggregate basis, should be adapted to the level of granularity of the different asset classes.

To reduce barriers to entry on the market, it is necessary to streamline ESMA disclosure templates and adapt the related due diligence requirements. ESMA disclosure templates are not fit for purpose for private deals and represent an unnecessary costly burden. When determining reporting requirements, a clear distinction should be introduced made

depending on the role of the investor: long-term investment versus market-making or hedging.

13. 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 FSB report itself recognizes the limitations of its assessment of the main effects of the reforms on the financing of the economy, stating in particular that "Evaluating the broader effects of the risk retention and prudential requirements involves an assessment of their social benefits and costs. These assessments typically estimate the expected benefits of reforms in terms of reducing the likelihood and severity of financial crises. Concerning costs, such exercises generally assume that more stringent regulatory requirements increase the funding costs of financial institutions that are in turn passed on to borrowers through higher lending spreads, thereby reducing overall lending and economic output. To be comprehensive, such cost-benefit analyses require a general equilibrium model of the economy, which goes beyond the scope of this evaluation. An indication of potential costs and benefits of securitisation reforms can be inferred from examining the effects of the reforms on overall financing to the economy and on financial system structure and resilience (see section 5)."

Paris Europlace concurs that the assessment of the impacts of the securitisation reforms on the financing of the economy lacks a more holistic approach, given the reduced scope of asset classes and reforms included in the analysis, and the lack of focus on regional implementation and market specificities.

More generally, Paris Europlace would like to remind that, consistently with the other evaluation reports published so far by the FSB, such ex-post impact analysis are largely inconsequential, as the potential damage on the market functioning cannot easily be reversed ex post. Generally, the market has adapted, notably by shifting activities away from the regulated firms toward non-regulated or less regulated firms. Such changes in market structure should be taken into account, given that in theory, regulation should be business model neutral. It is not acceptable to conclude that there is no impact because the economy has continued to be financed (albeit through other channels than securitisation).

Actually, the FSB evaluation framework should be reformed, so that such evaluations of the impact of reforms should be made ex-ante, and not ex-post.

Before adopting regulatory rules, standard setters should not limit themselves to quantitative studies assessing the micro impact (at banks' level) and should aim to include the use of econometrics models for assessing the macro impact (at the level of the economy) ex-ante. This has not been done historically for the securitisation reforms, nor for any of the post-GFC reform agenda.

We will follow this lead and keep our answer at a high conceptual level: Regulatory rules should be consistent with the relative riskiness and liquidity of different financial instruments. Deviating from this principle leads either to partial or complete elimination of financial

activities or to regulatory arbitrage by the industry, unacceptable to regulators. There are economic and financial stability consequences of such deviations.

As an example of such detrimental effect of regulatory reforms on market functioning, one only needs to look at the collapse of the economic importance of traditional European securitisation, defined as the ratio of the Total Outstanding Amount to GDP. [For a graph, see slide 8 of the presentation available at https://www.eesc.europa.eu/en/news-media/presentations/securitisation-eu-way-forward-georges-duponcheele-presentation].
This ratio dropped continuously since 2012, where it was at 9.3%. In 2023, it was 4.3%. This is relevant as the year 2012 corresponds to the BCBS issuing its first proposal on how future rules might be framed, and encompasses the time period where such rules were adopted in Europe. One may conclude that securitisation no longer finances European economic growth. Furthermore, there are strong country and sectoral differences in the EU country-specific markets, with one commonality: those markets are not proportional to the country/sector GDP.

It is not possible to quantify independently all the economic co-factors that are explaining why the traditional placed securitisation market is moribund in Europe, but we note that the FSB has mentioned the main ones in Box 8 in Section 5.1 (Financing to the economy) of its report, as stated by "stakeholders": disclosure requirements, EU due diligence requirements, EU additional constraints applied to STC, EU Solvency II capital charges, bank capital calibration, EU LCR treatment of securitisation. It is notable from this list, that the majority of items derives from the EU rules, and not from IOSCO/BCBS rules (although the 'elephant-in-the-room' is clearly the BCBS bank capital calibration of securitisation exposures). Paris Europlace, as a stakeholder, produced a report asking for reforms on all of these points in addition to others.

One may infer from the previous two paragraphs that there is a large untapped financing source that could boost economic growth in all European countries and sectors without encumbering bank balance sheets or requiring unrealistic increases in bank equity needed to augment risk capacity. Thus, a focus on the legal format (i.e., whether a securitisation is executed in the traditional ('true sale') format rather than the synthetic format) is not the appropriate concept to assess the financing to the economy by the securitisation technique.

For a proper economic assessment, the FSB should ask whether a securitisation brings "capital velocity" by which we mean that securitisation permits a bank to free up capital that it can reinvest in new lending (see paper European Competitiveness and Securitisation Regulations on https://www.riskcontrollimited.com/wp-content/uploads/2024/08/European-Competitiveness-and-Securitisation-Regulations-v56.pdf). Retained securitisations or covered bond instruments (a 'securitisation-given-default' instrument) provide funding to the economy, but not financing, which requires additional risk taking. Section 5.1 of the report does not make sufficiently clear the distinction between funding to the economy and financing to the economy.

By including the economic notion of "capital velocity", the FSB could provide a comprehensive picture of the impact of reforms. The European picture of securitisation as a tool financing the economy would change materially, because of the focus of the European market on risk transfer transactions. And this development has been enabled by the EU-

specific synthetic STS framework (not a IOSCO/BCBS rule, although clearly inspired by the latter).

Furthermore, the fact that EU banks are not able to turn-over their balance-sheets, or increase the velocity of their balance-sheet, has a significant impact on their Return on Equity (RoE). In 2023, the average RoE of EU banks was 7.6%, compared with 9.9% for their US counterparts. This underperformance, partially due to the absence of a scalable securitisation market, also translates in a continuous decline in valuation, which in turn prevents banks to attract fresh equity capital in the market. This lack of profitability and investor appetite for bank stocks is a European vulnerability, and the development of securitisation would contribute to improve bank valuations and access to capital, therefore increasing their resilience and their shock absorbing capacity, therefore reducing financial stability risks.

One approach to assess ex-post the impact of reforms on the financing of the economy would be to adopt a "what-if" view, as the shrinking of the securitisation since 2012 in the EU can be seen as an opportunity loss. The question to be answered would become "If securitisation issuance had been maintained (or had grown in line with other regions), how much capital would banks have saved, and how much additional lending could they have generated over the period, while maintaining their capital ratio unchanged? Assuming reinvestment of capital at the same risk/return level, what would have been the impact on the Return on equity? Assuming same trends in the non-bank lending sector, what would have been the impact on the overall leverage of the corporate and household sector? What would have been the impact on EU GDP?

Such analysis would provide a solid base to judge the relevance of reforming the securitisation prudential framework, and allow the FSB to formulate recommendations to standard setters to that effect.

14. 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?

Paris-Europlace concurs that "the reforms have contributed to a redistribution of risk from banks to the non-bank financial intermediation (NBFI) sector, with banks shifting towards higher-rated tranches leading to an overall decrease in their risk-weighted asset density. However, the shift to the NBFI sector is not unique to securitisation as various conjunctural factors and structural changes in the global financial system since the GFC have increased reliance on market-based intermediation."

The FSB report goes on stating that "The financial stability impact of the redistribution of risks from the banking to the NBFI sector is difficult to assess since it is unclear if the non-bank entities taking on the risks previously held by banks are well-placed to assume them given their funding structure and ability to withstand losses in stress events."

Paris Europlace believes that the FSB should do a better job in differentiating the key trends in this redistribution of risks from the banking to the non-banking sector, by separating:

- On one hand, the evolution of the share of banks and non-banks in the origination of loans to businesses and households, across geographies.

- On the other hand, the evolution of the share of banks and non-banks in the securitisation market, distinguishing the issuance trends by asset class and by type of securitisation, and the ownership of securitized exposure, by seniority, type of transactions, and geographies.

Securitisation is at the cross roads of those two trends, as it allows to transfer risks originated in the banking sector to non-banks market participants.

While reducing the excessive reliance on bank funding has been a stated objective of the CMU project, Paris Europlace believes that an efficient financing of the European economy should rely on both Banks and capital markets. Securitisation acts as a bridge between bank lending and capital markets, and can be a very effective lever to change the balance between banking and market financing in the EU.

