Setting the standard
for securitisation

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2nd September 2021

Dear Sirs and Madams

PCS would like to thank HM Treasury for the opportunity to participate in this call for evidence.

PCS is an independent not-for-profit initiative set up in 2012 by securitisation market participants with strong support from public authorities and with the purpose of supporting the revitalisation of a strong and safe European securitisation market.

Since 2019, Prime Collateralised Securities (PCS) UK Ltd., PCS' UK arm, has been authorised by the UK Financial Conduct Authority as a TPV.

As an independent body, PCS' views are its own and our contribution to this call for evidence should not be read as representing the position of our members either collectively or individually.

Introduction

PCS supports the analysis of HMT in the call for evidence as to the potential benefits of a strong but safe UK securitisation market.

We would go further though and invite HMT to see the potential of the UK securitisation market as transcending merely its role as a useful additional funding source for banks with benefits for financial stability.

A look at the financial structure of the United States indicates that securitisation can play a central and fundamental role in providing ample and flexible funding to the real economy. This it can achieve in three ways (which we develop in our answer to question 10):

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- First by becoming a flexible tool for banks to manage proactively and on an ongoing basis their capital to be able to meet the real economy's funding needs.

- Secondly, by allowing the growth of a meaningful non-bank financial sector (especially around fintech) that will grow the funding envelope available to the real economy while - properly supervised – reducing the systemic risk associated with deposit taking institutions.

- Thirdly, by generating a large volume of high quality/low risk capital market instruments providing UK based investable assets for UK insurance companies, pension funds and asset managers.

PCS would therefore encourage HMG to have a much more ambitious vision for the financial sector where securitisation can positively reshape the financial architecture of the UK.

In that sense, PCS feels that the call for evidence's assertion that the volumes of UK securitisation show a fairly positive picture is over-optimistic both in historical terms (compared to pre-GFC), in terms of potential and in terms of where these volumes should be to have a meaningful positive impact on the UK's financial system.[1]

Response to the questions

1. What are your considerations for investing in an STS versus non-STS securitisation?

We are not investors.

2. What impact, if any, has the Sec Reg had on your investment decisions for investing in a securitisation position, and why?

We are not investors.

PCS has been informed though that bank treasuries, since the coming into force of the Sec Reg, have a marked preference for STS securitisations because of their greater capital efficiency and because of the eligibility of most STS securitisations for inclusion in Liquidity Cover Ratio (LCR) pools.

PCS also notes that, to date, only one buy-to-let UK mortgage securitisation has sought STS status[2]. Having spoken to a number of originators of such securitisations, PCS was told their primary reason for not seeking STS status was that buy-to-let mortgage securitisations were not eligible for inclusion in the

[1] In this respect, we draw attention to the comparison with the US where 2021 opened with outstanding securitisation volumes of £8,051bn (45% of US GDP) compared to UK outstandings of £207bn (10.5% of GDP). Data from AFME and the World Bank.
[2] Lanebrook Mortgage Transaction 2021-1 plc originated by Shawbrook Bank

LCR pools and this led to a lack of interest from bank treasuries as potential investors. We acknowledge though that this is hearsay and, as we are not investors, cannot speak to the matter from direct experience.

3. What changes to the Sec Reg would encourage you to invest more in securitisations of SME exposures?

We are not investors.

However, it seems to us that the best way to encourage investment in more securitisations of SME exposures is to encourage investment more generally in securitisation. For the best way to do the latter we refer you to our response to questions 9 and 10.

4. How, in your view, has the introduction of the Sec Reg affected the UK's securitisation market since it took effect on 1 January 2019?

PCS was, and strongly remains, in favour of the creation of a specific category of high-quality securitisations defined by law and overseen by regulation. This reform was necessary both to re-establish trust in a product the reputation of which was battered by the GFC and to prevent a re-occurrence of the disasters of 2007-2008 when opaque and badly structured securitisations were marketed as high-quality products.

With over a hundred individual criteria, it is inevitable that some aspects of STS are imperfect. The same can be said of other aspects of the Sec Reg concerning the extensive disclosure requirements or the due diligence burden imposed on investors. Technical improvements are clearly possible.

However, the Sec Reg and especially the creation of the STS regime has laid the foundation for a safe but also simple and standardised securitisation market for the UK that can increase substantially in volume. It allows for the development of a deep market for bonds that are correctly understood to be "plain vanilla" capital market instruments. Absent such a regulated category, securitisation would have to be viewed as potentially too complex or problematic an asset class for most investors.

Nevertheless, the benefits of the Sec Reg in the creation of a deep, safe and plain vanilla UK securitisation market remain unfulfilled.

The Sec Reg has not really reversed the decline in the market – which is a failure since it was designed to bring back safe securitisation as a major part of the overall financial architecture of the UK.

The market's failure to grow is in part due to monetary policy. The understandably extremely accommodative monetary policy of the Bank of England has made very cheap liquidity available to all UK banks. Alternative

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and more expensive forms of financing such as securitisations are therefore unattractive to most bank treasuries.

There is no meaningful quantitative measure of this impact since there has never been a period of so deep and so prolonged generous monetary policy in our history.

However, in the absence of quantitative data, anecdotal data is what one must wrestle with.

