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Setting the Standard for Securitisation

Securitisation – "Quo Vadis?"

2nd December 2021

Agenda

- Introduction – why “Quo Vadis?”
- Monetary Policy
- Basel III and the “output floors”
- How green will my securitisation be?
- The Securitisation Regulation Review(s)
- Calibration Issues
- Bringing it all together

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Setting the Standard for Securitisation

Monetary Policy

Monetary Policy

ECB

ECB Toolbox

Monetary Policy

ECB Toolbox

ECB's Monetary Intervention Toolbox

Standard Tools

Non-Standard Monetary Policy Measures

1998	MRO Main Refinancing Operations	1 week cash
	LTRO Longer Term Refinancing Operations	3 month cash
2009	APP Asset Purchase Program	Bond Purchase Program
2012	OMT Outright Monetary Transactions	Public Debt Funding
2014	TLTRO Targeted Long Term Refinancing Operations	3 year cash
2020	PEPP Pandemic Emergency Purchase Program	Bond Purchase Program

Monetary Policy

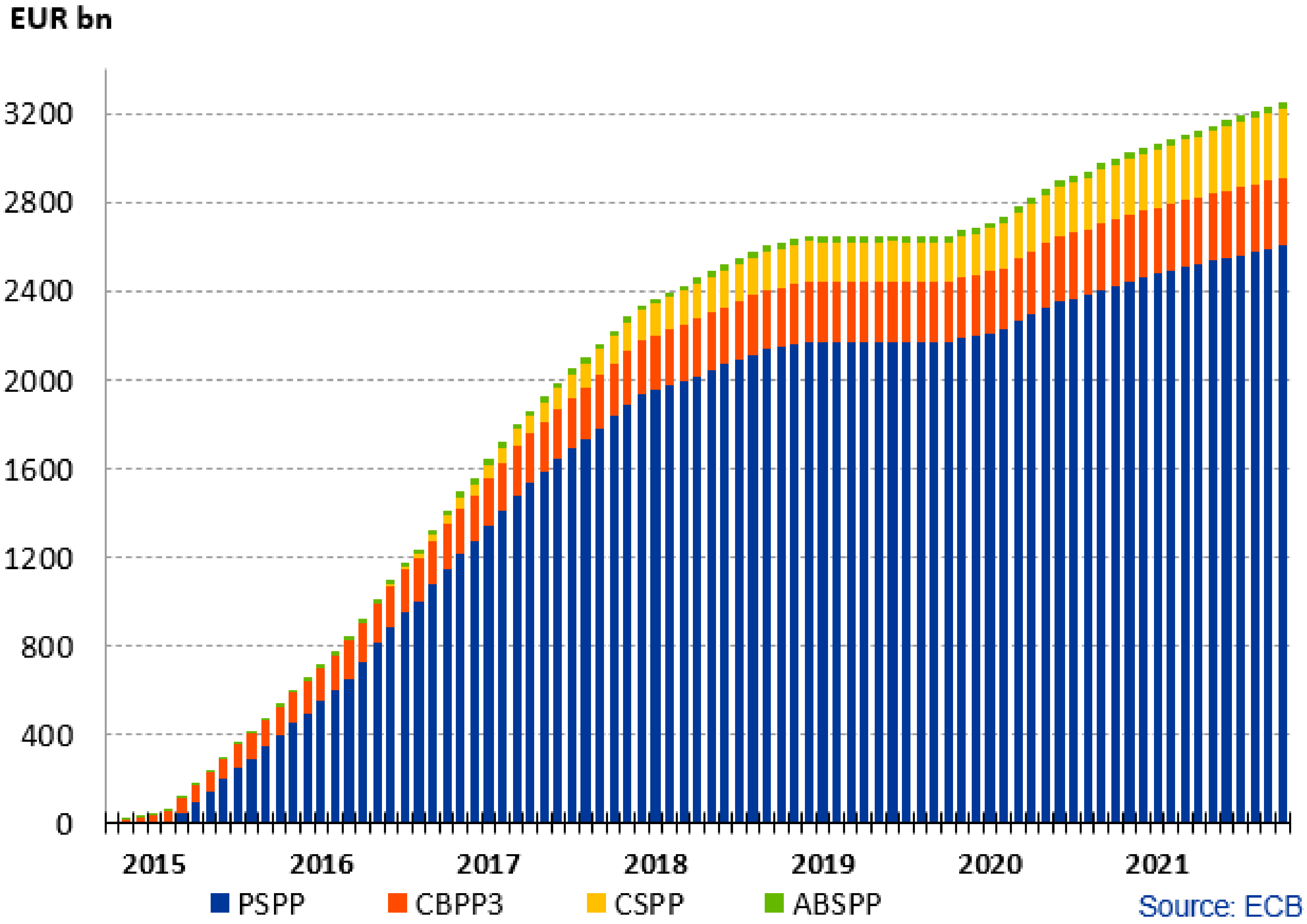
ECB Toolbox

Asset Purchase Programs

Monetary Policy

ECB Toolbox
Asset Purchase Program

Evolution over time – Cumulative net purchases by Program

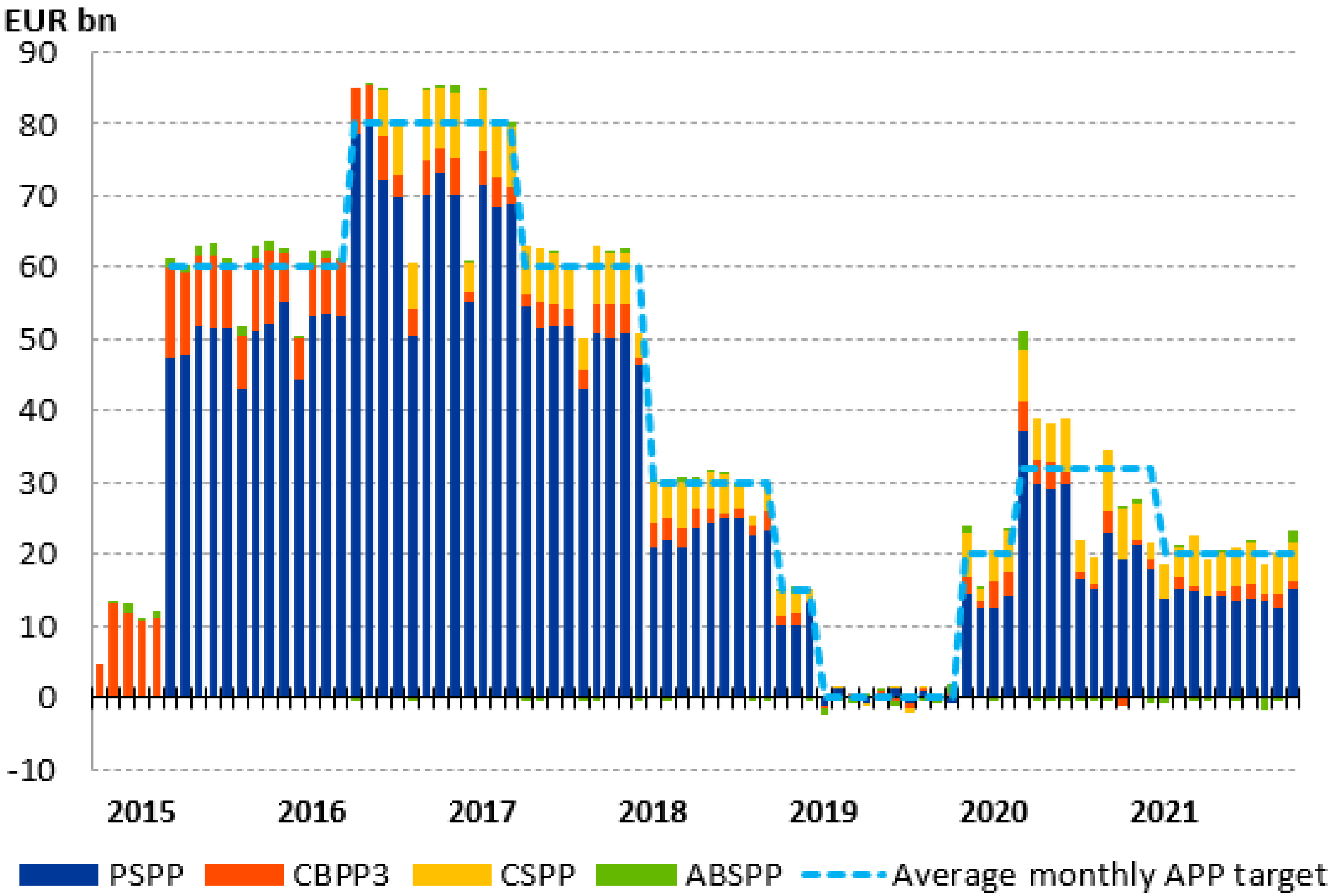


Source: ECB

Monetary Policy

ECB Toolbox
