PCS

Setting the Standard for Securitisation

Securitisation – “Quo Vadis” Revisited

24th January 2023

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	1998	MRO	Main Refinancing Operations	1 week cash
		LTRO	Longer Term Refinancing Operations	3 month cash
Non-Standard Monetary Policy Measures	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 Program

Monetary Policy

ECB Toolbox
Asset Purchase Program

ECB's Asset Purchase Program (APP) comes in four flavours:

- PSPP — Public Sector Purchase Program
- CSPP — Corporate Sector Purchase Program
- CBPP3 — Covered Bond Purchase Program
- ABSPP — Asset Backed Securities Purchase Program

Monetary Policy

ECB Toolbox Asset Purchase Program

Outstanding Balance per program – end '21 compared to end '22

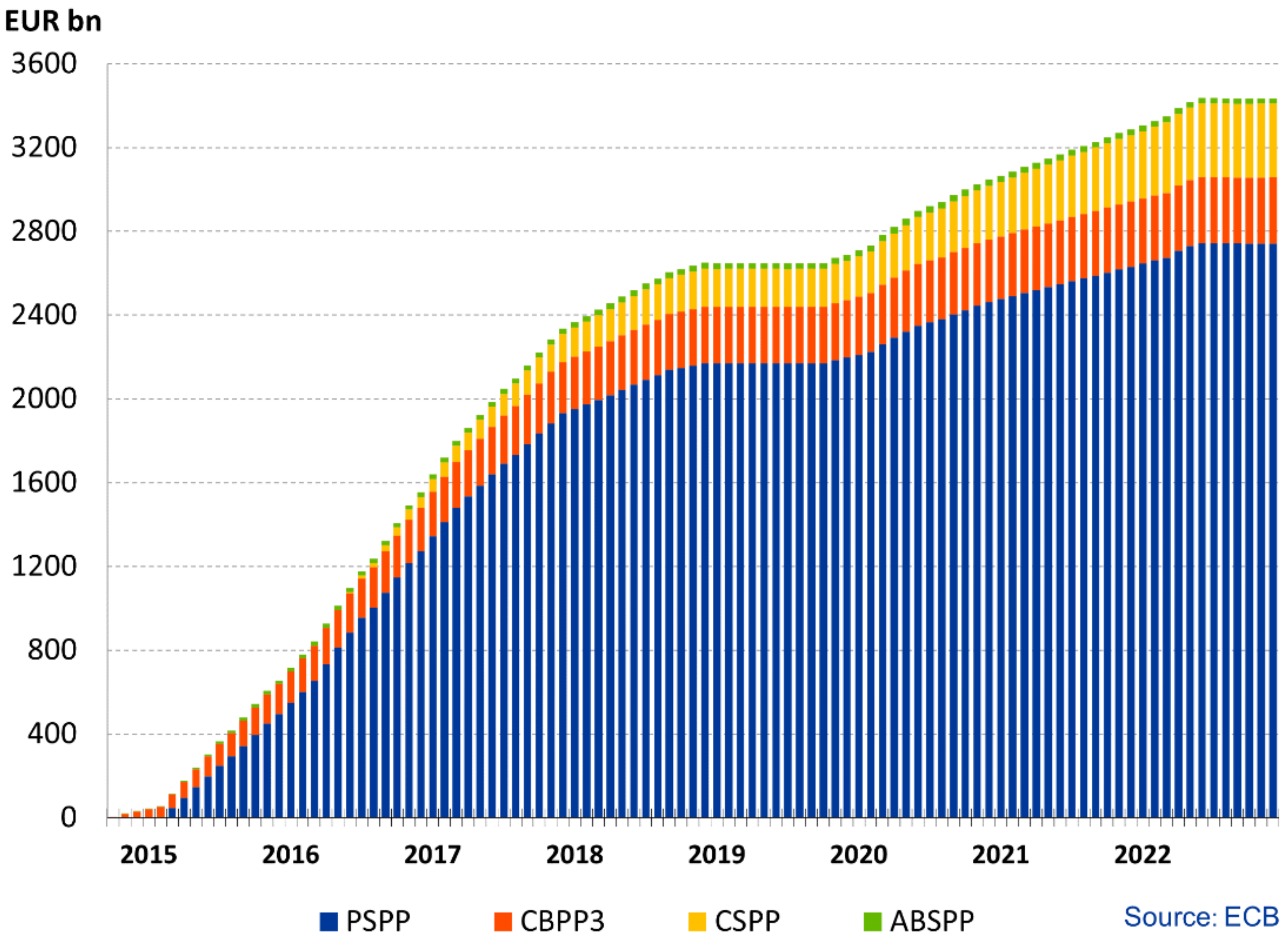
PSPP Public Sector Purchase Program
CSPP Corporate Sector Purchase Program
CBPP3 Covered Bond Purchase Program
ABSPP Asset Backed Securities Purchase Program