One clear piece of anecdotal data is the absence of any meaningful insurance money invested in STS securitisation. Since bringing to the STS market new investors and particularly insurance companies and pension funds was a key rationale behind the introduction of the regime, their absence indicates a failure to achieve a fundamental purpose of the Sec Reg. Further, this is not a failing that can be laid at the door of central bank policy.

This is a clear case of the Sec Reg having failed positively to impact the market. In conclusion, the Sec Reg has had a positive effect on the market by laying down the foundations of the market that stakeholders, both in the public and private sector, wish to see. But it has yet to fulfil its potential by leading to meaningful increases in issuance volumes and the return of securitisation as both a routine and major channel of UK financing.

5. In your views, has any ambiguity around the geographical scope of the Sec Reg's requirements impeded securitisation transactions? If so, what clarifications could be helpful?

The ambiguity has not, in our opinion, impacted UK securitisations.

That said, as the capital markets are global, these ambiguities need to be resolved to allow both UK and non-UK based participants to understand the rules they are to operate under.

In resolving these ambiguities, the key question that must be answered by HMG is that of the balance between free-flowing international capital markets and the need to supervise players to avoid a repeat of the GFC. Here one needs to measure the cost of reliance by regulators and governments on third country regulators and governments to look after their interests when financial problems are imported from those third countries.

Broadly, the EU decided that reliance on third country rules and regulators was not acceptable for reasons of sovereignty and what has now become known in

Brussels as "strategic autonomy". This seems to be leading the EU towards an extra-territorial approach. [3]

PCS is very sympathetic to the concerns of the EU but considers – and expressed this view at the time the Sec Reg was being drafted – that the solution chosen is excessively restrictive.

PCS at the time suggested an approach that was not based on a "one-size fits all" rule encompassing the whole of other jurisdictions' securitisation regimes. We rejected the notion that the EU (and today, the UK) was required to either recognise the entirety of another jurisdiction's securitisation rules as equivalent to local rules or, at the other extreme, reject them entirely.

In the alternative, we supported (and still support) an approach that examines the individual provisions of the Sec Reg (such as disclosure, retention, STS criteria, etc…) and lays down the rules third country securitisations must meet to be accepted as "equivalent" for the purposes of each of those individual components.

As an example, it seems that the disclosure obligations in article 7 of the Sec Reg together with the extremely detailed and prescriptive templates issued by ESMA should not be applied to third country securitisations but that there should be a requirement for substantially equivalent disclosure[4]. This achieves, in our view, the proper balance between, on the one hand, investor protection and level playing field requirements and, on the other hand, reasonable deference for third country rules and support for a global capital market.

But as a counter example, we do not believe that STS benefits should be granted to securitisations that do not fully meet the STS criteria since to do so would not only disadvantage UK originators required to meet a higher standard but also undermine the purpose of the Sec Reg in creating a single, familiar and standardised "plain vanilla" category for investors.

To resolve the regulatory supervision issue, HMG should rely on inter-regulator MOUs which provide for real cooperation on enforcement.

6. How do you think the UK securitisation market has performed in comparison to other jurisdictions, both:

a. Since the GFC, and

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[3] The Joint Committee of the ESAs Report (May 2021) suggests a solution that is not technically "extra-territorial" but, by requiring either the enforcement of the rules in their entirety by EU investors or the creation of an intra-EU entity to which the regulations can apply, achieves the equivalence of extra-territorial reach.

[4] We note that this is the position already adopted by the UK in the amendment to Article 7(3)(d) incorporated in the Securitisation (Amendment) (EU Exit) Regulations 2019

PCS

b. In response to Covid-19?

PCS is aware that other respondents to the call for evidence will provide the quantitative data required to answer these questions and so will not duplicate it here.

7. If you have not originated, issued or invested in an STS compliant securitisation yet, what were the main reasons?

We are not originators, issuers or investors.

8. If you have previously chosen not to designate a securitisation as STS even where the transaction was likely to qualify as STS, what were your reasons?

We are not originators.

9. What are currently, in your view, the main impediments to the growth of the UK's STS market?

Part of the answer lies in Bank of England monetary policy as set out in our response to question 4. This policy of providing near free and near unlimited liquidity to UK banks has crowded out other forms of bank funding, including securitisation.

But central bank policy is not the sole cause of the Sec Reg's failure to restart the UK securitisation regime. PCS has drawn attention, both in the UK and the EU, to the continued disconnect between the extremely high standard enshrined in the STS designation, together with the extremely robust performance of securitisation transactions meeting STS criteria during the GFC and the current CRR and Solvency II capital requirements for banks and insurance companies holding STS bonds.

This is not the place to develop quantitatively these arguments, but PCS and many other stakeholders produced at the time of the drafting of the Sec Reg (and attendant CRR and Solvency II changes) extensive quantitative data demonstrating these points. The passage of time since 2016/2017 has only confirmed the analysis.

PCS has also drawn attention to the incoherence in the treatment of STS securitisations in the LCR rules with the treatment of instruments of equivalent or worse liquidity.

In addition, the extensive and prescriptive disclosure requirements for originators and due diligence requirements for investors generate costs in time and money that are unique to securitisation as an asset class.

Therefore, PCS would list the main impediments to growth of the market as follows:

1. Excessive capital requirements for banks holding securitisation positions;

2. Inappropriate rules for eligibility of securitisations to bank liquidity cover pools;

3. Excessively prescriptive and detailed disclosure rules, especially for private transactions;

4. The absence of a level playing field both in terms of disclosure by originators and due diligence requirements on investors between securitisations and other asset based financial instruments.

