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Position paper

of the Association of German Banks on securitisations

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Looking to the future – optimising the production line for securitisations

In the coming years, European society will face the enormous challenge of rapidly advancing the green and digital transformation of the economy with investments worth billions of euros. The EU Commission estimates that the additional investment required will be 620 billion euros – per annum. This volume of funds can only be financed through an intelligent combination of available capital sources: businesses' own funds, bank loans, capital market and public funding. In particular, more private capital must flow into the economy via the capital market. Without a strong capital market, the green and digital transformation will simply not succeed.

Banks can play a key role as intermediaries between the businesses that need financing and the capital market. In line with the needs of investors on the capital market, banks can put together financing through loans that match the investors' risk profiles. This means that banks can generate investments that are not accessible via the capital market. At the same time, this can free up capacity for banks to grant further loans. And the instrument that is most suitable for doing this is securitisation. Securitisations are an important instrument for managing both the capital and liquidity of a bank.

As a result of the 2008 financial crisis, European securitisations were unjustly discredited. This is clearly demonstrated by the very low default rates of European securitisations before, during and after the crisis. Nevertheless, in Europe, there is a stigma surrounding securitisations, which played a key role in the 2008 financial crisis. Even the introduction of comprehensive regulation has done little to change this. Rather, what we are seeing is that although the original objectives for regulating securitisations were well thought through, they are now being forgotten about in the legislative process. The result is excessively conservative and sometimes impractical requirements.

At the same time, the discussion about revitalising the securitisation market is often focussed on the US. However, a direct comparison of the US and European securitisation markets is only useful to a certain extent. The two securitisation markets function in fundamentally different ways. The US model of 'agency securitisation' (Fannie Mae, Freddie Mac, Ginnie Mae) is not the way the securitisation market works in Europe. The majority of the US securitisation market is conducted through US agencies (securitisation of residential real estate financing). In so doing, these government institutions assume all or some of the credit risk. The investor then bears, in particular, any risk from changes in the interest rate. Excluding agency securitisations, the volume of US securitisations issued in 2022 was only four times that of the volume of securitisations placed in Europe.[1] Due to these differences, it is problematic to base an assessment of the European securitisation market on the US securitisation market.[2]

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[1] German Council of Economic Experts: Report on the institutional and regulatory differences between the American and European securitization markets

[2] Report on the institutional and regulatory differences between the American and European securitization markets (econstor.eu)

The Association of German Banks has conducted a comprehensive analysis of proposals developed in recent years to improve the regulation of securitisations. The findings show that no single proposal on its own would bring about a breakthrough to revitalise the securitisation market. Instead, some adjustments need to be made in a number of areas. The key aim of all these adjustments must be to make the securitisation process as a whole more efficient. This also means not focussing solely on regulatory requirements. Other areas of the production line, such as supervisory processes or market practice, offer scope for further opportunities for improvement.

When looking at the German securitisation market, unlike in the US, securitisations of residential real estate financing play only a subordinate role. In Germany, residential real estate is refinanced using more classic instruments, such as pfandbriefe/covered bonds. Pfandbriefe/covered bonds are particularly interesting for investors due to their dual recourse (issuer and securities pool serve as repayment source). Any potential measures to revitalise the securitisation market in Europe should take this aspect into account. It has also become clear that the securitisation of car, leasing and consumer finance is unproblematic. The level of standardisation in these products is already very high and the processes are largely routine now.

If you are going to put forward the argument that securitisations should contribute to the digital and sustainable transformation, then we believe it makes sense to focus on precisely those forms of financing that can make a greater contribution in this regard. The securitisation of financing aimed at making businesses more digital and sustainable, for example, or particular forms of infrastructure financing, must be the subject of analyses into further standardising the securitisation process. This means that the framework for the securitisation of SME financing, corporate loans, commercial real estate and infrastructure financing, in particular, must be improved. Targeted promotion and modification of securitisation structures for these areas would increase the profitability of such securitisations, but could also help to free up capacity for financing, which could ultimately have a positive impact on the real economy.