Asset Purchase Program

Evolution over time – Net purchases by Program



Source: ECB

Monetary Policy

ECB Toolbox
Pandemic Emergency Purchase Program

ECB's Purchase Program – and then there was the PEPP

- The Pandemic Emergency Purchase Program (PEPP) launched in March 2020
- Started at €750bn and increased to €1,85 trillion
- Will go on till at least March 2022

Monetary Policy

ECB Toolbox Purchase Programs

Some general points regarding ECB's APP and PEPP

- ECB was on its way to winding down purchases and liquidity injections but COVID occurred
- The ABSPP and "repo eligibility" should not be confused
- The APP and its purchases of ABS can have a meaningful impact on pricing
- The APP **is not** a key macro-driver for the future of European securitisation

Monetary Policy

ECB Toolbox

Targeted Long Term Refinancing Operations

Monetary Policy

ECB Toolbox
Targeted Long Term Refinancing Operations

ECB's TLTRO – Why banks do not need funding from securitisation

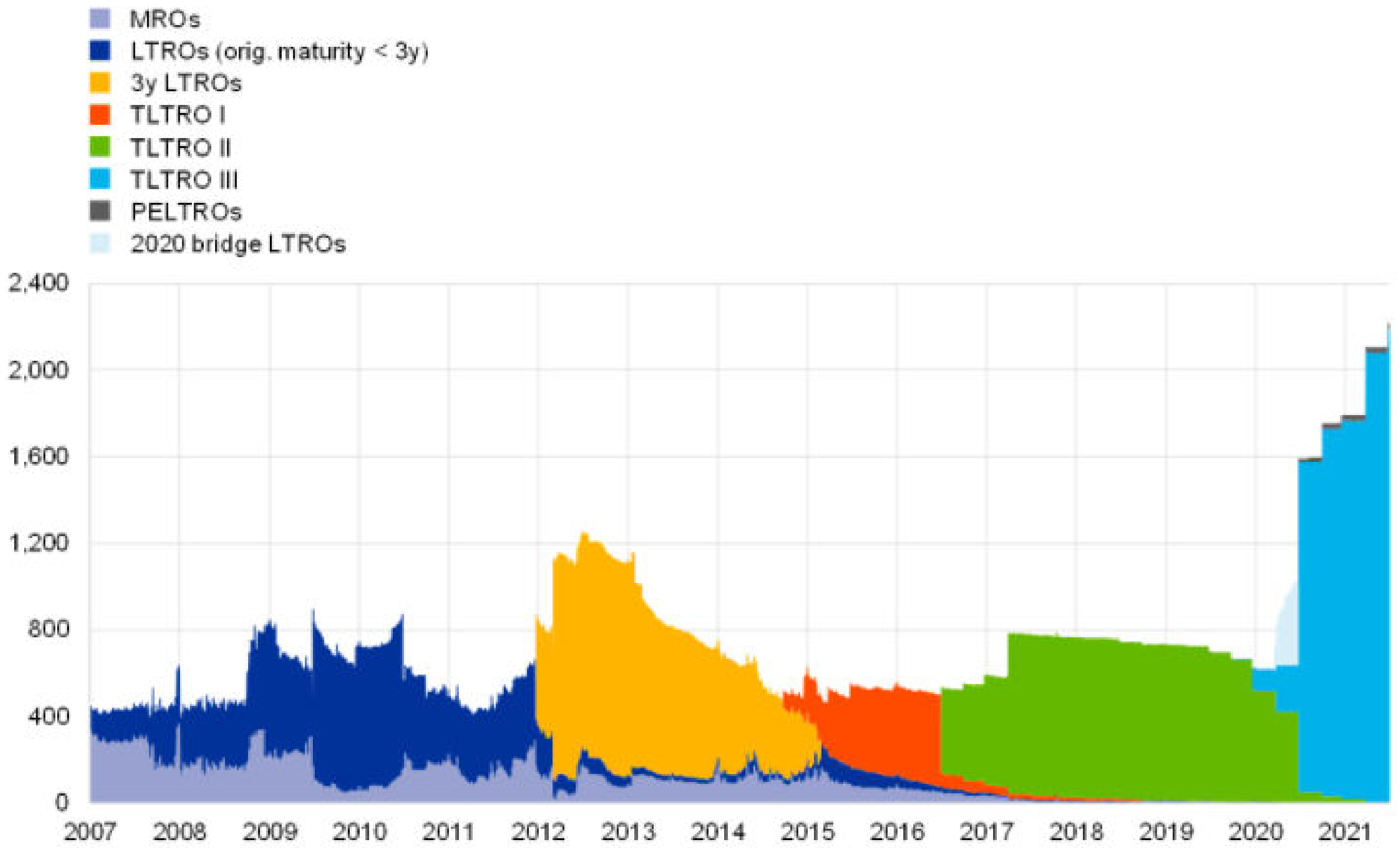
- The TLTRO is direct lending to banks at ultra-low rates – rates no securitisation can compete against
- 3-year facilities , except for PELTRO (pandemic emergency longer-term refinancing operations) where maturities are shorter (e.g 12mths for 2021 disbursements)