Figures from ECB as of October 2021 (blue) and December 2022 (red)

Monetary Policy

ECB Toolbox
Asset Purchase Program

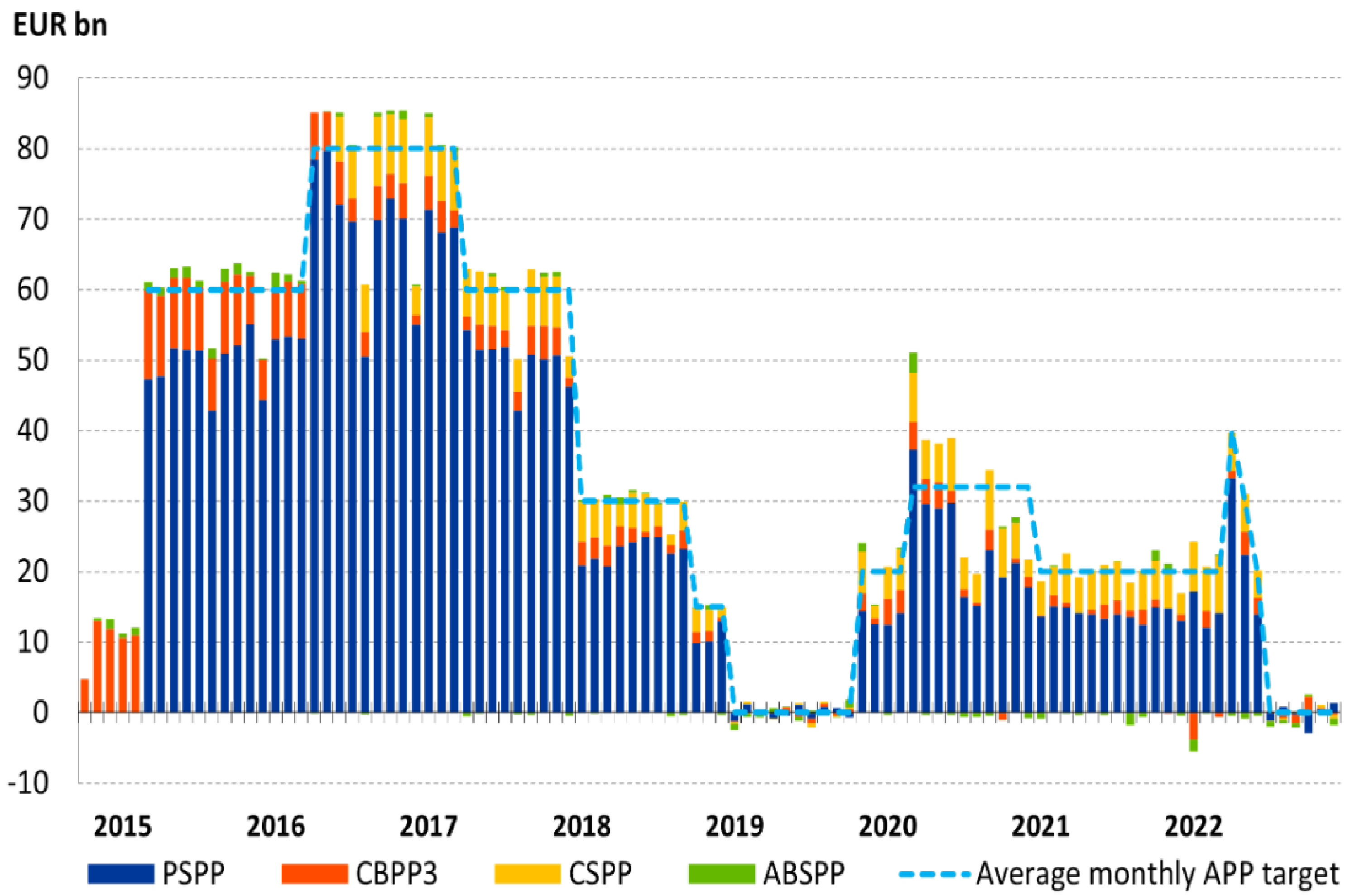
Evolution over time – Cumulative net purchases by Program – Revisited