Indeed, such complementary vision would allow to rely on the existing safe and highly supervised origination by banks, while providing investors with reliable investible assets in which they would not have accessed otherwise, at the level of seniority and yield that corresponds best to their risk return appetite. Thanks to securitisation, investors have access to unique opportunities in terms of exposure type and in terms of risk/reward spectrum. They can obtain exposure to sectors of the economy that can hardly be reached otherwise (SME and consumer loans) and have a very granular approach to the level of risk they want to be exposed to, thanks to the tranching technique.

Bank origination remain the dominant model in the EU, especially as regards households and SMEs, even if some non-bank lending develops in the digital world. Banks have a very dense network of presence in the territories across the 27 member states, have a direct knowledge of their customers and manage their relationships in a long-term view.

Importantly, they are subject to a wide range of regulations in their origination activities, as summarized in the EBA Loan Origination and Monitoring guidelines. Not only are they expected to carefully assess the credit risk of their borrowers over the medium term, but they are also subject to consumer protection rules, Know Your Customers, ESG assessments, granular reporting of their risks, on-going monitoring through time, etc… And their capacity to comply with this wide range of rules is supervised by the SSM and NCAs on an ongoing and intrusive basis across the Union.

By contrast, non-bank lenders are subject to much less regulation although they are also subject to consumer legislation (if applicable) and rules on lending (e.g., on responsible lending) and are not under a similarly intrusive supervisory oversight.

Maintaining the pressure on bank capital requirements without giving the possibility to banks to share the risks with investors thanks to an efficient securitisation framework, would further grow the share of non-bank origination, which was at the roots of the US securitisation crisis, as sub-prime mortgages were mainly originated by mortgage brokers.

All in all, not only the development of securitisation in Europe would not increase financial stability risks, but the lack of securitisation may be a financial stability risk in itself, as shown in the recent publications by the IMF, the FSB and other policy makers trying to assess and address the financial stability risks of so-called “Non-Bank Financial Intermediation” or NBFI.

Finally, risk sharing through securitisation by construction reduces the risk of credit losses by the issuing bank in case of downturn, therefore increasing their resilience. Depending on the nature of the tranches sold, this benefit can be described differently, but in all cases, it is reducing vulnerability:

- When selling all or part of the first loss and mezzanine tranches in an SRT transaction, and keeping the senior tranche, the probability that the portfolio losses will exceed the first loss and mezzanine is minimal, whereas, the bank would be fully exposed if this portfolio had not been securitized (or issued in a covered bond format)

- When keeping the first losses and selling the senior tranche in a cash securitisation with an exclusive funding objective, and even if the SRT is not obtained, the issuing bank will have capped its losses and protected itself against a low probability, extreme loss in the portfolio.

15. Other issues: Are there any other issues or relevant factors that should be considered as part of the evaluation?

Paris-Europlace regrets that the report does not leverage the industry contributions provided in the earlier stage of the project.

The key messages are reflected in box 8:

Box 8: Stakeholder concerns about the effects of securitisation reforms

Some stakeholders have expressed concerns about the potentially dampening impact of G20 and jurisdiction-specific reforms on securitisation markets.130 The main concerns are described below.

The implementation of disclosure requirements was seen as too prescriptive and not sufficiently proportionate in some jurisdictions. For example, some EU stakeholders argued that the transparency and reporting framework for securitisations has increased transaction costs for issuers, which may make less regulated or transparent instruments appear more attractive.

Some market participants also argued that the EU due diligence requirements could be more principles-based, to better reflect investor needs and avoid adding to compliance costs and discouraging cross-border investments in securitisations.

Some stakeholders perceive progress in STC issuance as disappointing. They consider the relevant requirements in the EU (STS framework) to go further and be more constraining than the BCBS-IOSCO provisions, thereby limiting the supply of eligible securitisations.

EU stakeholders argue that Solvency II is not sufficiently risk sensitive or reflective of the actual risk in securitisation investments, which has allegedly reduced insurers’ interest in

this product. Relatedly, some stakeholders argue that the bank capital calibration for securitisation exposures has resulted in overly prudent risk weights and that further analysis is needed in relation to capital non-neutrality.

Some EU and US stakeholders suggest the treatment of securitisation in the LCR framework compared to other alternatives (e.g. covered bonds) has inhibited investment in this product by banks."

It is a pity that the FSB does not analyse each of those key messages in the body of the report, suggesting that the dialogue with the industry has not been fully taken into account in the FSB work.

2 September 2024

FSB Consultation Report Response

Evaluation of the Effects of the G20 Financial Regulatory Reforms on Securitisation

About Paris Europlace

Paris Europlace represents Paris international financial centre's market players, including banks, insurance companies, asset managers, financial intermediaries, international corporates, and other financial services providers. Paris Europlace ambitions include making the European Union more resilient and attractive to better fund the twin transition.

Paris Europlace has a dedicated Securitisation Committee (SC), under its European Financial Regulation Committee, which adopts an international approach when analysing the ongoing financial and prudential regulation in the EU and other jurisdictions (primarily the United States and the United Kingdom).

Members of Paris Europlace SC are securitisation specialists, often with decades of practice in this market, and working both on the issuing and investing sides, but also on transaction structuring, labelling, rating, servicing, thereby Paris Europlace is uniquely qualified to provide fact-based feedback to European policy makers, considering the overall securitisation ecosystem.

Questions for consultation

Paris Europlace Securitisation Committee welcomes the FSB invitation to comment on this consultation report and the questions set out below.

Background

Paris Europlace notes that this consultation report presents the preliminary results of the evaluation of the effects of the G20 financial regulatory reforms on securitisation that have been implemented to date. The evaluation focuses, in terms of reforms, on the International Organization of Securities Commissions (IOSCO) minimum retention recommendations and the Basel Committee on Banking Supervision (BCBS) revisions to prudential requirements for banks' securitisation-related exposures; and in terms of scope, on the collateralised debt/loan obligation (CDO/CLO) and the non-government-guaranteed part of the residential mortgage-backed securities (RMBS) market segments.

Paris Europlace regrets that the FSB chose to reduce the scope of the report to a narrow set of asset classes and a narrow set of policies. This choice leaves major aspects of the securitisation market unaddressed, although they also contribute to the financing of the economy, be it through Asset-Backed Commercial Paper, Consumer credit ABS or SRT synthetic securitisation, among others. It also disregards the impact of reporting, disclosure and due diligence rules, as well as rules impacting (re)insurers as investors or risk takers, credit rating agencies, and structuring requirements other than retention rules, such as restrictions in re-securitisation, limits in relative size and maturity profiles applying to UCITS, etc…

Paris Europlace strongly encourages the FSB to broaden its analysis to provide with a more holistic assessment, as the FSB intends to continue its analysis of the reforms, including through empirical work, and to publish its final report at the end of 2024.

Paris Europlace also understands that this FSB evaluation work is part of a broader evaluation program launched in 2017[1]. This ex-post evaluation framework has been applied successively to various aspects of the financial markets post Global Financial Crisis (GFC) reforms, namely Infrastructure Finance and Central Clearing of Derivatives in 2018, SME financing in 2020, too-big-to-fail reforms in 2021. **As far as Paris Europlace members, involved in most of those consultations, have experienced, all those reports have concluded that reforms had achieved their purpose, without measurable negative consequences on the economy. This outcome is disappointing and suggests that the analytical framework and/or the governance of the process may result in missed opportunities to address unintended consequences, putting into question the very purpose of the evaluation program.** As then FSB Chairman Randal Quarles stated:

"*In any system as complex and consequential as the body of post-crisis financial regulations, there will always be aspects-and sometimes material aspects-that can be improved on the basis of experience and analysis. A credible review process that is both rigorous and dispassionate will find a few*."[2]

Paris Europlace urges the FSB to finalize its analysis in a truly open mindset, as recommended by former Chair Quarles, recognizing specific areas of over-shooting and recommending concrete, targeted improvements or revisions to standard setters. The case of securitisation is clearly in such a situation where, in particular in the European Union (EU), the functioning of the market has been

[1] https://www.fsb.org/2017/07/framework-for-post-implementation-evaluation-of-the-effects-of-the-g20-financial-regulatory-reforms/

[2] Randal Quarles, February 10, 2019 – Speech to the Bank of International Settlements https://www.federalreserve.gov/newsevents/speech/quarles20190210a.html

significantly hampered by many reforms, as shown by multiple recent reports[3]. **Therefore, ending this evaluation without any substantial action plan to be implemented by IOSCO, BCBS and/or key jurisdictions could raise questions as to the credibility of the overall FSB evaluation framework**, at a time when financing needs to address the twin transition are huge.