Monetary Policy

ECB Toolbox
Targeted Long Term Refinancing Operations

Borrowing from the Eurosystem

(EUR billions)

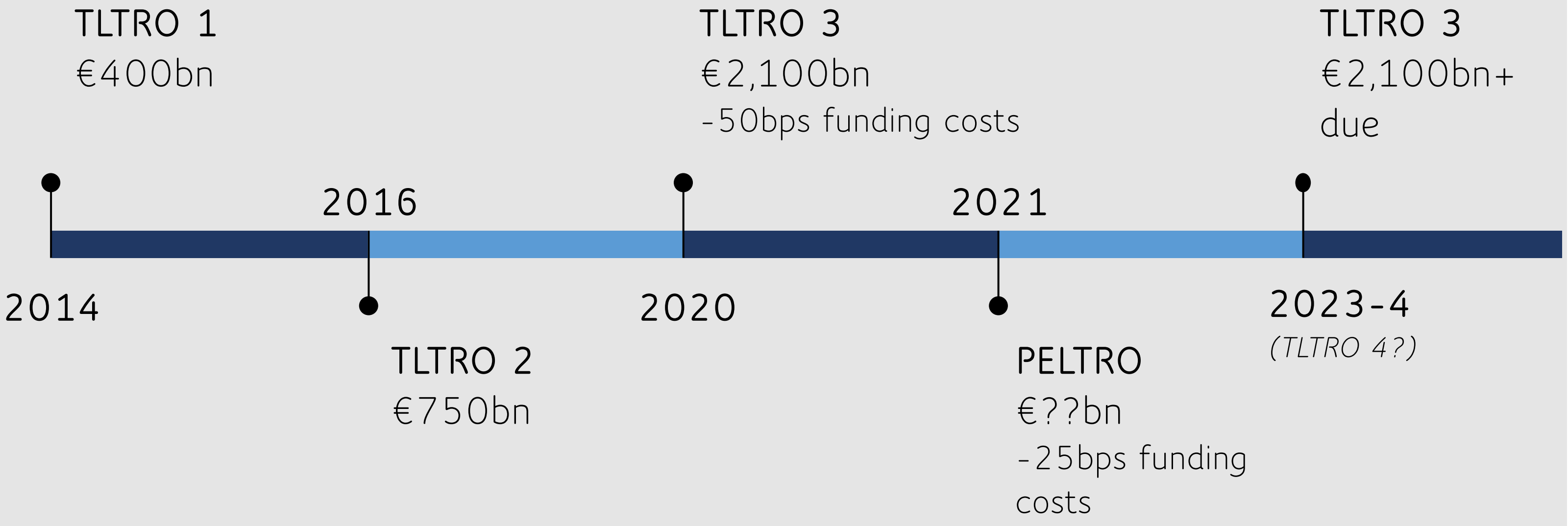


Sources: ECB and ECB calculations.

Monetary Policy

ECB Toolbox
TLTRO Timeline

Timeline



Monetary Policy

BoE

BoE Toolbox

Monetary Policy

BoE Toolbox

Bank of England's toolbox – Same tools, different application

The Bank of England's purchase program never allowed for the purchase of securitisations