Monetary Policy

ECB Toolbox
Asset Purchase Program

Evolution over time – Net purchases by Program – Revisited



Monetary Policy

ECB Toolbox Asset Purchase Program

ECB's Balance Sheet scheduled to reduce meaningfully in 2023:

- Net purchases stopped in July 2022 leaving only reinvestments to hold totals steady
- ECB announced in December that it would stop reinvesting €15bn a month between March and June (effective drop in re-investments of 50%)
- Current expectation remains of further reductions post-June

Monetary Policy

ECB Toolbox

Pandemic Emergency Purchase Program

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
- And ended as predicted in March 2022

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

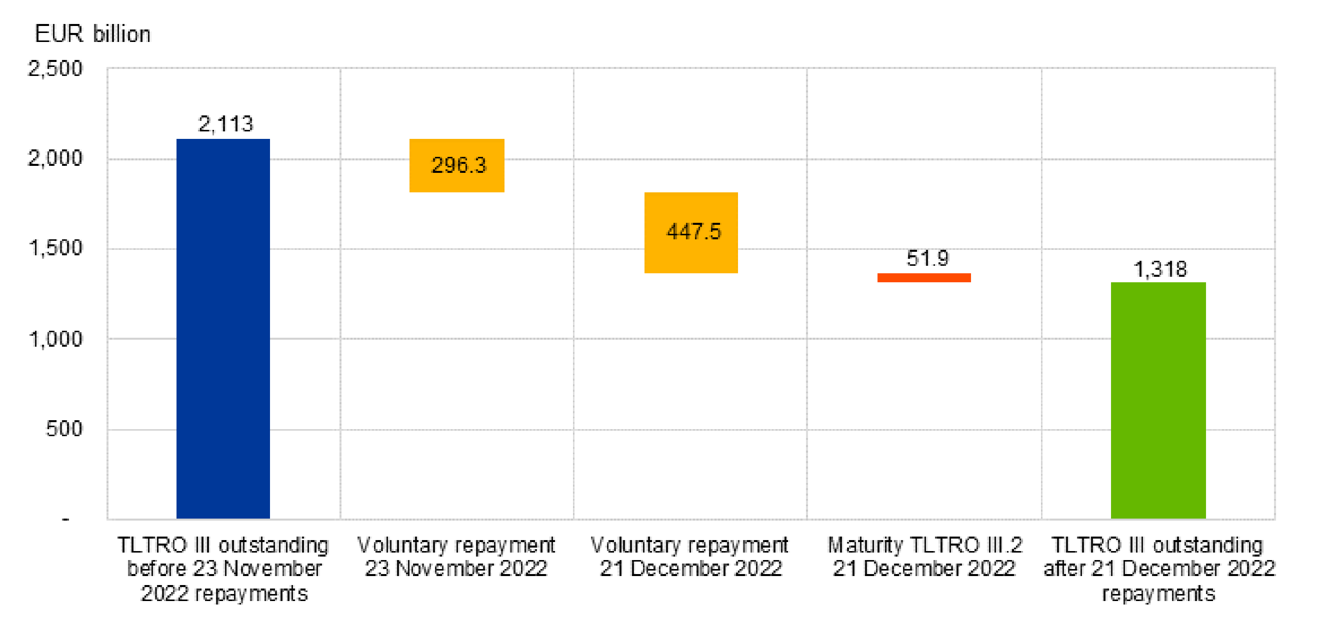
- The TLTRO is direct lending to banks at ultra-low rates – rates no securitisation can compete against
- 3-year facilities , except for PELTRO (pandemic emergency longer-term refinancing operations) where maturities are shorter (e.g 12mths for 2021 disbursements)
- PELTRO is almost fully repaid

Monetary Policy

ECB Toolbox
Targeted Long Term Refinancing Operations

ECB's TLTRO – Developments in 2022 and expectations for 2023

- ECB unilaterally changed the interest rate on TLTRO in October 2022
- With scheduled maturities and the less attractive terms substantial repayments of TLTRO are expected in 2023