Questions

Overall

1. 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?

Paris Europlace agrees that the main objective of the reforms was to reduce misaligned incentives and moral hazard, and thereby limit systemic risk. There is no doubt that US securitisation has represented a major systemic risk during the GFC, as a factor of contagion across various types of market participants and across geographies. However, it should be noted that:

- The European securitisation market performed much better during the GFC and did not contribute to the crisis in any significant way.

- At the time, the US « originate and distribute » framework represented a significant moral hazard issue, which has since been solved in particular by the retention rules, which ensure « skin in the game » by the originator, as implemented in Dodd Frank and in the EU Securitisation Regulation. Such measures have allowed to significantly reduce the systemic risk that had materialized during the GFC, subject to proper implementation by jurisdictions, and appropriate supervisory scrutiny, ensuring that rules are not circumvented.

At the same time, **prudential rules have become extremely conservative for banks and insurance companies, notably in Europe, which has driven a significant shrinkage of the EU securitization market, with low supply by issuers and low demand from investors**. Looking at current issuance volumes in the EU, it is clear that securitisation does not have the scale that may generate a systemic risk, and would have considerable room for growth before reaching a potentially worrying level.

In the US, where retention rules have been implemented, but where the prudential treatment has remained basically local, as BCBS reforms (STC and prudential rules) have not been implemented, the market promptly restarted after the GFC, and is now much bigger compared to pre GFC levels, without having generated any systemic risk concern during the recent episodes of turmoil, linked to COVID-19, the US Treasury market issues, the Russian war in Ukraine, or the recent regional banks failures.

While comparing how the international standards have been implemented across jurisdictions, **we would welcome that the FSB encourages the EU to remove some of the gold-plating, for example, in**

[3] Examples include the 2024 reports chaired by Enrico Letta (https://www.consilium.europa.eu/media/ny3j24sm/much-more-than-a-market-report-by-enrico-letta.pdf), Christian Noyer (https://www.tresor.economie.gouv.fr/Articles/e3283a8f-69de-46c2-9b8a-4b8836394798/files/6b8593b5-ca31-45a3-b61c-11c95cf0fc4b) Paschal Donohoe (https://www.consilium.europa.eu/media/70782/peg-to-pec-letter-march-2024-final.pdf) and the January 2023 Joint Committee advice (banking) on the review of the securitisation prudential framework (https://www.eiopa.europa.eu/document/download/fd921094-c861-4583-9a41-60bc09e6b779_en?filename=JC%202022%2066%20-%20JC%20advice%20on%20the%20review%20of%20the%20securitisation%20prudential%20framework%20-%20Banking.pdf)

the extremely prescriptive and narrow definition of STS compared to STC, or in the very intrusive and burdensome interpretation of the principle-based notion of "Significant Risk Transfer".

2. Analytical approach: Are the descriptive analyses used to evaluate the effects of the securitisation reforms appropriate? Are there other such analyses to consider? What types of empirical analysis based on available data could inform the evaluation?

Paris Europlace agrees with the aspects studied by the FSB, including the complexity and opaqueness of structures; credit enhancement; changes in the investor base; credit quality of underlying loans and credit performance; pricing of securitised assets; and the robustness of these markets during recent episodes of stress and in hypothetical adverse scenario analyses.

Paris Europlace also welcomes that the FSB has excluded US agency securitisations, such as those of Fanny Mae in the US, from the analysis. The US agency market is so different in its dynamics and rationale, that incorporating it in an analysis of securitisation would have been misleading. **In the same vein, Paris Europlace strongly recommends that the FSB also excludes the retained securitisation transactions, which in our view are not part of the securitisation market, but are structured for pure liquidity and collateral management**. Incorporating them in any analytical work inaccurately flatters the size of the European market. Indeed, the distorting impact of including them is well illustrated by a graph that appears in the FSB report (see graph 6 on page 21). Adjusting for the retained transactions (where, by construction, neither retention rules not prudential rules play a role) would provide a much more realistic assessment of the persistently subdued European securitisation market, despite the expected benefit of introducing the STS framework.

Overview of securitisation markets

3. Trends: Are the securitisation market trends presented in this report adequate given the scope of the evaluation? Are there other important trends that should be included and, if so, what additional data sources could be used for this purpose?

As regards the chapter presenting market trends, as explained above, it would be more relevant to exclude from the comparisons the retained transactions, which are not market transactions.

It would also be useful, in addition to the horizontal analysis, to **explain separately the trends for each of the major geographies, which would help understanding the drivers behind the figures, and subsequently exploring potential recommendations.**

In Europe, the securitisation market has collapsed since the GFC, particularly the segment of publicly placed issuances. Between 2007 and 2023, total annual issuance volumes of securitised assets dropped in Europe from EUR407bn to EUR213bn according to AFME data, a decrease of 48%, a trend which was not observed in other jurisdictions. **In addition, the ratio of the European to the US issuance has remained below 20% since 2012, while it reached 85% in 2008**[4]. According to the latest AFME CMU report[5], EU securitisation issuance adjusted by GDP continues to languish far behind global competitors. In 2023, EU issuance was equal to 0.4% of EU GDP which compares with 0.9% in the UK, 1.1% in the US (excluding issuance guaranteed by the government agencies), 2.4% in Australia, 1.0% in Japan and 1.5% in China, as AFME data also show.

[4] Source: AFME

[5] AFME - Capital Markets Union - Key Performance Indicators – Sixth Edition - European Capital Markets: scaling up capital markets - November 2023

A reverse trend has been noticed in synthetic SRT transactions, with a growing volume of securitized assets year after year, from a low base, and as SRT securitisation became progressively recognised as a reliable tool in bank's capital management toolkit, also in the wake of ongoing increases in the prudential regulatory and supervisory pressure on the overall balance sheet, which has taken place since the Global Financial Crisis. In 2023, at global level, banks executed synthetic SRT transactions on EUR 207bn of loans, covered by EUR18.5bn (close to 9%) of tranches attaching generally at 0%. EU banks executed SRT transactions on EUR 107bn of loans.[6]

Whether the underdevelopment of the securitisation market in Europe is driven by a lack of offer or a lack of demand is often debated in policy circles, to focus potential regulatory adjustments on the most binding constraints. Paris Europlace considers that the securitisation market must be looked at as an ecosystem, and that the instrument must make sense both for the issuers and the investors. A decade ago, the post-crisis regulatory agenda implemented a very conservative framework probably aiming at disincentivising the use of securitisation, both from the issuers and investors standpoints, the (expected) outcome has been to discourage both regulated issuers and regulated investors.

On the supply side, while banks would be natural users of securitisation in their funding and capital strategies, their share in placed securitisation issuance has constantly reduced, while non-banks' share has increased, whether corporates, credit funds, digital lending platforms, etc. Indeed, securitisation is today an expensive option for banks, used mostly at the margin, to diversify funding sources or transfer some risks, with high costs and discouraging barriers to entry for many medium size banks.

Actually, the prudential framework for banks was calibrated at a very conservative level, disconnected from the economic risks, thus creating a significant 'non-neutrality' in the framework (i.e., the capital requirement after securitisation is higher than before securitisation, sometimes a multiple of the capital requirement of the underlying pool).

Another factor often cited to explain the decline in public securitisation issuance by banks is the abundant liquidity provided by central banks. Although this may have played a role in cash securitisation, it has no impact on synthetic transactions aiming at risk transfer. And even in cash transactions, we have observed only limited improvement with the more restrictive monetary policy recently implemented. It should be observed that other jurisdictions also provided abundant liquidity to banks over the last decade, but their securitisation market continued to experience solid growth.

From an issuer perspective, the decision to securitise a portfolio must be value creating, which means that the cost of securitisation must be compensated by a commensurate capital saving, otherwise the transaction is value destroying, and just does not happen.

In the EU, banks are the main source of funding to the economy, and therefore should be recognised as the natural and main source of, or transmission channel for, assets to be securitised. However, the existing prudential framework entails undue disincentives for banks to issue securitisation, stemming from the excessive 'capital non-neutrality', i.e., the fact that capital attached to securitised portfolio significantly exceeds the capital attached to the portfolio before securitisation.

This capital non-neutrality is driven by two distinct prudential rules:

- the 'p-factor' which distributes the capital across securitisation tranches,
- the risk weight floor applied to the most senior tranche.