10. How do you think securitisation could better support the financing of the real economy, in particular SMEs? What specific measures would support this?

We see securitisation being able to better support the financing of the real economy in two ways.

First, by allowing banks safely but proactively to manage capital.

Combined with a sensible bank significant risk transfer (SRT) regime, securitisation allows the volume of credit flowing to the economy no longer to be constrained by banks' capacity to raise capital.

Currently, there is an artificial link between the amount that banks can advance to the real economy and the amount that can be raised by banks as capital (whether from the markets or from retained profits). This link is artificial since the growth potential of the British economy is only weakly correlated with the capacity of banks to raise capital. In the face of increased capital requirements, such as faced by banks with Basel IV but also flowing from economic growth, if banks find capital raising too expensive or difficult, they have only two options: to reduce their lending or to reduce their existing prudential assets. The latter can only be done via whole loan sales – a limited market – or securitisation.

Securitisation as a funding tool has many benefits. But, to better support the funding of the economy, it is securitisation's capacity to free up capital for additional lending that has the greatest potential benefit. A deep SRT

securitisation market should prevent constraints on the amount of bank financing that can artificially limit economic growth.

Secondly, it allows for the emergence of a broad category of non-bank lenders which can meet their funding requirements in large part from the securitisation market. In this respect, we note that challenger financial institutions generally and fintechs in particular are traditionally caught in a difficult position in that they cannot raise meaningful amounts of funding without a track record and cannot achieve a track record without meaningful funding. Securitisation, by being asset based can overcome this vicious circle. By allowing the emergence of lenders able directly to mobilise savings locked in insurance companies, pension funds and asset managers for lending to the real economy, securitisation can expand the envelope of financing to the real economy.

By the use of tranching and therefore the creation of very safe AAA investments, it can do this without requiring risk averse capital market lenders to take excessive credit risks.

This is particularly relevant to SME lending, which is traditionally considered too risky for direct investment by conservative market participants. But those same conservative market participants can fund up to 85% of a pool of SME loans in the form of a AAA senior securitisation tranche.

It should also be noted that both these developments reduce systemic risk to the UK financial system without the concomitant reduction in available finance that would normally be attendant to such a reduction.

The specific measures that support this are those that are able to deepen the securitisation market. They are also measures that correct distortions that unjustifiably penalise securitisation as a financing tool.

Specific measures:

Immediate measures:

These are measures PCS believes should be enacted as soon as possible and which are not, in our opinion, controversial.

A. Better CRR

The current capital requirements for banks holding STS securitisations do not correspond to the actual risks embedded in these positions.

The basic flaw of the current calibrations of STS securitisations is simple. Following the GFC, the Basel Committee concluded that risk weights for securitisations should be substantially greater than the risks of the

PCS

underlying securitised assets because of “agency risk”. This expression covers the idea that the very act of securitising creates additional risks[5].

To counter these identified agency risks, a multiplier was added to the formulae setting the capital required to hold a securitisation: the *p* factor.

It is this *p* factor (together with the arbitrary floors on senior tranches) that accounts for the non-neutrality of the capital requirements – i.e. that the capital requirements of the same pool of assets in securitised form is a multiple of the capital requirement of those assets before they were securitised.

But soon after the *p* factor was introduced, European legislators also created the STS regime designed intentionally and explicitly to exclude agency risks from securitisations meeting its hundred plus criteria. In discussions with regulators, we have yet to identify an agency risk that is not addressed in the STS regime.

But the legislation failed fully to follow through, maintaining a high *p* factor even though agency risks had been removed from STS securitisations.

The calibration bias in securitisation capital for banks can be corrected through reviewing the CRR calibration of the *p* factor for the SEC-IRBA (art. 259 of the CRR) and of the *p* factor for SEC-SA (art. 261 of the CRR). Although we believe that in the absence of identified agency risks, the *p* factor should logically be set at zero, we acknowledge the conservative approach of regulators and recommend a *p* factor of no more than 0.25 for STS deals.

We would be happy to provide the Treasury with all the quantitative data supporting this approach.

B. Better LCR rules

The 2018 amendment to the LCR Delegated Act did not provide any recognition of the strength of the new STS standard but simply inserted the new standard (STS) in place of the old, weaker eligibility standard.

[5] The most obvious agency risk was the originate-to-distribute model common in the US sub-prime sector where it was rightly perceived that a finance house originating mortgages which would all be swiftly sold would originate worse quality assets. Similarly, lack of transparency was an agency risk.

Yet, the new STS standard is considerably more comprehensive than the old LCR eligibility standard– containing over 100 separate criteria. The new STS standard is backed by a sanctions' regime. The new

standard is framed by new regulated market participants – TPVs and SRs – to reinforce its integrity and transparency. The new standard is an official designation enhancing its market liquidity. And yet, this new STS standard was granted no benefits whatsoever in the revised LCR rules.

Again, it is essential to complete the reforms of the securitisation framework begun with the creation of STS criteria and re-classify STS senior tranches to Level 1 or, at worse, 2A and restore the eligibility at a single-A rating level to recognise substantial improvement introduced by the STS standard.