Monetary Policy

ECB Toolbox
ECB Balance Sheet

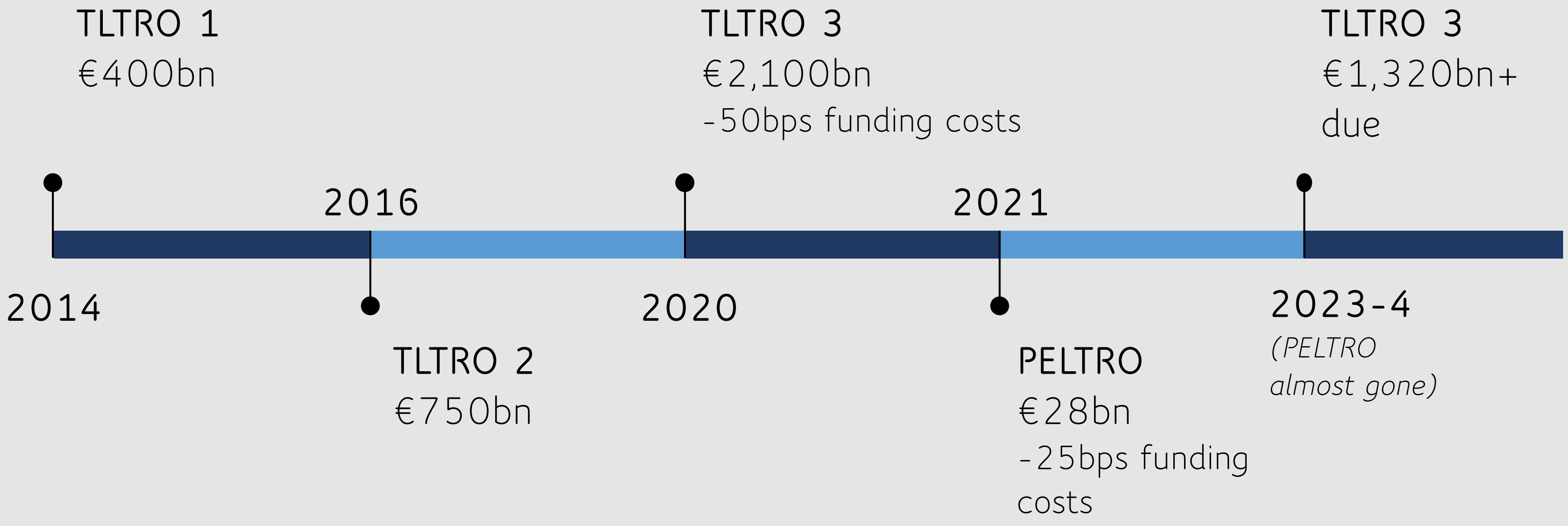
ECB's Balance Sheet scheduled to reduce meaningfully in 2023:

- With the announced and expected reductions in APP re-investments and the expected repayments of TLTRO, the ECB's balance sheet is expected to reduce by 15% (representing 50% of EZ GDP – down from 70%)
- For securitisation TLTRO funding replacement could be helpful
- The loss of the ABSPP may impact prices somewhat but….
- Will probably impact the price of securitisation's prime competitor more – covered bonds so could, if it reduces the spread differential, be favourable to securitisation in the EU

Monetary Policy

ECB Toolbox
TLTRO Timeline

Timeline



Monetary Policy

BoE

BoE Toolbox

Monetary Policy

BoE Toolbox Lending

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 for financial institutions (and the CCFF for corporates):

- FLS – Funding for Lending Scheme to help house purchases – 4 year maturity now closed with the final repayments made in September 2021 - GONE
- TFS – Term Funding Scheme as a direct "cheap money" scheme for banks – 4 year maturity now closed and the final repayments were made in February 2022 - GONE
- TFSSME – Term Funding Scheme with additional incentives for SMEs – "cheap money" scheme for banks to be channelled into SME lending – still has £182bn outstanding (as of 18.01.23) but new uptakes are minimal

Monetary Policy

BoE Toolbox Asset Purchase Facility (APF)