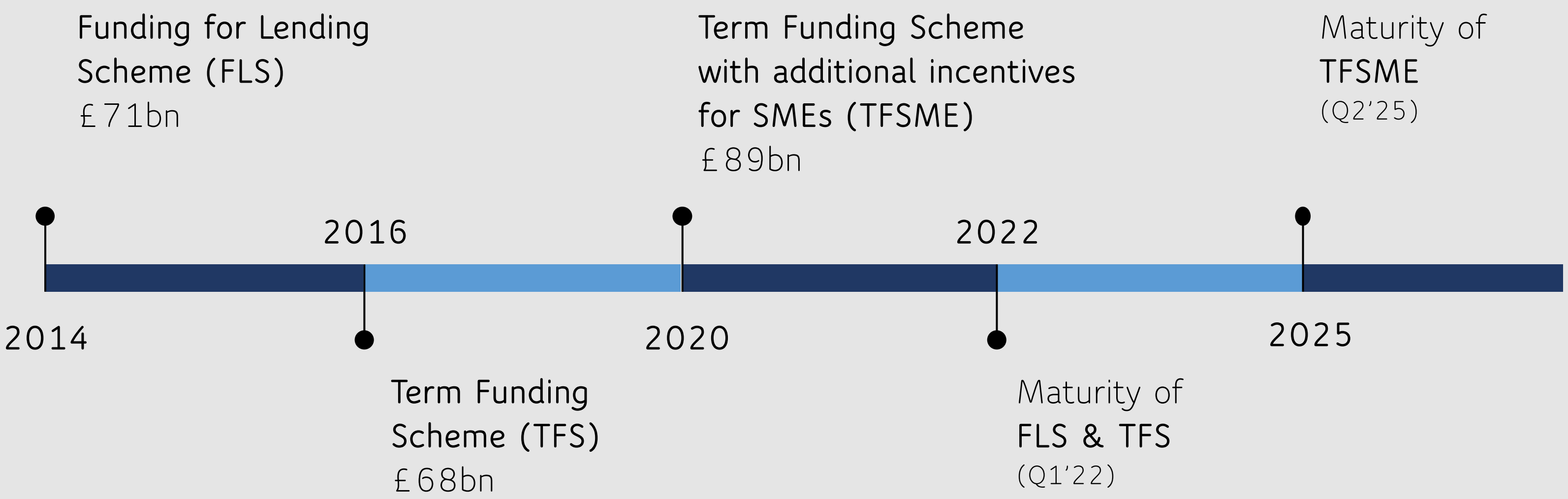
The Bank of England ran three funding schemes:

- FLS – Funding for Lending Scheme to help house purchases – 4 year maturity now closed
- TFS – Term Funding Scheme as a direct "cheap money" scheme for banks – 4 year maturity now closed
- TFSSME – Term Funding Scheme with additional incentives for SMEs – "cheap money" scheme for banks to be channelled into SME lending

Monetary Policy

BoE Timeline

Timeline



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Basel III and the "output floors"

Basel III

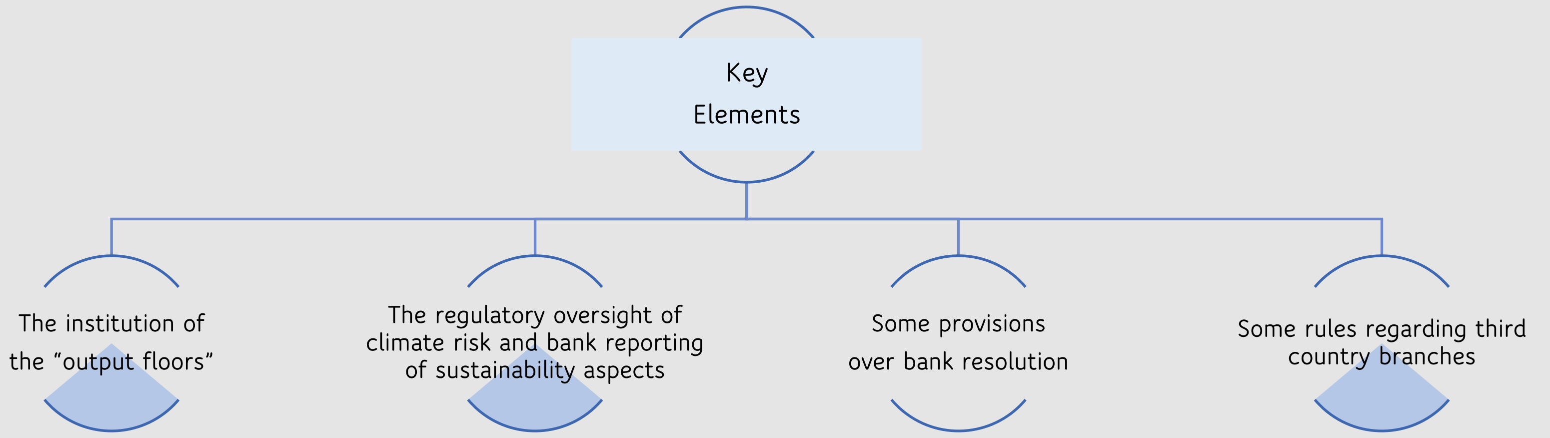
Implementation

EU Basel III Implementation

Basel III implementation

Draft EU laws

On 27 October 2021 the European Commission published its final Basel III implementation package



Three of those could impact securitisation

These are legislative drafts that will now be discussed and amended by the European Parliament and the Member States gathered in the European Council

Much is controversial and a smooth passage is highly unlikely

Basel III implementation

Third Country Branches (TBCs)

The EU is concerned that many non-European banks are operating through branches rather than subsidiaries

The proposal is that any third country branch with €30bn or more of assets in a Member State should be subject to a review to determine whether it poses a systemic risk

If it is held to pose a systemic risk it will be required to convert into a subsidiary or be subject to the same prudential rules as a subsidiary

Why does this matter for securitisation?

Because it could change the capital requirements for non-European banks and require them to seek ways of managing capital in the EU including entering into SRT securitisations

Basel III implementation

Output Floors

Let's start by saying that output floors are very controversial

The "output floors" proposed in the draft legislation are floors to how low capital requirements can go for any set of assets held by a IRB bank

Before "output floors", sophisticated banks could, with regulatory approval, use internal models to measure the risk weight for an asset (RW_{irb})

The bank's capital requirement would then be calculated by multiplying the asset by (RW_{irb})

After "output floors", banks need to calculate for any pool two numbers:

(a) the risk as measured by the internal model (RW_{irb}) and;

(b) the number equal to 72.5% of the revised risk measured by the standardised approach (RWsa)

The bank's capital requirement would then be calculated using the higher of those two numbers

Basel III implementation

Output Floors

The European Commission pushed out the time for the **entry into force of the output floors to January 2025**

There is a **transition period of five years**

In that period the floor will increase from **50% of Ksa** to **72.5% of Ksa**

The EBA and Commission's numbers show **EU banks will need to increase capital** as a result of the output floors **by an average of 9%**

European banks are challenging these numbers

Basel III implementation

Output Floors & Securitisation

The capital required for an IRB Bank is a function of RWA:

$$\boldsymbol{K_{irb} = max\begin{Bmatrix} RW_{irb} \\ 0.725 \times RWsa \end{Bmatrix} \times (\text{on BS Assets}) \times SREP_{\text{Ratio}}}$$