Finally, securitisation is the only asset class that has a maturity cap at five years for LCR eligibility. This arbitrary cap does not appear to be backed by any empirical data and fits oddly with the possibility of including a twenty-year covered bond in the LCR pools. This maturity cap should also be removed.

C. Better Solvency II

Key targets for increased investor involvement in securitisation are insurance undertakings. Here again, Solvency II calibrations display an unjustifiable non-neutrality. This time, the non-neutrality does not arise from an artificial *p* factor but as an equally artificial artefact of the division within the legislation of risk assessment into different "modules" using completely different methodologies.

The result of this artificial distinction is that the capital required by an insurer to be set aside for the purchase of a whole pool of mortgages is less than the capital required to purchase via a securitisation only the senior 80% of the risk of the identical pool. This is even though the securitised pool is considerably more liquid than the un-securitised whole loan pool.

In addition, the data on which the original calculations, were based adversely and idiosyncratically affected securitisations compared to other asset classes. Much of the worse effects of this in the original Solvency II calibrations was ameliorated following the STS Regulation, but – as with CRR – to fulfil the purpose of the new STS standard it is necessary to revisit what we believe to be a no-longer justified non-

neutrality. This is particularly, but not only, true of the treatment of junior tranches of STS securitisations.

Again, PCS would be happy to provide the Treasury with the quantitative data supporting this approach.

D. More sensible SRT process

For securitisation to deliver its potential for the funding of the real economy, it must enable banks to obtain (when justified) a reduction in RWAs and concomitant reduction in capital. In turn, this requires a sensible yet prudent set of SRT rules. PCS would therefore invite the Treasury and PRA to re-examine both the rules and the process for obtaining SRT treatment for originator banks to ensure that unnecessarily burdensome rules are eliminated.

PCS would be happy to provide examples to the Treasury.

E. Level-playing field

Issuing or purchasing a securitisation is never an absolute but a relative choice. Both originator and investors can always elect to issue or purchase a different instrument. Their decision will be driven by the *relative* benefits and costs of those instruments.

Today, for historical reasons, securitisation is the most regulated instrument in the world. This is despite analysis that conclusively demonstrated that European (including British) securitisations performed extremely well and entirely within expectation during and after the GFC.

As a result of articles 5 and 7 of the Sec Reg, the amount of disclosure by originators and due diligence by investors (both upfront and ongoing), especially at asset level, is onerous, time consuming and costly. This is a meaningful disincentive to issuing or purchasing a securitisation compared to other asset-based products, such as covered bonds, whole loan purchases or other asset-based secured financings.

PCS is very favourable to strong disclosure and due diligence requirements. (This is without prejudice to our view that the market would benefit from a number of technical adjustments in both areas.) However, we also strongly believe that to avoid market distortions the same disclosure and due diligence requirements should apply to other asset-based instruments such as covered bonds or whole loan purchases.

Broadly speaking, if an investment decision is to be based, in large part, on the assessment of the quality and future performance of financial assets, then the process that allows and requires an investor to assess those assets should be substantially identical.

PCS acknowledges that these changes will take longer to effect and require consultation with market stakeholders and a transition period. But they are important not only for the success of the securitisation market but also to remove distortions currently created by differentiated disclosure and due diligence regimes that encourage market participant towards products governed by lower standards.

More strategic measures:

These are more ambitious measures involving strategic choices, but which PCS believe could provide long-term support to the funding of the real economy and specifically SMEs.

A. “Fanny Mae” for SMEs

HMG may wish to consider a bolder approach involving the creation of an entity similar to the US Federal National Mortgage Association, (commonly known as Fanny Mae). In the UK this agency could focus not on mortgages but on SMEs. As in the US, the agency would purchase from bank and other lending institutions SME loans that conformed to defined standards. This would allow banks to lend with the knowledge that the capital used for such loans could be freed again rapidly for new lending. As with Fanny Mae it could operate with a full guarantee from HMG or with other forms of capital such as a partial guarantee of the junior tranches of securitisations issued by such entity.

PCS would not wish to minimise the complex strategic and technical issues such an approach would involve, but it would represent a potentially transformative move in the funding of SMEs in the UK.

B. HMG backed investment bank

Another, approach would be for HMG to invest directly or indirectly in the junior tranches of SME securitisations. This would probably be best done through a government supported investment bank or fund. This bank or fund could be wholly supported by the government or be a public/private partnership. It would play a role not dissimilar to that of the European Investment Bank within the EU.

These junior pieces could be purchased at slightly off market rates to generate financing of SMEs at interest rates more favourable to small businesses. The difference in the rates would embody a form of subsidy from the government but one that would not require direct transfers.

11. How, in your view, has the introduction of the Sec Reg affected the interconnectedness of financial institutions in the UK?

PCS sees no evidence that it has.

12. How could the Sec Reg do more to address the risks that securitisation activity in the UK poses to financial stability?

Securitisation activity poses a risk to financial stability when it leads to bad underwriting and the consequent generation of bad assets in the belief that those assets can be offloaded on unsuspecting investors.

The history of the GFC shows that UK securitisations did not pose a risk to UK financial stability save for the nascent but still small re-securitisation market (CDOs, CDO squareds, etc…). Such dangerous products are now banned in the UK.

In the STS asset classes, to this day – thirteen years after the onset of the crisis – the senior tranches of UK securitisations have not generated a single penny of loss for investors.