The STS framework was introduced through the Securitisation Regulation in 2019.[3] This framework for simple, transparent and standardised securitisations comprises around 112 criteria that need to be met in order to benefit from lower risk weights. By meeting these criteria, securitisation transactions tend to be more cost-effectively structured. However, in practice, the criteria are too complex for transition financing purposes. For example, in order to meet homogeneity requirements, the debtors in the securitisation pool must all be domiciled in the same sovereign territory. This limits the possibility of combining SME financing from different territories into one securitisation pool. But it is precisely this opportunity from pan-European securitisation portfolios that could promote securitisation for originators as well as increase interest in securitisation for investors, who can meet diversification requirements by investing in

[3] Regulation (EU) 2017/2402 (europa.eu)

a pan-European securitisation. As a result, a legislative initiative that could have contributed to improving cross-border securitisations for trade receivables has failed to deliver. In 2019, there was an attempt to harmonise the law applicable to the third-party effects of assignments of claims throughout the EU.[4] The German Banking Industry Committee had welcome this move in its comments on this matter. The German Banking Industry Committee has in fact made an additional proposal in this context. This should ensure that in the case of sub-portfolios with different exposure statutes, as can be the case with securitisations, the parties can choose which law is applied.[5]

The key question that needs to be addressed in connection with revitalising the securitisation market is the question of profitability. How can the securitisation process be made more efficient in Europe? How can the production line for securitisations be optimised? How can barriers to entry be lowered? How can transaction costs be reduced?

One possible driver of efficiency could be a greater degree of standardisation. Standardisation could be considered both in the legislative area as well as in market practice. Furthermore, the supervisory processes should also be taken into account in such an assessment. Legal standardisation could be achieved by harmonising legislative frameworks (see above). Market-related standardisation could be achieved, for example, by standardising contracts. The European Investment Bank (EIB) / the European Investment Fund (EIF) is already the central guarantor of synthetic securitisations. The at least partial involvement of a state institution in standardisation would also have the advantage of strengthening confidence in securitisation. Competences could be bundled here and a positive impact on the entire securitisation market could be expected as a result. With regard to supervisory processes, uncertainties and unpredictability are driving up costs for banks. There is also scope here for a more efficient approach.

There also needs to be an incentive for investors to invest in securitisations (again). The investor base is currently small. In our opinion, this is because the alternatives (e.g. direct purchase of loan portfolios, investment in covered bonds) are more cost effective. This refers to the transactions costs themselves, but also to the regulatory requirements that banks and insurance firms have to meet. The capital adequacy requirements for investment in securitisations are overly conservative for banks and insurance firms and, considering the extent of the regulatory requirements, do not reflect the inherent risk. Over the long term, regulatory requirements could increase the profitability of securitisations by, for example, reducing the p-factor. The European Commission had put forward concrete proposals on this as part of the implementation of Basel in the Banking Package. On the whole, the proposals are positive. For the reasons outlined above, extending these to include non-STS securitisations would be desirable.

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[4] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018PC0096
[5] Comments (in German only) (die-dk.de)

Synthetic securitisations are particularly important for capital management in banks. Synthetic securitisations are contractual agreements concluded directly with the investor. They therefore take account of the specific needs of the investor. Investors request information that corresponds to their needs. These needs are in addition to the general transparency requirements of the regulation. These requirements do not meet the investors' needs or are designed to meet the supervisory need for information. Here too, there are opportunities to make improvements.

Overall, initial entry or re-entry into the market involves a great deal of effort due to the extensive regulatory requirements. The need for specialist and therefore costly expertise should not be underestimated. It has been observed that potential investors' expertise in securitisations in particular has declined over time. In some cases, investments in securitisations were avoided for strategic reasons and due to the stigma surrounding securitisation. These barriers to entry and/or re-entry to the market could, at least in part, be minimised by a simplified and standardised securitisation process.

In summary, we believe there is a need for a comprehensive evaluation of the entire securitisation process, particularly for securitisations of portfolios which could be useful for the transformation. Isolated measures will not boost the securitisation market. In order to be able to overcome the challenges expected from the sustainable and digital transformation, we should be laying the foundations today, so we can make a contribution tomorrow. The specifics of the European markets need to be taken into account when doing so. The securitisation process must be made fit for the future, production costs need to fall and processes need to be optimised.