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

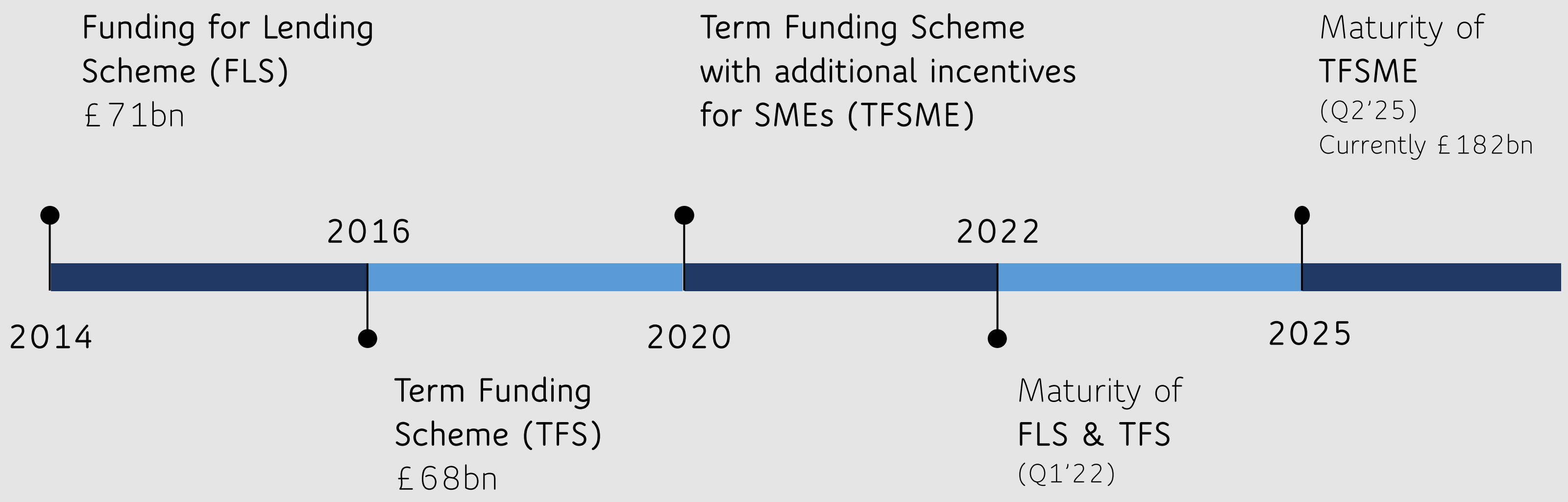
- The Bank of England's purchase program never allowed for the purchase of securitisations
- After the mini-budget debacle, the BoE still holds £828bn of gilts and £9.5bn of corporate bonds and £0 ABS (as of 18.01.23)

Note, as an aside, that £4bn of ABS traded that week without a hitch = a important marker for those who claim ABS is not liquid

Monetary Policy

BoE Timeline

Timeline



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Setting the Standard for Securitisation

Basel III and the “output floors”