Accordingly, PCS does not believe that securitisation activity conducted under the rules of the Sec Reg do pose any risk to the UK's financial stability and therefore cannot envisage any additional measures that are required to be taken.

13. To what extent have different Covid-19 measures affected the performance of the UK securitisation market?

PCS is aware that other respondents to this call for evidence will provide the quantitative information required by this question.

14. How, in your view, has EU Exit impacted the UK securitisation market?

It has further reduced the amount and increased the cost of funding sources for UK banks and fintech's.

It is difficult to gauge this impact quantitatively since UK STS issuance is so low.[6]

[6] As of 31st August, only 8 public STS transactions had been notified to the FCA for the whole of 2021.

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15. Does the risk retention framework effectively balance prudence and market functioning? If not, how could it be improved?

PCS believes that the retention framework appears broadly to fulfil its purpose.

Improvements would be to ensure that the correct party is retaining the risk – eg in CLOs. "Skin in the game" should always be held not by a party arbitrarily defined as the "originator" but by the party who selects the pool and extracts the profit from the securitisation when seen as part of a complete financial cycle. This consideration is most relevant for CLOs, NPLs with managers and some platform lending.

16. Which modalities do you use and what motivates this? How many securitisations (volume & value) have you used each modality for?

We are not originators.

17. Do you consider the risk retention modality when making investment decisions?

We are not investors.

18. What is the impact of the risk retention rules on securitisations of NPLs?

PCS is not currently involved in the NPL market and so has no special expertise in this area.

As a matter of common sense, we feel the recent EU changes for basing retention on the net price rather than the face value of the NPLs and the modifications to the rules on underwriting criteria seem sensible.[7]

19. In light of the PRA's ongoing consultation on the securitisation of NPLs, would the effectiveness of NPL securitisation be enhanced if the servicer was allowed to fulfil the risk retention requirement?

We need to go back to the purpose of the retention rules: to ensure that the party who "originates" the securitised assets and takes the benefit of the cycle of origination-securitisation has "skin-in-the game".

For this purpose, the party who "originates" the assets may be the original lender/lender of record but might also be the party who selects the assets, having purchased them in the market or the party who controls the selection and extracts the profit.

[7] Regulation (EU) 2021/557 of the European Parliament and of the Council of 31 March 2021 amending Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation to help the recovery from the COVID-19 crisis

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PCS' view is that the approach should not be merely to add parties to the list of who can be the risk retaining party thus allowing market participants to choose who they determine most convenient to saddle with the risk. The approach should be to have the widest list of possible risk retention parties ***together with a strict set of rules*** requiring that the economic "originator", notwithstanding their title or role in the set-up, retains the risk.

So, in answer to the question, the effectiveness of NPL securitisations would be enhanced by allowing a servicer to be the retention holder but only if the servicer is the party, as is often the case, who sets up the securitisation and extracts from it the equity benefit.

20. What are your considerations in deciding whether to issue a private or public securitisation?

We are not originators.

But in PCS' experience the discussions we have heard re market participants selecting private securitisations to avoid disclosure rules is not borne out by any of our interactions with our clients in the verification of private securitisations.

The choice seems primarily driven by who wishes to invest at what price. If a private market player is prepared to invest faster, more or at a lower price, the originator will choose the private markets.

Some originators also choose the public markets as a strategic choice to diversify their funding sources.

21. What are your considerations in deciding where to list your securitisation, both in the UK and in other jurisdictions?

We are not originators.

22. How do the costs and benefits of listing securitisations vary by jurisdiction?

We have no knowledge as to this matter.

23. Do you consider the disclosure requirements (both the content and format) for private securitisations to be sufficiently useful? If not, how could they be improved? Please answer with reference to:

a. Bilateral securitisations;

b. Intragroup securitisation transactions; and/or

c. Any other private securitisation transactions

As mentioned in our response to question 20, the notion of market participants selecting private securitisations to avoid disclosure rules is not borne out by any of our interactions with them.

Private transactions are marked by fewer investors (sometimes only one) and longer timeframes. In PCS' experience, the disclosure made by originators in private transactions is often greater and goes into more depth than in public transactions due to the close interaction between originator and investor(s). We have no evidence that private transactions suffer from a lower quality of disclosure.

Where the problem occurs is that the disclosure requirements in the Sec Reg and attendant RTSs are highly formalised allowing for very few departures from the prescribed rules even when such departure would be justified in the context of a given transaction.

PCS is not in favour of less disclosure in private transactions as a general proposition but believes that more flexibility should be allowed in private transactions to depart from the highly technical prescribed format when justified. This could be done by extending, for example, the cases when an originator can use ND fields.

For intragroup securitisations, we see no reasons whatsoever to require any level of disclosure.

24. Do you find the usefulness and quality of the information you receive on a securitisation to be materially different when available through an SR, to when it is not made available through an SR?

PCS suspects that the main value of an SR is to have single point of access.

We also understand that SRs run quality and consistency checks on the data provided to them. This should, theoretically, result globally higher quality information over time, but since we still do not have any SRs in the UK, no comparative data exists to confirm or contradict this assertion

25. Does the fact that a securitisation is not reported through an SR impact your ability or willingness to assess credit risk and/or invest in a securitisation?

We are not an investor.