Investors on publicly placed senior tranches are clearly not enough in number and volume, even in the current low level of issuance, especially since the ECB has discontinued its assets purchase program. It is basically limited to 20-30 bank investors, asset managers and public institutions. Not only the number of investors in these tranches has significantly reduced over the years, but also order sizes

[6] Source: IACPM Synthetic Securitization Market Volume Survey 2016-2023

(especially with asset managers) can be quite small (while much larger for covered bonds), placing reliance on a handful of anchor investors.

According to its 2022 report on Monitoring systemic risks in the EU securitisation market[7], the European Systemic Risk Board (ESRB) stated: "EU banks remain the main holders of EU securitisations. Nonetheless, EU banks retain securitisations mostly for use as collateral in central bank operations. In the second quarter of 2021 euro area banks held 84% of the total market value of euro area securitisations. Of these, 40% of true sale securitisations held by euro area banks had an AAA external credit rating. This apparent large share of banks does not show a dynamic market, as in the case of retained transactions, the bank only transforms illiquid portfolios into collateral eligible to the ECB, which does not create any room for new lending."

In the FSB report, the Graph 6 showing the proportion of securitisation assets held by banks, where banks are originator or sponsor, provides an interesting angle. It shows that **European banks predominantly use securitisation as an instrument closely linked to their own credit origination strategy, contrary to other regions**, in particular the Americas, where most bank holdings of securitisation tranches are for investment purposes. Once corrected by removing retained tranches (according to Table 1, and generally used data, about 50% of the outstanding), this pattern would deserve to be examined more closely. It can be interpreted in the following ways:

- European banks have been crowded out of the securitisation market as investors. This may be due to the punitive treatment of securitisation in the LCR, especially compared with covered bonds.
- European banks are more affected by prudential rules determining the capital relief applied to Significant Risk Transfer transactions.
- With such low level of investments, there is less contagion risks than in other regions.
- On most of their securitisation portfolios, there is no or very limited agency risks, given the underlying has been originated or sponsored by the bank, according to strict loan origination and monitoring guidelines, and therefore **the justification of capital non-neutrality with agency risk arguments does not hold.**

This is a good example of why it would be essential to have a regional approach as regards market trends and potential regulatory impacts, even if the securitisation market should be a global market.

Other important trends are missing, especially on SRT transactions:

• The growing participation of regional/local banks, both in the EU and US. This implies that any review of calibrations should not only focus on IRB banks, but also Standardized approaches (which will also impact IRB banks with the implementation of the Basel III output floor).

• The involvement of non-life insurers on the liability side in Europe, and their role in the US non-agency RMBS. Non-life insurers have the potential to contribute to the robustness of the market, as most of their risks are largely decorrelated from credit risk.

• The differences between the emerging US and the current European SRT markets, from both an issuer and an investor perspective, mostly due to differences in banks' prudential regulations: If local prudential regulations require higher RWA on similar assets, local banks have to protect thicker tranches to enable capital release. However, if the thickness of the protected tranches largely exceeds the cumulated expected and unexpected losses on the underlying loan pool, such thick tranches would not be priced at a level commensurate with investors target risk/return, which may incentivize them to consider leveraging their investment. This example illustrates that **regulatory differences, or**

[7] https://www.esrb.europa.eu/pub/pdf/reports/esrb.report_securisation.20220701~27958382b5.en.pdf

insufficient risk sensitivity, can be a source of arbitrage or leverage, which can disrupt the market and increase the risk of contagion in a crisis situation.

• The collected information covers a period of weak demand for credit, due to multiple crises. However, the huge investments needed for the digital and environmental transition, combined with the impact of deglobalization, can change rapidly the credit demand and reported behaviours. Non-bank lending is growing, together with banks' need to securitize so that most of the credit market remains delivered and service by regulated entities.

Securitisation reforms

4. Relevant reforms: Does the report appropriately describe the key aspects of the design and jurisdictional implementation of the BCBS and IOSCO reforms for analysing their impact on securitisation markets? Are there other important aspects of these reforms that should be considered for inclusion?

Paris Europlace fully supports the report statement that "*The risk sensitivity of the prudential framework is one of the drivers of a sustainable securitisation market that can support financing to the economy. Such a framework, by ensuring that capital charges are commensurate with the risks, enables banks to contribute to a proper functioning of the market and to channel lending to the real economy*." Indeed, we strong believe that a correct, risk-based calibration is a public good, the only way to avoid regulatory arbitrage, unlevel playing field, and build-up of risks in the least regulated area.

The FSB consultation report also states that "*the Basel III reforms increased overall capital charges for securitisation exposures and generally made them more risk sensitive. This was one of the intended effects of the reforms to enhance the resilience of the banking sector and promote a sound securitisation market. However, analysis of the appropriate specification and calibration of the prudential standards – in terms of the approaches, factors and risk weight formulae used – is beyond the scope of this evaluation, although authorities in some member jurisdictions have examined the framework risk sensitivity as part of their securitisation reforms evaluation (see p35)*."

The FSB decision to exclude the analysis of the commensurateness of the prudential standards from the scope of its evaluation is in our view a negation of the very purpose of the evaluation, and should be revisited, if the FSB intends to table a report that would bring added value to the policy community.

As regards the BCBS reforms, Paris Europlace considers that the description is insufficiently detailed, and in some cases biased.

For example, the report recognizes that the December 2014 reforms '*also included a capital non-neutral approach. Capital "non-neutrality" refers to the fact that under the Basel III reforms the total capital required for a securitisation (i.e. the sum of the capital required for all securitisation tranches) is greater than the amount of capital required for the underlying assets. This non-neutrality was introduced to address structural risks such as model and agency risks*." However, the report falls short of quantifying the non-neutrality, which in our experience can easily reach a factor of 2, a level that can certainly not be justified by model and agency risks, especially when banks are originators or sponsors. **Such an analysis of the degree of non-neutrality, which has never been made public by the BCBS, would be a significant value added for the report.** It would show how the framework (and notably the so-called p-factor") behaves, as a function of asset classes.

Another example is the description of the look-through approach. The report justifies this feature by stating that "*While the capital requirements were significantly increased, maximum risk weights for senior tranches based on a "look-through" approach were introduced. The "look-through" approach*

promotes consistency with the credit risk of the underlying pool of exposures and does not disincentivise securitisations of low credit risk exposures." Actually, the look-through approach (which means that the RW of a senior tranche cannot be higher than the risk weight of the securitisation pool) does work as a powerful disincentive to securitize. If a bank gets the same RW on the senior tranche, after having sold the junior tranches at a high cost, as the RW before securitisation, there is no capital relief, and the transaction is value destroying. Consequently, it just does not happen. **We encourage the FSB to develop a case study to assess this simple rule and show that the look-through approach is actually not risk-sensitive. A more risk-sensitive approach to assess the RW of the senior tranche, taking into account the risk of underlying assets, to avoid disincentivizing the securitisation of low-risk portfolios, would be to implement the "Risk-sensitive Risk Weight Floor" as proposed in our report[8].**

Overall, these examples show that the prudential framework lacks true risk-sensitivity, contrary to the stated goal.

Paris Europlace welcomes that the report refers, in Box 3, to EU and UK recent analyses on the securitisation framework. Indeed, in 2022, the European Supervisory Authorities (ESAs) reviewed the securitisation prudential framework for banking in the EU against the framework's original objective of contributing to the sound revival of the EU securitisation market on a prudent basis. In their report to the EC, the Joint Committee (JC) of the ESAs identified certain concerns about the framework's risk sensitivity.