The capital required for a SA Bank is a function of RWA:

$$\boldsymbol{K_{sa} = RW_{sa} \times (\text{on BS Assets}) \times Basel_{Ratio}}$$

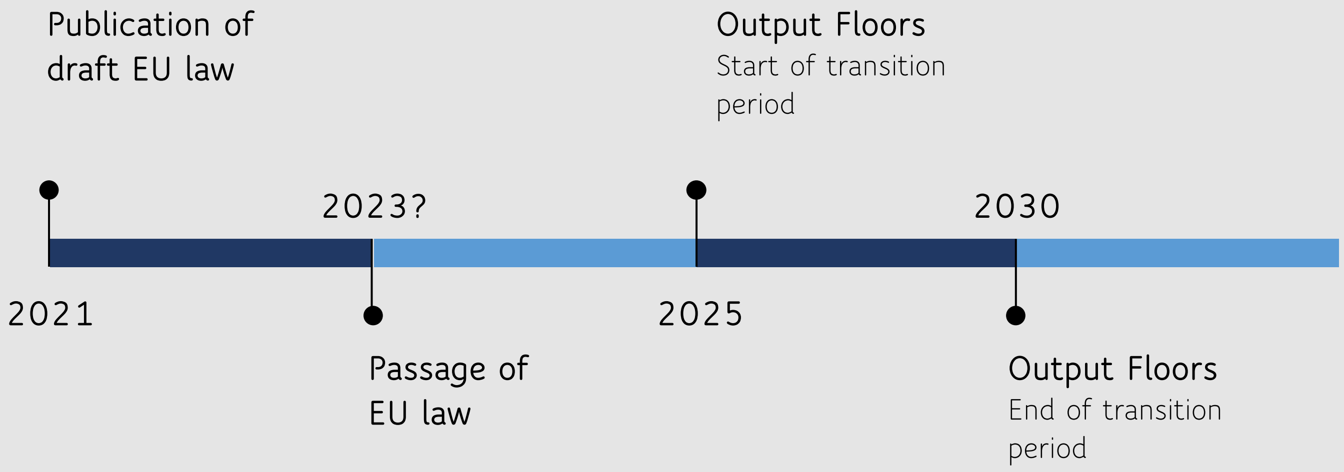
So if you reduce on B/S assets, your capital requirement will go down . . .

. . . assuming we have a workable SRT regime

Basel III implementation

Draft EU laws - Timeline

Timeline



Basel III

Implementation

UK Basel III Implementation

Basel III implementation

UK

Good question!

Theoretically, output floors should come in on the original timetable - Jan 2023

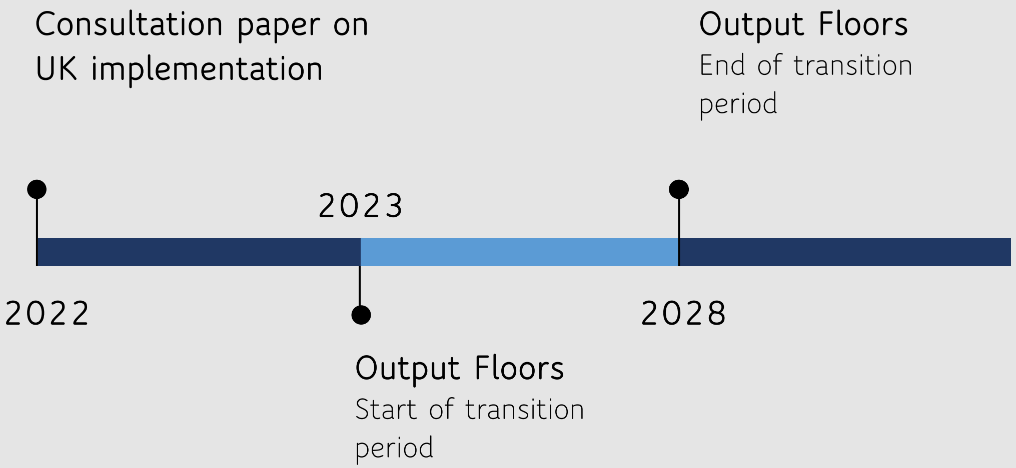
They should operate in the same way as in the EU

The UK government has yet to make key post-Brexit strategic decisions on macro-principles of financial regulation. So micro-decisions are in stasis

Basel III implementation

UK - Timeline

Timeline



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How green will my securitisation be?

Green and securitisation

Risk and opportunity

Green is both an opportunity and a threat to European securitisation

Opportunity	Threat
With few green capital market opportunities available, the need to invest in sustainable instruments could bring new investors to the securitisation market	At some point, the carrot of improved public image is likely to give way to a real regulatory "stick"
€120bn raised for European sustainable funds in 1Q21 alone	With every institution in Europe openly pushing market participants to invest in green, appetite for "non-green" instruments – especially "niche" instruments could drop

Green and securitisation

Nature of the risk

Three risks for securitisations:

- Assets vs proceeds
- Bespoke and idiosyncratically onerous disclosure requirements
- An entire bespoke regime that closes the door to green investors who will not wish to invest in an entirely different due diligence system solely for securitisation

Securitisation needs a level playing field!

For more information, see our Green Securitisation Webinar

Green and securitisation

EU General Legislation

- The European Commission issued draft Green Bond Standard legislation on 6th July 2021
- The EUGBS will now make its way through the European Parliament and Council to become law
- How fast this will happen is unclear
- The Council is moving fast but Parliament is harder to predict
- After the law, the technical standards

Green and securitisation

Key Requirements of the EU GBS

The new EUGBS will be open to any issuer of green bonds, including issuers located outside of the EU

There are four key requirements under the proposed framework:

Key Requirements
The funds raised by the bond should be allocated fully to projects aligned with the EU Taxonomy
There must be full transparency on how bond proceeds are allocated through detailed reporting requirements
All EU green bonds must be checked by an external reviewer to ensure compliance with the Regulation and that funded projects are aligned with the Taxonomy. Specific, limited flexibility is foreseen here for sovereign issuers
External reviewers providing services to issuers of EU green bonds must be registered with and supervised by the European Securities Markets Authority. This will ensure the quality and reliability of their services and reviews to protect investors and ensure market integrity. Specific, limited flexibility is foreseen here for sovereign issuers

Green and securitisation

What of securitisation specific rules?