26. Do you consider there would be any benefit to extending disclosure requirements for public securitisations to private securitisations, specifically:

a. The requirement to make information available through SRs; and/or

b. The requirement to fill in the templates on inside information or significant event information, as contained in Annex 14 and Annex 15 of the onshored Technical Standards?

See our answer to question 23.

27. To what extent has your firm benefitted from the temporary recognition of EU STS by the UK?

We have not.

***28. To what extent has a lack of recognition of UK STS by the EU impacted your firm*?**

We have lost at least one verification mandate from a UK originator whose sole investor was in the EU. We cannot know if this is a more widespread problem.

29. Do you have views on the merits, as well as any drawbacks, of HMT introducing an STS equivalence regime?

PCS is a very strong believer in the STS regime and the strict definition of STS. We note that the STC definition in Basel is much looser and provides for a much lower standard.

PCS also believes that strong and competent regulatory oversight with a capacity to sanction bad actors is important to any jurisdiction that seeks to provide a regulatory benefit to third country market participants.
We also support the notion of equivalence.

Therefore, we would support an STS equivalence regime based on an identical or near identical definition of STS, similar (but not necessarily identical or so tightly prescribed) levels of disclosure and appropriate inter-regulatory MOUs on enforcement and information exchange.

We also note that TPVs, as independent institutions regulated and subject to sanctions within the UK, could play a key role in enforcing equivalence from third country issuers. Their role, in particular, would be to assist in ensuring that the interpretation of specific criteria in non-UK jurisdictions was consistent with that used by UK regulators and issuers and understood by UK investors.

30. Are there any mechanisms other than an STS equivalence regime which, in your view, would give effect to the policy objectives in paragraph 5.7?

See answers to question 5 and 29. Short of equivalence, the rules should provide for specific and appropriate equivalent standards to be met by third country issuers with MOUs that allow appropriate supervision and information sharing.

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31. Do you have comments on the considerations relevant to making equivalence assessments under a new STS equivalence regime, as outlined in paragraphs 5.16 to 5.22?

On the three considerations:

A. *The Basel STC criteria*.

See our response to question 29. PCS does not consider the STC criteria to be sufficiently robust. Also, their vagueness allows for extreme variations of interpretation making the standard cover a very wide range of outcomes and risk profiles. Finally, to use this standard as equivalent to STS would be a substantial disadvantage to UK issuers required to adhere to a much higher standard.

B. *Supervisory cooperation*.

PCS believes that this is an important aspect of any STS recognition for third country securitisations.

C. *Mutual recognition*.

This is fundamentally a political question. However, even without mutual recognition it would appear to PCS that access by UK investors to safe capital market instruments from third countries is a positive outcome notwithstanding that this access in not reciprocated. Therefore, on balance, we would conclude that, although a desirable outcome which should be a negotiation aim, this should not be a pre-requisite.

32. Do you consider an adaptation period accompanying any potential withdrawal of equivalence would be useful in the operation of a new equivalence regime for STS securitisation?

Clearly, any adaptation period would be a positive as capital markets are fragilized by shocks. PCS would assume though that the decision on whether to adopt such an adaptation period should be dependent on the reason why the equivalence was withdrawn.

It is possible to envisage problems with the third country regime so deep and dangerous that only an immediate withdrawal is able adequately to protect the UK financial system. However, most cases are likely to be suitable for a phased withdrawal or a withdrawal subject to grandfathering provisions for existing holdings such as those provided today for EU STS transactions.

So, PCS would support the possibility of an adaptation period and a bias towards providing such period unless extreme circumstances prevailed.

33. If so, would it be desirable to introduce standardised adaptation periods for STS, or are there other factors which should be considered?

See our answer to question 32.

34. Do you have any other views related to STS equivalence which you think should be considered?

No.

35. If disclosure requirements on environmental performance were to apply to all underlying exposures:

a. Is there enough information available to fulfil any such obligation?

b. Are there any underlying exposures where the information would not be available or where it would not be proportionate to collect?

c. What type of information on the environmental impact would you suggest (please provide as much detail as possible for different underlying exposures)?

PCS is strongly in favour of disclosure of environmental performance. However, this is subject to some crucial points.

A. *Issues of level playing field*

Securitisation is already the most regulated capital market instrument in the world. PCS has already mentioned in its response to question 10 that a return of securitisation is hampered not by the amount of regulation (most of which PCS supports) but the fact that ***only*** securitisation is subject to this amount of regulation whilst equivalently risky (or riskier) instruments are not. To support securitisation, the playing field must be levelled.

Therefore, PCS would support mandatory environmental information to be provided for securitisation only if these requirements were equally extended to other market instrument such as covered, secured and unsecured bonds.

PCS

B. *Issues of availability*

There are very good reasons for requiring financial institutions to obtain and maintain records of the environmental impact of their lending and PCS strongly supports such actions. But the securitisation regulations are the wrong place to seek to compel or incentivise financial institutions to obtain this information.

In the current state of the market, mandatorily requiring environmental impact information that a financial institution may not possess as a condition to issuing a securitisation (but not other instruments) will merely result in a further contraction of the UK securitisation market, not an increase in the generation of such information.

If HMG wishes to compel or incentivise the acquisition of environmental impact information by financial players, it has other tools to do so. Therefore, the disclosure of environmental impact information in the context of a securitisation should be limited to situation where the originator possesses this information.