However, Paris Europlace disagrees with the FSB's choice to quote that "*the JC concluded that re-calibrating the securitisation prudential framework would not be a solution that would ensure the revival of the securitisation market."*[9] Actually, the Joint Committee itself stated that "*This advice includes targeted recommendations to support the securitisation market in a prudent manner and to promote the issuance of resilient securitisations qualifying for a more beneficial capital treatment, without jeopardizing investor protection and financial stability."* **Paris-Europlace urges the FSB to adopt a more open-minded approach in referring to the Joint Committee report, to make the evaluation work both credible and constructive.**

Later in the consultation report, the FSB describes only superficially the Joint Committee work by quoting: "*The JC noted that it is possible to increase the risk sensitivity of the framework, but this would require a more fundamental and comprehensive review before conclusive opinions can be formed. Work is ongoing by the ESAs on this issue as part of a follow-up review under Capital Requirements Regulation (CRR) and the Securitisation Regulation.*"

It is extremely disappointing that the FSB does not leverage in a more granular fashion on this important work. Actually, the Joint Committee "*makes the following recommendations with respect to the prudential framework for banks:*

• *Technical fixes to the prudential framework aiming at improving its consistency and clarity in the framework [see section 3.2 of the advice on banking].*

• *A more substantial, but still targeted, recommendation aimed at improving the risk sensitiveness of the framework by recognising the reduced model and agency risk associated to originators [see Section 3.3.1. of the advice on banking]. The JC advice elaborates on why a reduction of the risk weight floor*

---

[8] See https://www.riskcontrollimited.com/wp-content/uploads/2024/05/20240503-Rethinking-the-Securitisation-Risk-Weight-Floor-v61.pdf

[9] Full quote from **Joint Committee Advice on the review of the securitisation prudential framework (banking):** *"At this stage the JC considers that re-calibrating the securitisation prudential framework for institutions would not be a solution, which **alone** would ensure the revival of the securitisation market. While the treatment of securitisation in the capital and liquidity framework may play a role, the prudential framework is not, in itself, the key obstacle to the revival of the securitisation market. A holistic assessment shows that the current subdued status of the securitisation market is the result of an interplay of a series of factors, including the interplay between low supply and low demand, due to a lack of inherent interest from both sides."*

for senior tranches retained by originators may support further growth in the SRT market in a prudent manner, if accompanied by a set of appropriate safeguards. This would in particular promote the issuance of resilient securitisations, which can qualify for a more beneficial capital treatment, without jeopardising financial stability.

• General issues on the securitisation risk weight formulas that underpin the framework [see section 3.3.2 of advice on banking]. These however require further work which should be potentially brought for discussion to the Basel Committee on Banking Supervision (BCBS).”

Paris Europlace believes that this call by the EU regulatory agencies to the BCBS to review the securitisation framework should be echoed explicitly by the FSB in its final report, as it would otherwise be an important missed opportunity to reduce the current market fragmentation.

As regards the STC framework, the BCBS framework is principles-based. However, the STS framework as implemented in Europe is much more prescriptive. A detailed comparison between the two frameworks would be extremely helpful to better assess the impact the STS had on the EU securitisation market, and the fragmentation it generated, crowding out EU banks and investors from sponsoring or investing in non-EU securitisation. Indeed, EU-based institutional investors face specific difficulties investing in non-EU securitisation transactions as non-EU reporting entities cannot or are not willing to provide EU investors with the full article 7 template disclosure. **The FSB should encourage convergence and proportionality in disclosure and due diligence requirement to reduce market fragmentation. Similarly, EU banks involved in sponsoring or structuring securitisation on behalf of financial or corporate clients, are unable to compete in global markets, including accompanying their EU clients in their non-EU securitisation programs. Accessing the large US and Asian securitisation markets is also a pre-requisite for these EU banks to have the scale allowing them to maintain dedicated expert resources, and develop a viable business model.**

More generally, jurisdictional differences are not analysed in sufficient details. The qualification that the US framework is “*largely in line with the Basel III framework except for some parameters*” is only detailed in a footnote stating that “*Key differences between SSFA under the current US capital rule and the SEC-SA rule include lower p factor (0.5 compared to 1.0 in the Basel framework), a higher risk weight floor of 20%, a lack of specific treatment for non-performing exposures. See Annex 1 for a description for more details on the Basel approaches and the relevance of the p factor.*” The significance of those differences is not qualified.

5. 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?

Another key reform which would deserve a more in-depth analysis is the LCR. On this subject, the FSB report notes that “*The EU has also provided further incentives by recognising certain STC securitisations as a type of high-quality liquid asset (HQLA) for the LCR.*”

But actually, this recognition is accompanied with a punitive haircut (25%-35%), even for senior STS transactions. Indeed, these haircuts are totally dissuasive, and according to EBA Risk Dashboard, Level 2A and 2B combined (the most granular figure published by EBA, which includes STS securitisation), represent on average only 4% of the Total HQLA portfolio for European banks, which amounts to EUR5.5tr.

Consequently, while banks could be legitimate and sizeable investors in senior tranches of third-party securitisations, as part of their High-Quality Liquid Assets buffer, they were crowded out of the market.

Indeed, banks, even when buying STS tranches, are penalised with a significant haircut, higher than covered bonds, which makes them too onerous to play a role in the management of the liquidity buffer (LCR). It should also be noted that LCR eligibility is an important investment criterion for the banks but **also for non-bank investors, who take this liquidity aspect into account in their investment decision.**

6. Conceptual framework: Does the report adequately explain the objectives, transmission channels and expected outcomes of the securitisation reforms? What other metrics to assess the impact of the reforms should be considered?

To report on transmission channels, **the FSB should consider analysing the entire chains of risk transfer from loan origination to ultimate investors**. These chains can be very simple for bilateral transactions developed in partnership between banks and ultimate long-term investors, but become more complex, involving different steps of transformation and new transmission channels, if tranches are not directly protected by the ultimate investors. The report would be enhanced by identifying the various transmission channels and their factors of sensitivity along the most common chains of risk transfer.

Effectiveness of the securitisation reforms

7. 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?

As indicated in the report (p 56), "the period immediately prior to the GFC was characterised by 1) excessive risk taking and 2) the unsustainable build-up of leverage by the private sector". The GFC was actually triggered by mortgage brokers developing a large non-prime mortgage business that did not exist before, for the sole purpose of satisfying the demand of a new community of leveraged traders and investors relying on market prices and liquidity.

The FSB has primarily chosen the resilience of the underlying assets as proxy for securitisation resilience. Paris Europlace believes that this metric is not appropriate. Indeed, the purpose of securitisation is to transfer risk. Risk implies that the investor has a probability to incur some losses, in line with the seniority of the tranche. Securitisation can be used to transfer risk on any type of portfolio, from low risk through higher risk portfolios, and even NPLs. This is not an issue, as long as the portfolio's risk is transparent, and that risk characteristics are assessed following a rigorous credit and portfolio analysis.

Consequently, the FSB measure of resilience should rather be whether the observed defaults and migration of the tranches are in line with their stated initial risk.

More broadly, market resilience requires to assess:

1) at issuer level, stability in issuance of regular volumes of securitisations on assets originated from banks' core lending book, and not assets which exceed their risk appetite,

2) at investor level, stability in investment strategies, enabling to develop through-the-cycle experience of credit losses per asset class and region.

Therefore, we believe that the final report would be enhanced by analysing vintages of issuance on all asset classes to identify changes in issuers and investors strategies per (sub)asset class, and to understand the nature of the relationship between issuers and investors. This can be achieved by establishing transparency on the risk transfer chain between lenders and ultimate owners of risk, which can be either bilateral and based on long-term partnership, or separated by several steps of risk

transformation and leverage sensitive to changes in market prices and liquidity, but enabling scalability in a non-stress financial context.

8. 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?

As a preliminary remark, we note that most CLO managers essentially operate as asset managers, with light balance sheets, the only significant difference being that they raise funding in the form of tranched debt securities rather than equity or bonds investment in funds. As such, they may hold the assets they invest in through SPVs, funds and other vehicles.

Unlike other securitisation transactions, CLOs acquire loan assets that were not granted by the original lender with a view to being securitised, but rather, for the purpose of being distributed on the syndication market. CLOs invest in these loans as would any other participant to the syndication market, including in particular, credit institutions and other debt funds.

The FSB report focuses on CLOs using third party originators, which also act as retaining entity, while this does not reflect the only structuring option commonly used in the market: certain CLO managers hold the retention piece directly on their balance sheet and fund this holding by means of secured financing or repos.

The report is questioning whether a third-party originator can validly ensure an alignment of interest with the investors in the CLO, in particular because the entity acting as third-party originator is generally an SPV or a fund managed by the CLO manager but not necessarily affiliated to it. In practice, it usually issues notes or units held by third party investors. The report therefore seems to consider that the assets assigned to the CLO are originated by the CLO manager, whereas the SPV or fund is retaining the risk on behalf of such third-party investors.

This view is based on the two following assumptions:

- the actual originator would be the CLO manager rather than the “third party originator” (and the third-party originator would hold the asset on behalf of the CLO manager; and

- the “third party originator” would not be a substantive entity and the risk should be deemed to be borne by its investors.

According to this view, the third-party investors would bear the risk for the benefit of the CLO manager.