Article 26.d.6 – Sustainability Requirements

(for STS transactions)

Article 26.d.6. By 10 July 2021, the ESAs shall develop, through the Joint Committee of the European Supervisory Authorities, draft regulatory technical standards in accordance with Articles 10 to 14 of Regulations (EU) No 1093/2010, (EU) No 1094/2010 and (EU) No 1095/2010 on the content, methodologies and presentation of information referred to in the second subparagraph of paragraph 4 of this Article, in respect of the sustainability indicators in relation to adverse impacts on the climate and other environmental, social and governance-related adverse impacts.

- Under the new article 26.d.6 inserted in the Securitisation Regulation by the Synthetic STS Regulation, the ESAs working through the Joint Committee will have to propose a draft RTS on sustainability requirements for RMBS and auto loans and leases
- The law required the proposal to be presented to the Commission by 10th July 2021 but it is not yet out

Green and securitisation

What of securitisation specific rules?

Article 45a - Development of a sustainable securitisation framework

(for STS transactions)

Article 45.a.1. By 1 November 2021, EBA, in close cooperation with ESMA and EIOPA, shall publish a report on developing a specific sustainable securitisation framework for the purpose of integrating sustainability-related transparency requirements into this Regulation. That report shall duly assess in particular: (a) the implementation of proportionate disclosure and due diligence requirements relating to potential positive and adverse impacts of the assets financed by the underlying exposures on sustainability factors; (b) the content, methodologies and presentation of information in respect of sustainability factors in relation to positive and adverse impacts on environmental, social and governance-related matters; (c) how to establish a specific sustainable securitisation framework that mirrors or draws upon financial products covered under Articles 8 and 9 of Regulation (EU) 2019/2088 and takes into account, where appropriate, Regulation (EU) 2020/852 of the European Parliament and of the Council (*); (d) possible effects of a sustainable securitisation framework on financial stability, the scaling up of the Union securitisation market and of bank lending capacity.

- Under the new article 45a inserted in the Securitisation Regulation by the Synthetic STS Regulation, the EBA will have to propose a draft RTS on sustainability disclosure requirements for securitisations generally
- The law required the proposal to be presented to the Commission by 1st November 2021 but the EBA has indicated that it is prioritizing the STS disclosure work

Green and securitisation

What of securitisation specific rules?

How do these future disclosure rules fit with the whole EUGBS legislative development?

Good question for which no good answer is discernible

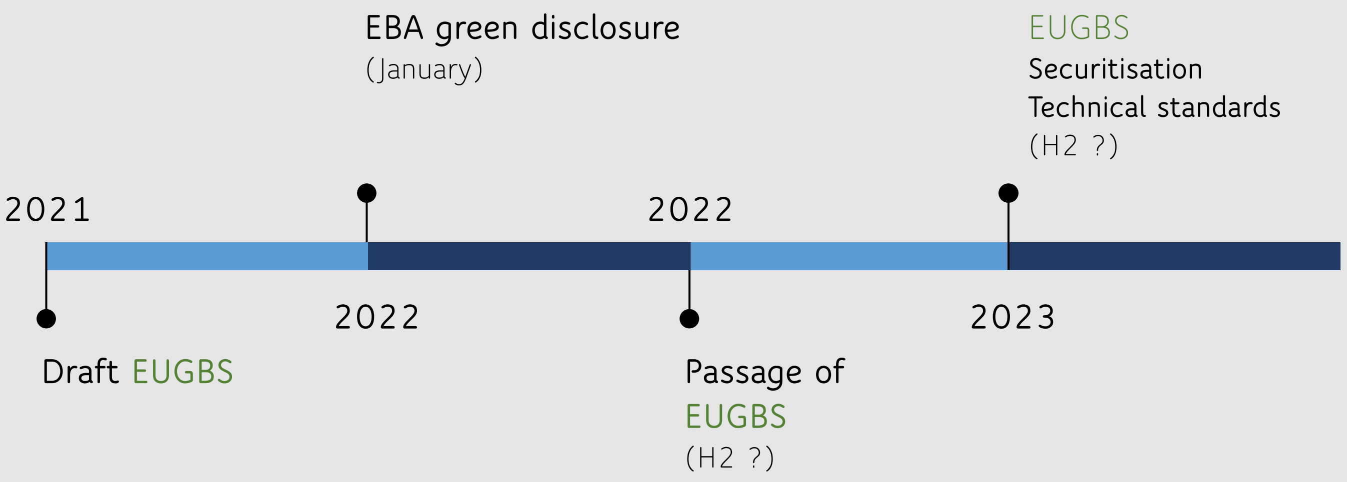
Best hope is that these proposals do not end with a “bespoke” and “idiosyncratic” regime for securitisation that imposes excessive disclosure requirements on the market compared to all equivalent markets

EBA’s proposals still need to be endorsed by the Commission

Green and securitisation

EU Timeline

Timeline



Green and securitisation

UK somewhat behind

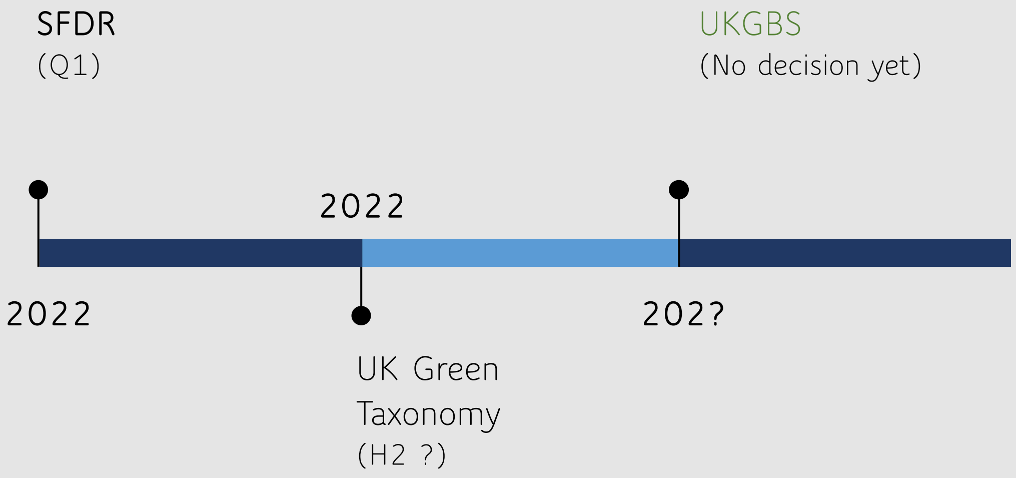
- UK Green Taxonomy likely by end of 2022
- No decision appears to have been made in respect of a UKGBS
- Even SFDR not yet in place with FCA disclosure requirements expected early 2022

