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Comments

Association of German Banks
Reply to ECB/BoE Discussion Paper “The case for a better functioning securitisation market in the European Union”

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General remarks

We warmly welcome the discussion paper prepared by the European Central Bank (ECB) and the Bank of England (BoE) on the case for a better functioning securitisation market in the European Union and appreciate the opportunity to respond.

Securitisations are an important risk-management tool for banks and businesses, enhance lending capacities, offer attractive investment opportunities and help to transmit monetary policy decisions. The positive views expressed by the ECB, BoE and other policymakers therefore send out an encouraging signal.

There nevertheless remain a number of impediments to an effectively functioning securitisation market. Securitisations are still suffering significantly from the aftermath of the financial crisis, even though many of them were not, and are not, comparable with sub-prime transactions.

The main obstacles to a revival of the market are new regulatory initiatives which are too focused on the type of securitisation that triggered the crisis and threaten to stifle sound transactions as well. Uncertainty surrounding the precise details of these initiatives in their final form is also hindering the market from moving in a positive direction.

Specific comments

Do respondents agree with the benefits of a well-functioning securitisation market as outlined in Section 2?
Yes, a well-functioning securitisation market can provide various groups of investors with tailored investment opportunities. Securitisations are a useful funding tool for loans granted to the real economy by both banks and non-banks and can open up new lending capacity for these market participants. Securitisation can serve as a means of risk management and risk transfer for banks and also for businesses that securitise. Furthermore, securitisation structures can help securitising businesses and banks to exercise discipline in servicing the underlying assets, both internally and externally.

Senior tranches, in particular, are a good source of collateral for various transactions. They can serve as collateral not only for central bank operations, but also for repos and derivative transactions. Sound liquidity management (using repos, for example) and sound risk management (using derivatives, for instance) gives banks greater flexibility to lend, thus indirectly helping the real economy. In addition, a smoothly functioning repo market plays a key role in the transmission mechanism of monetary policy.

As a result of various regulatory initiatives (LCR, mandatory CCP clearing of derivatives and collateralisation of non-CCP-cleared derivatives) and market trends (e.g. towards collateralised funding), the need for collateral is set to rise by several trillion euros. The use of securitisations as collateral could consequently gain in importance if they were granted eligibility for collateral purposes in these cases too.

Do respondents agree with the impediments to and economic concerns of investors that have been identified? Do respondents think that there are any additional impediments to investors, and if so, what are they?
The discussion paper provides a good overview of the impediments to investors. The overarching problem of stigmatisation means that, even internally, each and every decision to securitise or to invest in securitisations is eyed highly critically and sceptically, if not rejected out of hand.

Along with the stigma attached, the biggest problem for the securitisation market lies in current regulatory initiatives. Regrettably, post-crisis stigma has resulted in the objective of regulatory projects seeming to be driven by a horror scenario featuring subprime RMBS and CDOs squared. Under the Basel Committee's most recent proposals, risk weights for investment grade-rated senior tranches would increase substantially by up to ten-fold. On top of that, the level of the risk-weight floor would more than double from 7% to 15%, thus unduly penalising even high-quality securitisations – however defined – such as auto loan ABS. Moreover, there is not only concern about existing plans for unduly severe treatment of securitisations but also a general uncertainty surrounding the precise final form of requirements and about what additional rules may be introduced.

As well as banks, insurance companies (Solvency II) and money market funds (Money Market Funds Regulation) will also face significantly greater impediments to investing in securitisations, or may even be prevented from doing so altogether. The proposal for a Money Markets Regulation currently envisages prohibiting money market funds from investing in ABS if the maturity of the underlying securitised assets exceeds 397 days or if the assets take the form of loans to retail clients for the purpose of buying a car, for example. This means that all major groups of investors are affected and, other things being equal, will invest less in securitisations in the future.

Given that the above initiatives (and the LCR) have yet to be finalised, uncertainty is currently a major matter of concern and, with few exceptions, is choking off the market for securitisations. Part of the problem is the absence of grandfathering arrangements.

We believe the lack of secondary market liquidity is largely due to uncertainty surrounding upcoming regulation and could be partially solved by ensuring the appropriateness of future requirements.

The financial crisis originally broke out in a specific market segment, the US subprime RMBS segment, which – as the name suggests – was hardly synonymous with high quality. Seven years later, the stigmatisation of all securitisations should not be permitted to undermine the revival of the market for high-quality asset-backed securities. For this reason, capital requirements for banks and insurance companies should not be increased simply because of this stigma and without any economic rationale. Instead, regulators need to recognise the benefits and the stability of high-quality ABS. This includes ensuring they receive treatment equal to that accorded to comparable instruments, such as covered bonds.