We do not consider these assumptions appropriate for the following reasons:

- CLO managers that use third party originator usually create a substantive vehicle, whether in the form of a debt issuing entity or a fund, which is intended to be used on the long term to acquire loan assets on an on-going basis: these asset acquisitions are financed in different ways, which include debt or unit issuance, borrowing, and when the conditions are met, sale of sub-portfolios to CLOs established by the CLO manager; the third party originator is therefore taking the risk that the conditions to gather an appropriate sub-portfolio and to establish a new CLO may not be met, in which case it would remain exposed to the whole portfolio, both in market and credit terms;

- In order to be an eligible originator, the third-party originator must have originated more than 50% of the assets acquired by the CLO: in practice, this means that the third-party originator would have to be the most significant medium used by the CLO manager to originate loan assets;

- the investment by the third-party originator in loan assets is subject to a pre-established investment strategy, operated by a substantive credit business, involving a substantive corporate governance and credit and investment organisation;

- this investment strategy is defined in agreement with core investors holding the debt securities or units issued by the entity, with a view to establishing such investment strategy on the long term;

- the CLO manager is not necessarily expected to invest directly in these securities or units, but rather acts as an investment and management service provider to the originator, who is actually running the origination business: should the CLO manager disappear or fail to provide satisfactory services, the originator would have to seek to appoint another service provider to substitute the CLO manager to keep running its business.

The fact that the third-party originator is not part of the CLO manager's group is not relevant because the latter is rather acting as a service provider to the former. And the fact that the investors in the third-party originator are not affiliates of the CLO manager or the originator does not differ from any stockholders in any substantive company.

This analysis relies on the substance of the origination business of the third-party originator, based on:

- an actual investment strategy involving the purchase of loan assets on the long term, operated by means of an effective operating organisation; and

- the actual holding of a significant pool of assets on an on-going basis, such that the transfer of sub-portfolios to CLOs does not mechanically result in the liquidation of the whole portfolio, but leaves the originator with a substantive origination business and significant resources.

The analysis would likely be different with a proper SPV used to season assets warehoused for the sole purpose of establishing one single CLO, or that would not bear any risk itself, i.e. acting on a pure pass-through basis.

More broadly, we understand that some market participants maybe arguing that retention rules are not relevant in the case of CLOs

Paris Europlace strongly disagrees with an approach that would single out a specific type of issuers. The principle "same risk, same regulation" must be maintained and broadened where not yet implemented. We see no compelling reason why CLO's may be treated differently from banks securitisation of corporate or leveraged loans. Certainly, the quality of origination of banks cannot be considered as less robust, given the close supervisory scrutiny, which does not exist in the case of CLOs. For example, in the EU, banks are subject to strict Loan Origination and Monitoring guidelines, and Supervisory guidelines on leveraged loans that are currently being reviewed. The argument that CLOs are exclusively distributed to institutional investors is not either a specificity of CLOs. Most if not all securitisation issued by banks and by corporates (such as ABCPs) are also distributed to institutional investors.

As noted in the FSB report, retention rules have been a backbone in the post GFC securitisation reforms. They are now a well-accepted market practice, and it is doubtful that removing them would unlock significant market growth.

One argument could be that retention may be a bilateral contractual discussion between the issuer and the investor, rather than a one-size fits all rule. Paris Europlace warns that in this case, large experienced investors may have the market power to impose retention rules to issuers, but smaller investors may not be in a position to influence. This would translate in either a concentration of the risk in a smaller number of very large investors, or a lack of investor protection for smaller investor.

Instead of watering down retention rules, Paris Europlace believes that reporting and due diligence requirements should be reviewed to be more proportionate to the needs of investors.

9. Resilience metrics for the non-agency RMBS market: Does the report accurately describe the evolution of resilience indicators for the RMBS market? To what extent can the evolution of these indicators be attributed to the reforms?

As indicated in the report (p 56), "the period immediately prior to the GFC was characterised by 1) excessive risk taking and 2) the unsustainable build-up of leverage by the private sector". The GFC was actually triggered by banks developing a large non-prime mortgage business that did not exist before, for the sole purpose of satisfying the demand of a new community of leveraged traders and investors relying on market prices and liquidity.

Market resilience requires therefore:

1) at issuer level, stability in issuance of regular volumes of securitisations on assets originated from banks' core lending book, and not assets which exceed their risk appetite,

2) at investor level, stability in investment strategies, enabling to develop through-the-cycle experience of credit losses per asset class and region.

Therefore, we believe that the final report would be enhanced by analysing vintages of issuance on all asset classes to identify changes in issuers and investors strategies per (sub)asset class, and to understand the nature of the relationship between issuers and investors. This can be achieved by establishing transparency on the risk transfer chain between lenders and ultimate owners of risk, which can be either bilateral and based on long-term partnership, or separated by several steps of risk transformation and leverage sensitive to changes in market prices and liquidity, but enabling scalability in a non-stress financial context.

10. Risk retention in RMBS: Does the report accurately describe risk retention practices in the RMBS market before and after the reforms? What additional analyses could be included to assess the effectiveness of risk retention in RMBS across FSB jurisdictions?

n/a

11. 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?

Paris Europlace considers that the FSB analysis of the impact of the BCBS securitisation framework on banks' behaviours is very superficial and would deserve more consideration. This analysis should be informed by a deeper and more structured dialogue with banks, to better understand the banks' decision-making process as regards securitisation purpose, issuance, structuring, and investment strategies.

The BCBS securitisation reforms has had a direct impact on the viability of issuance for banks, and on banks as investors in 3rd party transactions. These impacts were largely disconnected from the broader initial Basel III impacts. **On the contrary, the increasing pressure on banks' capital should have translated into a larger use of securitisation to compensate some of this pressure. Given the excessive conservativeness of the BCBS securitisation framework, securitisation was unable to play its role in**

contributing to alleviate the capital pressure on banks, and banks had to limit the growth of their balance-sheets and lending origination instead.

While banks would be natural users of securitisation in their funding and capital strategies, their share in placed securitisation issuance has constantly reduced, while non-banks have increased, whether corporates, credit funds, digital lending platforms, etc. Indeed, securitisation is today an expensive option for retail banks, used mostly at the margin, to diversify funding sources or transfer some risks, with high costs and barriers to entry.

Actually, the prudential framework for banks was calibrated at a very conservative level, disconnected from the risks, creating a significant 'non-neutrality' in the framework (i.e., the capital requirement after securitisation is higher than before securitisation, sometimes a multiple of the capital requirement of the underlying pool).

From an issuer perspective, the decision to securitise a portfolio must be value creating, which means that the cost of securitisation must be compensated by a commensurate capital saving, otherwise the transaction is value destroying, and just does not happen.

In the EU, banks are the main source of funding to the economy, and therefore should be recognised as the natural and main source of, or transmission channel for, assets to be securitised. However, the existing prudential framework entails undue disincentives for banks to issue securitisation, stemming from the excessive 'capital non-neutrality', i.e., the fact that capital attached to securitised portfolio significantly exceeds the capital attached to the portfolio before securitisation.

This capital non-neutrality is driven by two distinct prudential rules:

- the 'p-factor' which distributes the capital across securitisation tranches (see Section 2.2),
- the risk weight floor applied to the most senior tranche (see Section 2.3).

Recently, and in particular after the possibility was given for synthetic transactions to be eligible to the STS label, the synthetic market has grown. However, given current calibration, only a limited portion of the banks' portfolios can be securitised in a value creating mode. Assuming that the quantitative issues are rectified, it will be important to also start thinking on how to further streamline the SRT assessment process, while making it more risk-sensitive.

Finally, in prudential reforms applicable to IRB banks, the report did not evaluate the combined impact of the RWA increase on the underlying assets and the output floor on retained senior tranches of SRT transactions.

12. 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?

Beyond the prudential issues faced by issuers and investors, the scale-up of the securitisation market also requires a true market to develop, both primary and secondary. For this ecosystem to develop, the market should be open to a broader range of issuers and investors, including UCITS funds, to increase volumes, which requires reducing existing barriers to entry and unnecessary regulatory burden for issuers and investors. Policy makers should introduce proportionality in due diligence and reporting requirements, notably as regards senior high-grade transactions, private transactions, and involvement of EU players in third-country transactions.

Policy makers should review the current disclosure and due diligence requirements in order to more accurately meet the supervisors' and investors' needs, while limiting the burden of completing the regulatory disclosure to what is actually necessary.