The UK government has yet to make key post-Brexit strategic decisions on macro-principles of financial regulation. So micro-decisions are in stasis

Green and securitisation

UK Timeline

Timeline



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The Securitisation Regulation Review(s)

Securitisation Review
(ex-calibrations)

EU - Any meat?

As required by the law, the European Commission launched a review of the Securitisation Regime in 2021

A consultation on securitisation closed end of September 2021

The consultation questions should be read with the May 2021 Report by the Joint-Committee of the ESAs on the functioning of the European securitisation regime

Key takeaways

- Few visible game changers
- Some relief on disclosure for private transactions
- Greater involvement of NCAs

Securitisation Review (ex-calibrations)

UK – For real?

- The review is mandated by law so it will take place
- A consultation closed early September 2021
- Now what?

The UK government has yet to make key post-Brexit strategic decisions on macro-principles of financial regulation. So micro-decisions are in stasis

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Setting the Standard for Securitisation

Calibration Issues

The Calibration Issues

EU
The unfinished reform

Ever since the passage of the Securitisation Regulation in December 2017, these have been the **three key issues raised by the market**:

- **CRR calibrations of STS securitisations for bank investors and the infamous *p* factor**
- **Solvency II calibration of STS securitisations for insurance investors**
- **The eligibility criteria for inclusion in bank liquidity cover ratios (LCR)**

The necessary steps are well analysed and were endorsed in the June 2020 report of the independent committee set up by the Commission itself

A resolution to the calibration issues would be a material help to the European securitisation markets

For more information on the technical aspects of the calibration issues you can read PCS's article: "the indispensable reform" (pages 59-68)

The Calibration Issues

EU
The unfinished reform

The good news: The Commission has officially indicated that the calibration issues are up for review

- In mid-October 2021, the Commission published a call for evidence to the Joint-Committee of the ESAs request their views on the calibration issues

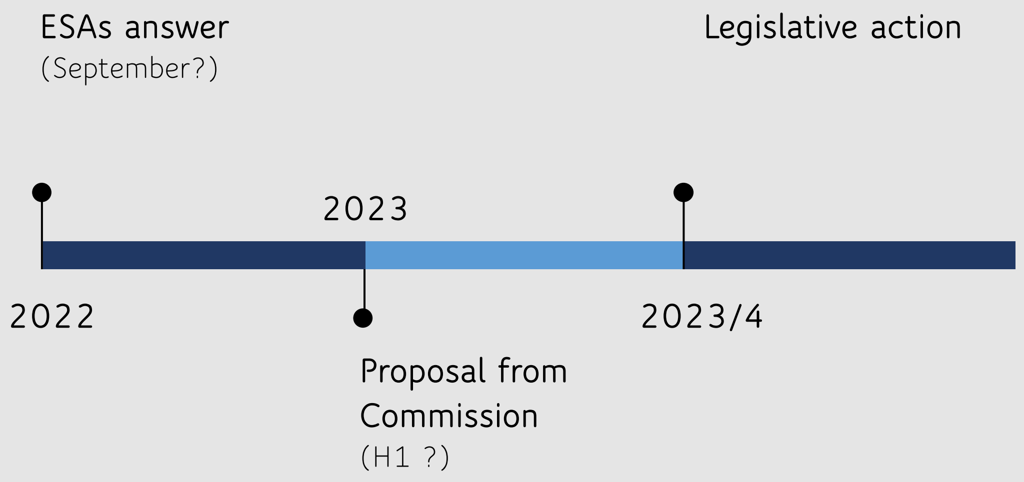
The bad news: the ESAs are not required to respond before September 2022

- Even assuming the ESAs do not miss the deadline, this means that realistically the Commission is unlikely to produce any concrete proposal till 2023
- And any slippage sees us drift into the last year of this Commission when little is done

The Calibration Issues

EU - Timetable

Timeline



The Calibration Issues

UK –No visibility yet

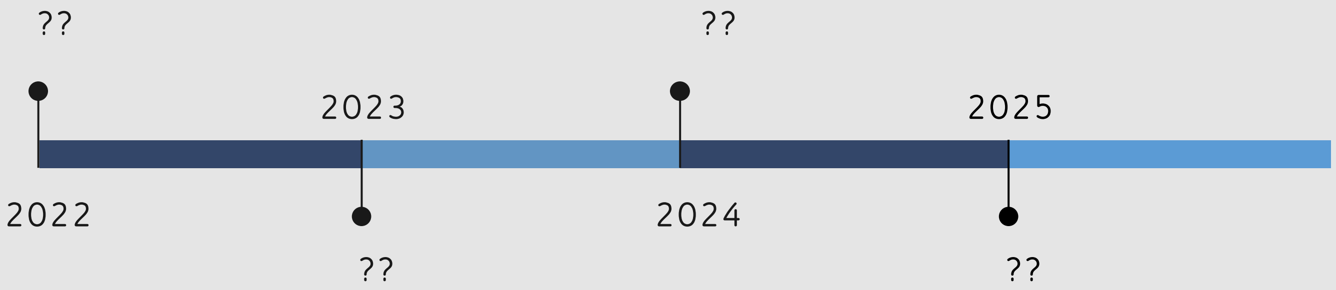
- Currently, no discussions appear to be taking place
- UK has the additional question of whether to extend STS to synthetics

The UK government has yet to make key post-Brexit strategic decisions on macro-principles of financial regulation. So micro-decisions are in stasis

The Calibration Issues

UK – Timetable

Timeline



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Summary

Much can still happen, but patience will be required

EU - Timetable

- ECB action in the face of inflation not likely before mid-2022 at earliest with progressive impact on issuance
- Basel III output floors only biting from January 2025 so meaningful impact on EU securitisation issuance a few years before (2023?)
- The calibration issues not likely solved before mid-to-late 2023

So many questions, so few answers

UK – Timetable

Bank of England action on inflation likely swifter than for ECS and many programs already closed – so positive impact on issuance in the UK can be expected as soon as 2022

For everything else, well . . .