C. *Common-sense approach*

It should be recognised that although the disclosure of environmental impact information can be useful in the context of mortgage loans or car loans, it is meaningless in the context of credit card debt and impossible to obtain for trade receivables.

The requirements should therefore be made on an asset-class by asset-class basis based on a common-sense approach as to both the availability and usefulness of the information.

36. In respect of current disclosure on residential mortgages and auto loans and leases:

a. Is the environmental performance data on a securitisation's underlying exposures which you currently receive sufficiently useful?

b. What other information would you find useful, if any?

We are not investors.

37. In respect of underlying exposures other than residential mortgages and auto loans and leases:

a. Are there other types of underlying exposures for which you would find it useful to have information on their environmental impact? If yes, which ones?

PCS

b. What information would you find useful?

Subject to the answer in 35 on availability and level playing fields, CLOs and SME securitisations would *prima facie* appear most suitable to this type of disclosure.

38. Generally: How attractive, relative to other investable ESG securities, are securitisations that disclose environmental performance information?

We have no information on this point.

39. What additional readily available information on securitised underlying exposures could support the mainstreaming of ESG? Which underlying exposures would that impact?

None we can think of.

40. Do you have any views on how the Sec Reg can better support the government's aims for green finance in the near future?

Multiple and privately defined standards with no authoritative interpretation raise the issue of greenwashing. They are likely to lead to high-profile scandals that will harm green investing for a long time, especially by retail investors. Therefore, the creation of a taxonomy by HMG backed by regulatory enforcement (via the FCA) is, in our view, a key step in the creation of a long-term green financial architecture. However, for the now well-rehearsed reasons of levelling playing fields, the Sec Reg is not the place for such taxonomy.

Securitisation can play a very important role in financing the transition to a sustainable economy. But the need for such a transition reflects the absence, today, of large volumes of sustainable finance assets.

Therefore, should HMG elect to define a "green securitisation" standard via Sec Reg amendments, it should do so with the following aims:

- to ensure a level playing field where equivalent instruments are treated in an equivalent manner;
- to maximise securitisation's contribution to the vital transition to a sustainable economy;
- to reflect conceptual and logical coherence in the UK's approach to green financing;

To achieve this, it is essential that the definition of "green securitisation" not be limited to the securitisation of the minuscule amount of existing green assets

PCS

but, as with all other capital market instruments, encompasses securitisations where the proceeds are used to transition the UK to a sustainable economy.

41. What are your considerations, including costs and benefits, when deciding whether to use a TPV to verify STS compliance?

Not for us to say.

42. When making investment decisions, how important is it to you that the compliance with the STS criteria is verified by a TPV? Please explain why.

We are told that it is.

As evidence, we would draw attention to the fact that not only in the UK but across the whole of Europe PCS is not aware of a single STS transaction publicly placed[8] with investors without a TPV.

We also note that there are over a hundred criteria to check in verifying an STS transaction. Even if investors are familiar with those criteria and fully understand them, it does not remove the necessity of someone actually checking them systematically not only for securitisations purchased but also for securitisations an investor is considering for purchase.

That task that is mechanically time consuming and requires knowledge of the complexities of interpretating sometimes ambiguous criteria. That task (in contradistinction with credit analysis which is individuated) is also identical for each investor. It is therefore economically efficient to socialize its cost.

In addition, considering the cost and repetitive nature of the verification of STS, there is a real concern, absent TPVs whose sole purpose this is, that once familiarity sets in, investors will not check the hundred plus criteria (or only do it for "risky" deals), relying on the fact that any given deal has *barely* changed from the previous one they looked at. That is exactly what happened pre-GFC: investors stopped checking because of familiarity with products such as sub-prime and failed to see the incremental changes as their quality deteriorated over time before finally triggering catastrophic losses.

43. Do you think the TPV regime under the Sec Reg is appropriate? In particular:

a. What are your views on the impact of the authorisation process for TPVs on the level of competition in the market?

b. What do you think could help foster competition?

[8] As distinct from transactions which may be public but either retained by the originator or privately placed.

c. Given the role that TPVs play in the STS market and the current number of authorised TPVs, do you think there might be any risk of harm arising from over-reliance on the assessment of a TPV?

d. Do you think the TPV regime should be amended to address those risks?

To respond to this question, we believe it is important to understand why TPVs exist.

Broadly speaking, the UK approach to regulation, with which we have much sympathy, is that regulation should be introduced to remedy known market failures. This contrast with other approaches which posit that regulation should be introduced *ex ante* to shape markets into a form deemed appropriate by public authorities.

This Sec Reg, including the creation of TPVs, came into being as a result of a catastrophe with some, primarily US, securitisations that almost destroyed capitalism.

One of the identified and acknowledged reasons for this catastrophe was investor reliance on CRAs.

Before the crisis, investors relied on unregulated rating agencies to socialize the cost of analysing securitisations even though they were paid by the originators thus creating a major conflict of interest.

TPVs socialize the cost of analysing securitisations for the investors even though we are paid by the originators thus creating a major conflict of interest.

This is the paradigmatic case of a known and catastrophic market failure that requires remedy.

The specific benefits of the current TPV regime are regulating and preventing conflicts of interest of the type that, in part, triggered the previous crisis whilst not burdening investors with costly and repetitive due diligence. This is, of course, the same approach that was adopted to resolve the problem with CRAs.