Do respondents agree with the impediments to and economic concerns of issuers that have been identified? Do respondents agree that the infrastructure concerns raised above affect the economics of securitisation? Do respondents think that there are any additional impediments to issuers, and if so, what are they?
We essentially agree with the discussion paper's conclusions. A further problem affecting both issuers and investors is that the regulatory treatment of securitisations is significantly more stringent than that accorded to comparable instruments such as Pfandbriefe. The costs generated by the regulatory requirements tend to make investors demand higher yields and issuers expect lower funding costs if, for instance, the underlying assets are also eligible for inclusion in a covered bonds' cover pool.

Do respondents agree that market liquidity may be a barrier to a well-functioning securitisation market?
Market liquidity is important to all financial instruments, albeit to differing extents. While secondary market liquidity is extremely important to shares, for example, this does not apply in equal measure to the securitisation market, where the investment strategy is often to buy and hold. This is also the result of the desired tailoring of many securitisation transactions to specific investors. We consider it important, too, to consider liquidity not only in the outright sale market but also in the repo market, which also offers the opportunity to raise liquidity at short notice.

The view of the Bank of England and the ECB is that a 'qualifying securitisation' should be defined as a security where risk and pay-offs can be consistently and predictably understood. Do respondents agree with this definition? What characteristics of a 'qualifying securitisation' not already included in the principles in Box 3 should warrant such treatments? Do respondents have any comments on the principles in Box 3?
We warmly welcome the idea of setting out certain criteria which characterise high-quality securitisations and defining instruments which meet these criteria as "qualifying securitisations". It should not, however, be inferred that, conversely, all non-qualifying securitisations are badly constructed and dangerous. They simply display different characteristics. Furthermore, experience shows that the devil is often in the detail. The industry should therefore be closely involved in specifying and fleshing out certain of the principles. The self-liquidating criterion, for

instance, should not lead to the exclusion of auto financing with balloon payments, which rating agencies have found to deliver better performance than full payout agreements.

Since the crisis, a number of private-sector initiatives have tried to strengthen the securitisation market by awarding a type of quality seal to securitisations thereby signalling the fulfilment of certain criteria. Many of these same criteria are mentioned in the discussion paper. These seals of quality include the "certified by TSI" and PCS labels.

We would also like to point out that securitisations are, by their very nature, not simple in structure and thus automatically have a certain degree of complexity. Complexity should therefore not, in itself, be grounds for exclusion. Transparency is a far more important criterion. During the financial crisis, a lack of transparency frequently led to fire sales since investors were uncertain about the quality of the underlying assets. Even securitisations whose underlying assets were very stable in value were sold off in fire sales. This could have been prevented by greater transparency.

Since different regulatory initiatives are pursuing different objectives, we believe it will be very difficult to create a single, all-purpose set of criteria. The requirements for inclusion in the liquidity buffer may not be the same as those for the assignment of a lower risk weight. It would nevertheless be desirable for the criteria to be as standardised as possible. This will make it easier for both investors and issuers to assess the impact of different rules and regulations on securitisations and the positive effects of a "qualifying certification" will add up. It should also be borne in mind that issuers will try to fulfil the different quality criteria for different aspects of regulation in order to make their securitisations more attractive and target the broadest possible range of investors.

The discussion paper's description of securitisations as a risk transfer device highlights the positive effect of these transactions on banks' lending capacities. At the same time, however, it is asserted that synthetic transactions are more complex than true sale securitisations and should not, in consequence, be counted as a qualifying securitisation. In our view, a product's complexity is only partially determined by whether it takes the form of a true sale or synthetic transaction. We believe it is far more important to consider the entire structure of the securitisation, and also all the parties involved. The counterparty credit risk associated with synthetic transactions can be mitigated with the help of collateralisation mechanisms, including the posting by the collateral provider of cash collateral to be either deposited at the originating bank or held by a counterparty whose creditworthiness is beyond reproach and pledged to the securitising bank. In one respect, moreover, synthetic transactions are less complex than true sale transactions because the securitised assets are not sold on. On top of that, the use of synthetic transactions accommodates the potential objection of the bank's clients to the idea of their liabilities being transferred to a third party.

As we see it, therefore, the true sale versus synthetic issue should not be the sole criterion for determining whether or not a securitisation may be considered a qualifying securitisation. It is much more important, in our view, to focus on prudent lending practices, compliance with risk retention requirements, robust structures and transparency. This applies all the more given that transactions are subject to approval by national regulators.

The complexity of a true sale transaction, by contrast, is usually determined by the legal requirements which need to be met in a jurisdiction in order to ensure effective legal transfer of the assets to the ABS investors. With this in mind, a low level of complexity – however this may be defined – cannot in itself be considered a sound qualifying criterion. As well as meeting the criteria mentioned above (risk retention, robustness and transparency), these transactions should, above all, serve a financing purpose for companies in the real economy.