The UK government has yet to make key post-Brexit strategic decisions on macro-principles of financial regulation. So micro-decisions are in stasis

But beware!

The importance of technical stuff

This presentation deals with the macro components that *should* drive the size and shape of the European Securitisation market

However, any healthily securitisation market is depended on a workable technical, regulatory set of rules

Please bear in mind, an unfortunate choice of technical standards can have a disproportionate negative impact on the market, that can even overwhelm macro considerations

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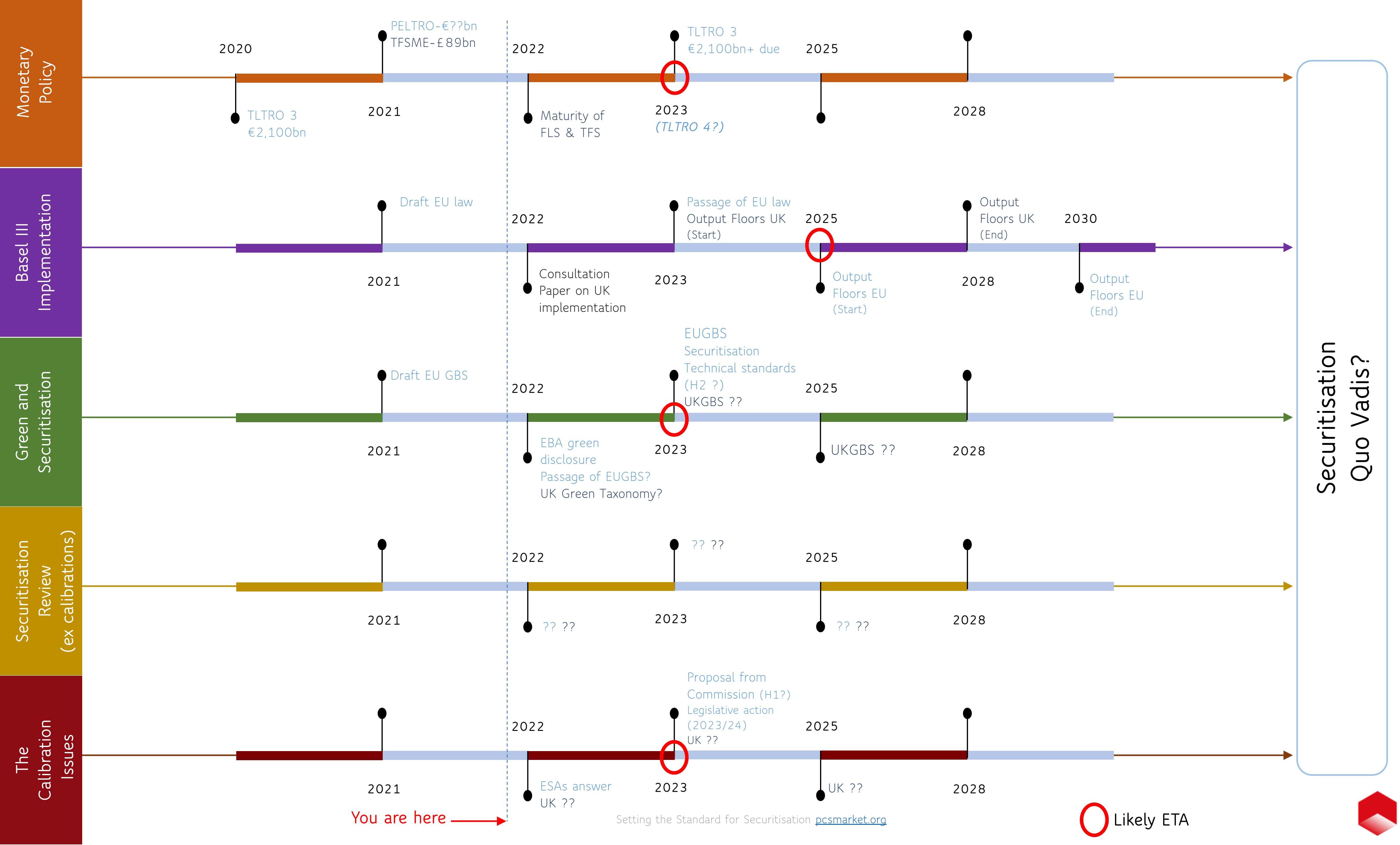
Quo Vadis?


Monetary Policy
2020
TLTRO 3
€2,100bn
2021
PELTRO-€??bn
TFSME-£89bn
2022
Maturity of
FLS & TFS
TLTRO 3
€2,100bn+ due
2023
(TLTRO 4?)
2025
2028
Basel III Implementation
Draft EU law
2021
2022
Consultation
Paper on UK
implementation
Passage of EU law
Output Floors UK
(Start)
2023
2025
Output
Floors EU
(Start)
Output
Floors UK
(End)
2028
2030
Output
Floors EU
(End)
Green and Securitisation
Draft EU GBS
2021
2022
EBA green
disclosure
Passage of EUGBS?
UK Green Taxonomy?
EUGBS
Securitisation
Technical standards
(H2 ?)
UKGBS ??
2023
2025
UKGBS ??
2028
Securitisation Review (ex calibrations)
2021
2022
?? ??
?? ??
2023
2025
?? ??
2028
The Calibration Issues
2021
2022
ESAs answer
UK ??
Proposal from
Commission (H1?)
Legislative action
(2023/24)
UK ??
2023
2025
UK ??
2028
You are here
Securitisation
Quo Vadis?
Likely ETA

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Thank you for your attention

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