Simplifying the reporting process would also benefit less frequent European bank issuers, and to that end, one could explore the consolidation of the multiple reporting formats and obligations currently affecting issuers and investors into an integrated due diligence and disclosure framework, which would allow for proportionality as a function of the type of transaction, based on different criteria.

Indeed, it is essential to differentiate the due diligence obligations and disclosure templates according to different categories of issuers and investors, based on the different asset classes, types of transaction and types of placement, with a view to adapting the nature and extent of information disclosure and due diligence requirements to these different situations.

The prescriptive templates produced by ESMA for the purposes of the disclosure under Article 7 SECR ("ESMA Templates") have been largely discussed among the different market participants. Some question the relevance of such templates, as opposed to a principle-based approach, while other question the appropriateness of the format of the ESMA Templates as they stand.

While we understand that a certain degree of standardisation is required for supervision purposes, we believe there is a consensus about the fact that the current templates are too detailed and that neither the investors nor the regulators need such level of details. While transparency is key for investors, any overdetailed disclosure reporting is in our view an obstacle to the development of the securitisation market and a comprehensive review would therefore be highly necessary.

We, therefore, believe that the current templates should be reviewed in order to more accurately meet the regulators' and investors' needs, while limiting the burden of completing the disclosure to what is actually necessary. Simplifying the report process would also benefit less frequent European bank issuers, and to that end, one could explore the consolidation of the multiple reporting formats and obligations currently affecting issuers and investors into a single reporting document format.

A debate has been taking place as to whether the same template (or format) of reporting should apply to public and private securitisations. This debate has raised the question of the definition of public versus private transactions (which currently depends on whether a prospectus has been established or not), but the answer to this question has proved to be complex and raise other issues.

We thus think that this criterion should not be the only one taken into account to determine the reporting regime, and that there should be a gradation of reporting depending on a more nuanced list of categories of transactions.

While transactions for which a prospectus has been established would always be subject to the full ESMA Templates reporting, other transactions would be subject to a proportionate reporting format depending on (i) the granularity of the securitised assets, (ii) the type of investors (regulated or not, subject to other reporting obligations or not), (iii) the existence of a secondary market (which make more unlikely the existence of a direct relationship and disclosure channel between the originator and the investors, and may result in the transfer to non-regulated investors), and finally (iv) the existence of confidentiality issues (which may impose the privacy of a detailed disclosure).

These different criteria could determine (a) where a loan-by-loan disclosure is both useful and practical (e.g. for public transactions, or for securitisation of certain categories of assets), (b) where the investors would rely mainly on a standardised disclosure (e.g. in respect of securitisation for which an active secondary market exists, and investors need to process a due diligence on automated and comparable basis), or where the relevant ESMA Templates would be in priority for supervisory purposes, and therefore (c) whether the regulatory disclosure should be publicly available or limited to either (i) the supervisors and/or (ii) the relevant investors.

While a detailed and standardised loan-level reporting may be required for public securitisations or securitisations of certain categories of assets, for which an active secondary market exists, subject always to warrantying the necessary level of confidentiality, this is not the case in other situations; for instance:

- certain categories of investors do not rely on the ESMA Templates to carry on their own due diligence and monitoring, and agree directly with the originator upon the type of disclosure they need;

- regulators do not review detailed loan-by-loan data, but instead process aggregated reporting based on the existing reporting used for ABCP transactions;

- in any event, originators would have the option to use a more detailed reporting template if they deem it appropriate.

All in all, such gradation of the disclosure would allow for more adequate and proportionate due diligence requirements. On the one hand, whilst standardised disclosure would allow investors in tradable asset-backed securities to implement automated or formatted due diligence, more sophisticated investors in tailor-made transactions, based on a more direct and ongoing relationship with the originator, would be authorised to determine the extent and the nature of information and reporting process and format best adapted to their needs, while ensuring (i) processable reporting for supervision purposes and (ii) confidentiality of the disclosed information where needed for commercial or legal reasons. On the other hand, the type of disclosure, whether on a loan by loan or aggregate basis, should be adapted to the level of granularity of the different asset classes.

To reduce barriers to entry on the market, it is necessary to streamline ESMA disclosure templates and adapt the related due diligence requirements. ESMA disclosure templates are not fit for purpose for private deals and represent an unnecessary costly burden. When determining reporting requirements, a clear distinction should be introduced made depending on the role of the investor: long-term investment versus market-making or hedging.

Broader effects of the reforms

13. 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 FSB report itself recognizes the limitations of its assessment of the main effects of the reforms on the financing of the economy, stating in particular that "*Evaluating the broader effects of the risk retention and prudential requirements involves an assessment of their social benefits and costs. These assessments typically estimate the expected benefits of reforms in terms of reducing the likelihood and severity of financial crises. Concerning costs, such exercises generally assume that more stringent regulatory requirements increase the funding costs of financial institutions that are in turn passed on to borrowers through higher lending spreads, thereby reducing overall lending and economic output. To be comprehensive, such cost-benefit analyses require a general equilibrium model of the economy,* ***which goes beyond the scope of this evaluation****. An indication of potential costs and benefits of securitisation reforms can be inferred from examining the effects of the reforms on overall financing to the economy and on financial system structure and resilience (see section 5)."*

Paris Europlace concurs that the assessment of the impacts of the securitisation reforms on the financing of the economy lacks a more holistic approach, given the reduced scope of asset classes and reforms included in the analysis, and the lack of focus on regional implementation and market specificities.

More generally, Paris Europlace would like to remind that, consistently with the other evaluation reports published so far by the FSB, such ex-post impact analysis are largely inconsequential, as **the potential damage on the market functioning cannot easily be reversed ex post**. Generally, the market has adapted, notably by shifting activities away from the regulated firms toward non-regulated or less

regulated firms. Such changes in market structure should be taken into account, given that in theory, regulation should be business model neutral. **It is not acceptable to conclude that there is no impact because the economy has continued to be financed (albeit through other channels than securitisation).**

Actually, the FSB evaluation framework should be reformed, so that such evaluations of the impact of reforms should be made ex-ante, and not ex-post.

Before adopting regulatory rules, standard setters should not limit themselves to quantitative studies assessing the micro impact (at banks' level) and should aim to include the use of econometrics models for assessing the macro impact (at the level of the economy) ex-ante. This has not been done historically for the securitisation reforms, nor for any of the post-GFC reform agenda.

We will follow this lead and keep our answer at a high conceptual level: Regulatory rules should be consistent with the relative riskiness and liquidity of different financial instruments. Deviating from this principle leads either to partial or complete elimination of financial activities or to regulatory arbitrage by the industry, unacceptable to regulators. There are economic and financial stability consequences of such deviations.

As an example of such detrimental effect of regulatory reforms on market functioning, one only needs to look at the collapse of the economic importance of traditional European securitisation, defined as the ratio of the Total Outstanding Amount to GDP. [For a graph, see slide 8 of the presentation available at https://www.eesc.europa.eu/en/news-media/presentations/securitisation-eu-way-forward-georges-duponcheele-presentation]. This ratio dropped continuously since 2012, where it was at 9.3%. In 2023, it was 4.3%. This is relevant as the year 2012 corresponds to the BCBS issuing its first proposal on how future rules might be framed, and encompasses the time period where such rules were adopted in Europe. One may conclude that securitisation no longer finances European economic growth. Furthermore, there are strong country and sectoral differences in the EU country-specific markets, with one commonality: those markets are not proportional to the country/sector GDP.

It is not possible to quantify independently all the economic co-factors that are explaining why the traditional placed securitisation market is moribund in Europe, but we note that the FSB has mentioned the main ones in Box 8 in Section 5.1 (*Financing to the economy*) of its report, as stated by "stakeholders": disclosure requirements, EU due diligence requirements, EU additional constraints applied to STC, EU Solvency II capital charges, bank capital calibration, EU LCR treatment of securitisation. It is notable from this list, that the majority of items derives from the EU rules, and not from IOSCO/BCBS rules (although the 'elephant-in-the-room' is clearly the BCBS bank capital calibration of securitisation exposures). Paris Europlace, as a stakeholder, produced a report asking for reforms on all of these points in addition to others.

One may infer from the previous two paragraphs that there is a large untapped financing source that could boost economic growth in all European countries and sectors without encumbering bank balance sheets or requiring unrealistic increases in bank equity needed to augment risk capacity. Thus, a focus on the legal format (i.e., whether a securitisation is executed in the traditional ('true sale') format rather than the synthetic format) is not the appropriate concept to assess the financing to the economy by the securitisation technique.