Paragraph 134 in Box 3 lists asset classes which may be considered qualifying securitisations subject to meeting all other criteria. We understand that this list is not supposed to be exhaustive. Nevertheless, we would welcome the explicit mention of trade receivables, which play a major role in funding the real economy. Particularly when used in asset-backed commercial paper (ABCP) transactions, these are assets of large and medium-sized companies generated in the course of their normal business (e.g. assets arising from delivery and performance) and are thus a key funding tool for businesses. It is noteworthy that these transactions performed well and proved stable, even during the crisis. In general, we support the transparency criteria for qualifying transactions. We would nevertheless like to point out that, owing to confidentiality concerns and a lack of available data at the real-economy businesses selling trade receivables in ABCP programmes, it is not possible to provide the same degree of detail about individual loans or assets as that which can be supplied by financial institutions. The excellent credit quality of these transactions is adequately demonstrated by the extremely low counterparty default rate on the receivables of large and medium-sized companies.

An inability to provide highly detailed information about the securitised pool on a scale which may well be possible in bank securitisations should not prevent ABCP transactions from obtaining a qualifying certification.

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

Provided the regulatory treatment is defined clearly and not too punitive, the result may be higher liquidity for the segment in question. Just as, for example, the central bank eligibility of certain assets tends to increase the liquidity of these assets also in private markets, a "qualifying certification" will be able to achieve this for securitisations as well. Both "central bank-eligible" and "qualifying" are/would be easily monitorable criteria and a reduction in complexity that enhance transparency and create a degree of certainty for market participants. At the same time, it should be ensured that investors do not rely solely on a 'qualifying certification' and do not dispense with any assessment of their own.

This will only be possible, however, if the regulatory framework for high-quality ABS is not tightened simultaneously.

These principles may then provide a framework to aid various authorities and market participants to set their own eligibility criteria. How might such a framework be developed? What role could the appropriate authorities play in the process of certifying that a transaction is a 'qualifying securitisation'? What are the associated risks?
The framework should provide for a transparent and robust securitisation market. The criteria themselves should be unambiguous, robust and clearly formulated to avoid legal uncertainty and to facilitate implementation.

Moreover, it should be considered that different regulations serve different purposes. Thus, it does not seem possible and desirable to define completely the same set of criteria for each regulation. By means of example, for hold-to-maturity investors liquidity is not as important as credit quality, whereas for banks' trading books liquidity and credit quality are very important. On the other hand, the criteria should be as uniform as possible to simplify assessment of adherence to high-quality criteria. This would further facilitate issuer compliance with different regulations. To increase the attractiveness of the ABS they issue, issuers probably will seek to comply with high-quality credit-related and liquidity-related requirements that add to the requirements as a whole.

Thus, we propose a building-block approach with a clear set of credit-quality-related criteria that have to be adhered to for credit products and a set of liquidity-related criteria that have to be adhered to for liquidity products. At any rate, it has to be avoided that criteria that refer to the same purpose are similar but not the same due to the fact that different regulators might have different opinions on their specification.

Do respondents think that harmonisation and further conversion software could bring benefits to securitisation markets? If so, which asset classes should be targeted? How can accessibility to the existing loan level data be improved, so that it provides most value to investors?
No. The level of harmonisation seems sufficient for the time being. It is more important to first observe the impact of the ECB and Bank of England loan level initiative. In addition, past experience with data harmonisation and software conversion shows that they are expensive. In most cases, the additional costs more than outweigh the benefits. Should further data harmonisation between the Bank of England and the ECB be considered, then not the maximum of both but the intersection should be selected. Moreover, such further harmonisation could only entail benefits if it included harmonisation with the US requirements, which could be a task for IOSCO.

Do respondents think that initiatives currently undertaken by authorities in the area of standardisation of prospectuses and investor reports and trade transparency are sufficient or is there scope for further improvements? Would the availability of prospectuses and standardised investor reports in a single location be helpful to securitisation markets?
A central location (website) where prospectuses are collected and made available may be helpful. It is also conceivable that fulfilment of certain requirements regarding the content and format of prospectuses could be part of a 'qualifying certification'.

Rigid pre-trade and post-trade transparency requirements are unsuited in our view to strengthening liquidity in securitisation markets. Where instruments are not continuously traded, the current price at which a purchase or sale would be possible may differ greatly from the last traded price (post-trade transparency). Mandatory pre-trade transparency could deter market makers or also just any activity in the market. Pre-trade and post-trade transparency should rather be the endogenous consequence of increased market liquidity. If pre and post trade transparency were a prior condition, liquidity could, however, be choked as a result.