The only alternatives are:

- Allowing investors to rely on unregulated TPVs burdened by unmanaged and unregulated conflict of interests – back to 2006 and the CRAs.

- Not allowing investors to rely on TPVs thus forcing them to do the entire due diligence of STS themselves. This is a hugely time-consuming task that is identical for each investor and thus massively duplicative. It is, more importantly, a task the investor community told policy makers they

PCS

would not engage in. It was indeed the position of the investor community that requiring them to perform unaided this task would lead them to abandon the STS market altogether, that led to the creation of TPVs in the first place. This would come, as outlined in our response to question 42, with the very serious risk that the task would simply not be performed adequately by those few investors still willing to participate in the market.

- Allowing the investors to rely on the originators telling them their securitisations are of the highest quality but not requiring the investors to due diligence that assertion – again back to 2006.

There are additional advantages to the existence of TPVs who verify numerous transactions, namely their capacity to identify emerging divergences in the interpretation of STS criteria between different originators and their legal advisers. Being able to identify these divergences, TPVs can bring market participants and, if required, the FCA together to settle an interpretation. This is a process PCS can attest to and has been an important part of creating a truly singular STS asset class.

On the authorisation process, PCS' authorisation took one to two months and cost £250.00. The Financial Conduct Authorities process was, in our opinion, swift, sensible and very competent. It is difficult to envisage a lightening of the process.

The real issue with competition is that, so far this year, there have been 7 public transactions verified in the UK[9]. By the end of the year, it is likely on current trends that we will have around 13 to 14 transactions at best. Even with 100% of the market, this is not sufficient to keep one single analyst fully employed.

PCS is a not-for-profit initiative created by market participants with the social purpose of supporting high quality securitisation. This is why we are committed to continuing our role as a TPV, notwithstanding that it is not, on current volumes, an economically viable task. We are able to do this because of historical income from our pre-2019 labelling activities and transfer payments from assisting our EU sister company in its own EU verification work.

There is no competition because a pool that cannot feed a single player has no attraction for any would be additional entrants. This has nothing to do with barriers to entry. If they were 40 deals a year, we have absolutely no doubt that competition would arise.

[9] As of 31st August, as per the FCA. See: https://data.fca.org.uk/#/sts/stssecuritisations

44. SSPEs have specific obligations under Article 7 to ensure sufficient provision of information to investors. Do you consider this information to be sufficient to be able to ascertain a full view of the transactions, including the level of interconnectedness of institutions (if so desired)?

The level of information provided is greater in securitisation than for any other capital market instrument. We have never heard an investor complain that they lacked information since the passage of the Sec Reg. PCS is not an investor but has extensive experience and has no evidence of any deficiency in this area. It is not clear how any disclosure relating to the securitised assets and the structural features of a transaction could provide information about financial interconnectedness. That information would flow from an understanding of who held what securitisations. This cannot be provided by the SSPE in a free market where securitisations can trade.

45. Do you think that this will be improved by the existence of authorised SRs?

PCS is broadly favourable to the introduction of authorised SRs but, for the reasons mentioned in our response to question 44, cannot see how authorised SRs would improve information for investors and even less when it comes to interconnectedness.

46. As an originator/sponsor/investor, how many SSPEs do you interact with on a per transaction/programme basis?

PCS is not an originator or sponsor but usually there is one SSPE per transaction, sometimes two in the case of ABCP.

47. Do you have any concerns with the robustness of the SSPE regime regarding its ability to:

a. ensure it is insolvency remote; and

b. ensure it has sufficient funds to continue operations (both generally and in the context of an enforcement or acceleration notice)?

PCS is not aware of any securitisation in the UK (or elsewhere) in the last 33 years (including the GFC) which defaulted as a result of the failure of the SSPE (rather than a failure of the underlying securitised assets). Although it is not theoretically impossible for an SSPE to fail, it is extremely unlikely and is not, in our opinion, a meaningful risk.

48. Should HM Treasury introduce a system of LLBs to replace and centralise the functions of SSPEs?

No. This is a solution in search of a problem as, to our knowledge, no SSPE has caused the failing by itself of a securitisation. In addition, even in the case

an SSPE suffers collapse, this would only affect a single transaction. To replace the current set-up with a system of LLBs is to create a systemic risk where none existed before. Undoubtedly, this systemic risk could be managed via legislation, capitalisation, regulatory supervision or, more likely, a combination of the above but at a cost and for, as we have seen, no discernible benefit.

49. Do you have any comments on HM Treasury's views regarding the definition of institutional investor under the Sec Reg, as it applies to AIFMs?

No.

50. What are the practical effects of the due diligence requirements for non-UK AIFMs managing or marketing in the UK?

We have no comment on the matter.

51. Are there any perceived benefits of the extraterritorial requirements?

We have no comment on the matter.

52. Do you have any comments on HM Treasury's views regarding the definition of institutional investor under the Sec Reg, as it applies to AIFMs?

No.

53. Do respondents have any concerns with amending this definition? Would this risk any unintended consequences that HMT should be aware of?

We have no views on this matter.

PCS is at your disposal for any clarifications you may seek on our answers or to provide any further information you believe could be of assistance.

Yours faithfully

Ian Bell
Chief Executive Officer