For a proper economic assessment, the FSB should ask whether a securitisation brings "capital velocity" by which we mean that securitisation permits a bank to free up capital that it can reinvest in new lending (see paper European Competitiveness and Securitisation Regulations on https://www.riskcontrollimited.com/wp-content/uploads/2024/08/European-Competitiveness-and-Securitisation-Regulations-v56.pdf). Retained securitisations or covered bond instruments (a 'securitisation-given-default' instrument) provide funding to the economy, but not financing, which

requires additional risk taking. Section 5.1 of the report does not make sufficiently clear the distinction between funding to the economy and financing to the economy.

By including the economic notion of "capital velocity", the FSB could provide a comprehensive picture of the impact of reforms. The European picture of securitisation as a tool financing the economy would change materially, because of the focus of the European market on risk transfer transactions. And this development has been enabled by the EU-specific synthetic STS framework (not a IOSCO/BCBS rule, although clearly inspired by the latter).

Furthermore, the fact that EU banks are not able to turn-over their balance-sheets, or increase the velocity of their balance-sheet, has a significant impact on their Return on Equity (RoE). In 2023, the average RoE of EU banks was 7.6%, compared with 9.9% for their US counterparts. This underperformance, partially due to the absence of a scalable securitisation market, also translates in a continuous decline in valuation, which in turn prevents banks to attract fresh equity capital in the market. **This lack of profitability and investor appetite for bank stocks is a European vulnerability, and the development of securitisation would contribute to improve bank valuations and access to capital, therefore increasing their resilience and their shock absorbing capacity, therefore reducing financial stability risks.**

One approach to assess ex-post the impact of reforms on the financing of the economy would be to adopt a "what-if" view, as the shrinking of the securitisation since 2012 in the EU can be seen as an opportunity loss. The question to be answered would become "If securitisation issuance had been maintained (or had grown in line with other regions), how much capital would banks have saved, and how much additional lending could they have generated over the period, while maintaining their capital ratio unchanged? Assuming reinvestment of capital at the same risk/return level, what would have been the impact on the Return on equity? Assuming same trends in the non-bank lending sector, what would have been the impact on the overall leverage of the corporate and household sector? What would have been the impact on EU GDP?

Such analysis would provide a solid base to judge the relevance of reforming the securitisation prudential framework, and allow the FSB to formulate recommendations to standard setters to that effect.

14. 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?

Paris-Europlace concurs that "*the reforms have contributed to a redistribution of risk from banks to the non-bank financial intermediation (NBFI) sector, with banks shifting towards higher-rated tranches leading to an overall decrease in their risk-weighted asset density. However, the shift to the NBFI sector is not unique to securitisation as various conjunctural factors and structural changes in the global financial system since the GFC have increased reliance on market-based intermediation.*"

The FSB report goes on stating that *"The financial stability impact of the redistribution of risks from the banking to the NBFI sector is difficult to assess since it is unclear if the non-bank entities taking on the risks previously held by banks are well-placed to assume them given their funding structure and ability to withstand losses in stress events."*

Paris Europlace believes that the FSB should do a better job in differentiating the key trends in this redistribution of risks from the banking to the non-banking sector, by separating:

- On one hand, the evolution of the share of banks and non-banks **in the origination of loans** to businesses and households, across geographies.
- On the other hand, the evolution of the share of banks and non-banks **in the securitisation market**, distinguishing the issuance trends by asset class and by type of securitisation, and the ownership of securitized exposure, by seniority, type of transactions, and geographies.

Securitisation is at the cross roads of those two trends, as it allows to transfer risks originated in the banking sector to non-banks market participants.

While reducing the excessive reliance on bank funding has been a stated objective of the CMU project, Paris Europlace believes that **an efficient financing of the European economy should rely on both Banks and capital markets.** Securitisation acts as a bridge between bank lending and capital markets, and can be a very effective lever to change the balance between banking and market financing in the EU.

Indeed, **such complementary vision would allow to rely on the existing safe and highly supervised origination by banks, while providing investors with reliable investible assets in which they would not have accessed otherwise, at the level of seniority and yield that corresponds best to their risk return appetite.** Thanks to securitisation, investors have access to unique opportunities in terms of exposure type and in terms of risk/reward spectrum. They can obtain exposure to sectors of the economy that can hardly be reached otherwise (SME and consumer loans) and have a very granular approach to the level of risk they want to be exposed to, thanks to the tranching technique.

Bank origination remain the dominant model in the EU, especially as regards households and SMEs, even if some non-bank lending develops in the digital world. Banks have a very dense network of presence in the territories across the 27 member states, have a direct knowledge of their customers and manage their relationships in a long-term view.

Importantly, they are subject to a wide range of regulations in their origination activities, as summarized in the EBA Loan Origination and Monitoring guidelines. Not only are they expected to carefully assess the credit risk of their borrowers over the medium term, but they are also subject to consumer protection rules, Know Your Customers, ESG assessments, granular reporting of their risks, on-going monitoring through time, etc… And their capacity to comply with this wide range of rules is supervised by the SSM and NCAs on an ongoing and intrusive basis across the Union.

By contrast, non-bank lenders are subject to much less regulation although they are also subject to consumer legislation (if applicable) and rules on lending (e.g., on responsible lending) and are not under a similarly intrusive supervisory oversight.

Maintaining the pressure on bank capital requirements without giving the possibility to banks to share the risks with investors thanks to an efficient securitisation framework, would further grow the share of non-bank origination, which was at the roots of the US securitisation crisis, as sub-prime mortgages were mainly originated by mortgage brokers.

All in all, not only the development of securitisation in Europe would not increase financial stability risks, but the lack of securitisation may be a financial stability risk in itself, as shown in the recent publications by the IMF, the FSB and other policy makers trying to assess and address the financial stability risks of so-called “Non-Bank Financial Intermediation” or NBFI.

Finally, risk sharing through securitisation by construction reduces the risk of credit losses by the issuing bank in case of downturn, therefore increasing their resilience. Depending on the nature of the tranches sold, this benefit can be described differently, but in all cases, it is reducing vulnerability:

- When selling all or part of the first loss and mezzanine tranches in an SRT transaction, and keeping the senior tranche, the probability that the portfolio losses will exceed the first loss and

mezzanine is minimal, whereas, the bank would be fully exposed if this portfolio had not been securitized (or issued in a covered bond format)

- When keeping the first losses and selling the senior tranche in a cash securitisation with an exclusive funding objective, and even if the SRT is not obtained, the issuing bank will have capped its losses and protected itself against a low probability, extreme loss in the portfolio.

Additional considerations

15. Other issues: Are there any other issues or relevant factors that should be considered as part of the evaluation?

Paris-Europlace regrets that the report does not leverage the industry contributions provided in the earlier stage of the project.

The key messages are reflected in box 8:

Box 8: Stakeholder concerns about the effects of securitisation reforms

Some stakeholders have expressed concerns about the potentially dampening impact of G20 and jurisdiction-specific reforms on securitisation markets.130 The main concerns are described below.

*The implementation of **disclosure requirements** was seen as too prescriptive and not sufficiently proportionate in some jurisdictions. For example, some EU stakeholders argued that the transparency and reporting framework for securitisations has increased transaction costs for issuers, which may make less regulated or transparent instruments appear more attractive.*

*Some market participants also argued that the EU **due diligence requirements** could be more principles-based, to better reflect investor needs and avoid adding to compliance costs and discouraging cross-border investments in securitisations.*

*Some stakeholders perceive progress in **STC** issuance as disappointing. They consider the relevant requirements in the EU (STS framework) to go further and be more constraining than the BCBS-IOSCO provisions, thereby limiting the supply of eligible securitisations.*

*EU stakeholders argue that **Solvency II** is not sufficiently risk sensitive or reflective of the actual risk in securitisation investments, which has allegedly reduced insurers' interest in this product. Relatedly, some stakeholders argue that the **bank capital calibration for securitisation exposures** has resulted in overly prudent risk weights and that further analysis is needed in relation to capital non-neutrality.*

*Some EU and US stakeholders suggest the **treatment of securitisation in the LCR framework** compared to other alternatives (e.g. covered bonds) has inhibited investment in this product by banks."*

It is a pity that the FSB does not analyse each of those key messages in the body of the report, suggesting that the dialogue with the industry has not been fully taken into account in the FSB work.