To contribute to further improvement and standardisation as far as reasonable, the publication of best and sound practices on prospectuses based on analyses by the ECB or ESMA on a wide range of observed practices in the market could contribute to fostering market discipline. Further regulation should at any rate be avoided.

Do respondents agree that facilitating investors' access to credit data in an appropriate manner could support the emergence of securitisation markets? Would credit registers be helpful in this respect? If so, which asset classes should be targeted? In what form could access be granted to ensure that borrowers' confidentiality is preserved?
After implementation of the loan level initiative, the experience made with it should first be awaited. This initiative saw the establishment, in cooperation with various stakeholders (originators, investors, ECB, credit rating agencies, etc.), of data requirements regarded as sensible by these stakeholders. Some of the loan level data has only had to be reported to the ECB for a few months. We do not believe that any further expansion of reporting would be helpful at the present time.

In order to aid performance measurement and to provide investors with industry-level data, would it be helpful if certain macro-economic data were disclosed or if banks/non-banks published certain aggregated standardised data? What are the challenges of providing potential investors with sufficient borrower and loan-level data to enable them to model credit risk, and how can these be overcome? What other elements would in your view help to improve secondary market functioning for high-quality securitisation?
We take a critical view of the disclosure of macro-economic data by issuers for two reasons. Firstly, many originators do not have their own economic departments to deliver the required

analyses. Secondly, the publication of such analyses could encourage 'herding' behaviour should investors base their investment decisions on these.

As concerns the loan level data, the above comments apply. After implementation of the loan level initiative, the experience made with it should first be awaited.

Do respondents think that authorities should consider encouraging the industry to develop such benchmark indices? What risks might these give rise to? What indices would be useful and which could be easily produced?
This would certainly make sense sometime later. But first of all, the conditions for meaningful benchmark indices, namely liquid secondary markets, should be created. The conditions for increasing secondary market liquidity therefore first need to be improved and any additional impairment avoided. When it comes to regulatory initiatives that will have a negative impact on secondary market liquidity of ABS, mention should be made particularly of the proposed Basel Committee on Banking Supervision rules on the trading book review, of the Money Market Funds Regulation, and of the planned liquidity standards.

Do respondents agree that additional information in the form of a matrix showing implied ratings if the sovereign and ancillary facilities rating caps were to be set at higher levels would be helpful in supporting the investment process and contribute to increased transparency and liquidity?
Yes, as this would make clear to investors how ratings are produced.

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

With regard to the policy options mentioned, are there any other considerations authorities should be mindful of?
We expressly welcome the establishment of a joint BCBS/IOSCO task force to discuss developments on the securities markets and – as we understand it – potential measures to strengthen these markets.

A sensible approach in our view would be looking at the cumulative impact of all regulatory initiatives that directly or indirectly affect securitisations. Even though this is an ambitious undertaking, it should nevertheless be carried out in order to identify effects that may go beyond the regulatory objective that is directly pursued in each case.

To give but one example of such effects: even in the event that 'qualifying securitisations' are recognised as a liquidity buffer under the Liquidity Coverage Ratio (LCR), they will only be

recognised in the lowest category (Level 2B). The maximum volume of Level 2B assets, measured against the entire buffer, will not be allowed to exceed 15%. Securitisations will have to "share" this 15% with equities, certain types of corporate bond and other assets. This means that it can already be said today that the positive impact of inclusion of additional securitisations would be limited. This limitation on securitisations would have an even more negative impact as soon as more "qualifying securitisations" are available in the market. In terms of liquidity regulation from a bank perspective, a growth in "qualifying securitisations" would therefore be virtually completely ineffective. A revival of the securitisation market would – as far as the LCR is concerned – fail to materialise.

Do respondents think there are other policy options authorities should consider to support the emergence of simple, transparent and robust securitisation markets?
Particularly for lending to SMEs, different rules apply within Europe (e.g. with regard to notarial treatment of loan agreements, definition of default). The non-uniformity of these rules is an obstacle to securitisation. Their harmonisation should therefore be sought.

Beyond securitisation, might there be other ways of achieving (some of) the benefits of securitisation as outlined in Section 2? What might be the associated risks of such options?
Direct capital market access for SMEs would also generally be conceivable. At the same time, the continental European economy is strongly bank-based, so that indirect access via securitisation makes more sense in our view. Banks, as service providers, can enable particularly smaller businesses which do not want to issue bonds or securitise loans on their own to indirectly access the capital markets.

Do the principles set out in Box 3 seem broadly sensible given the objective of encouraging a set of securitisations that are more amenable to risk assessment? Are there any obvious unintended consequences?
In principle, yes. However, how these principles are specified in detail is crucial. It is extremely important that they are specified in close cooperation with the industry to avoid unintended consequences.