Basel III

Implementation

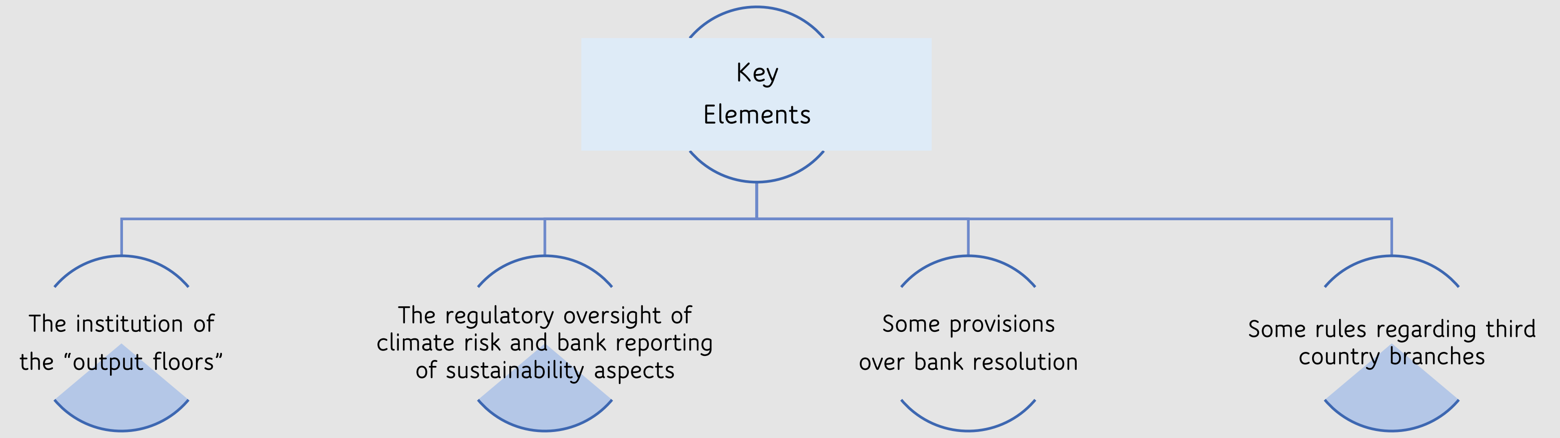
EU Basel III Implementation

Nothing new under the Basel sun

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 CRR bank

Before "output floors", *sophisticated* banks could, with regulatory approval, use internal models to measure the **risk of an asset**

The bank's capital requirement would be a function of **exposure** and **risk of the asset** (K_{irb})

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

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

(b) the number equal to 72.5% of the risk measured by the standardised approach (**Ksa**)

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

Basel III implementation

Output Floors & Securitisation

The capital required is a function of RWA
So if you reduce RWA, your capital requirement will go down. . .
..assuming we have a workable SRT regime

$$RWA \times 8\% = \text{Capital Requirement}$$

Capital under Standardised Approach

$$\text{Exposure} \times \text{Risk Weight} \times 8\% = \text{Capital Requirement}$$

Capital under Foundation IRB / Advanced IRB

Current

$$EAD \times K\left\{PD, LGD, M\right\} \times 12.5 \times 8\% = \text{Capital Requirement}$$

After Output Floor

$$\max\left\{ \begin{array}{l} EAD \times K\left\{PD, LGD, M\right\} \times 12.5 \\ 72.5\%\ RWA\ (\text{Standardised Approach}) \end{array} \right\} \times 8\% = \text{Capital Requirement}$$

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**

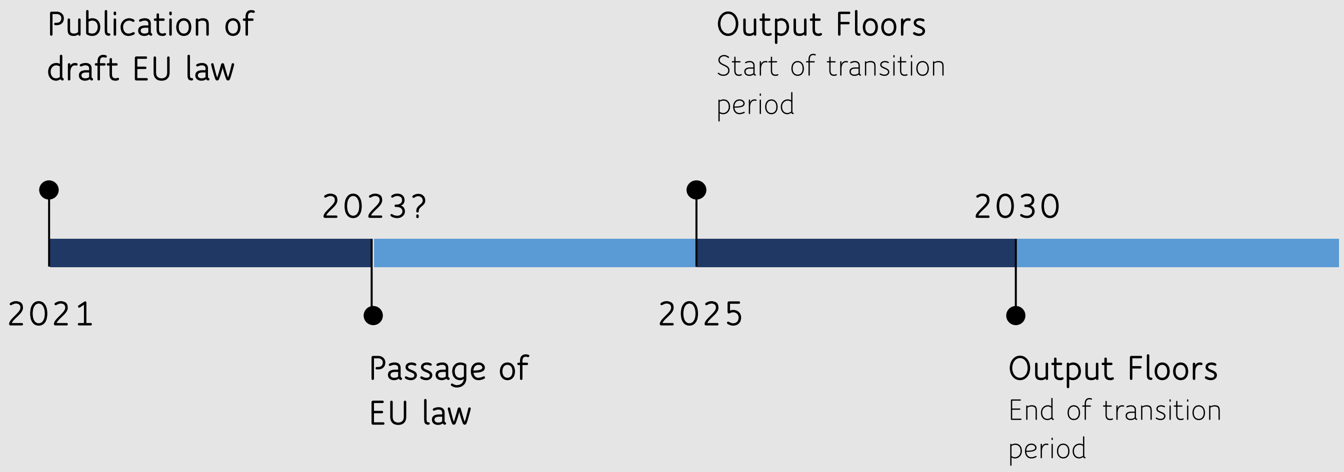
The EBA and Commission's numbers show **EU banks will need to increase capital** as a result of the output floors **by an average of 9%**

European banks are challenging these numbers

Basel III implementation

Draft EU laws - Timeline

Timeline



Basel III

Implementation

UK Basel III Implementation

Nothing new under the Basel sun

Basel III implementation

UK

Good question!

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

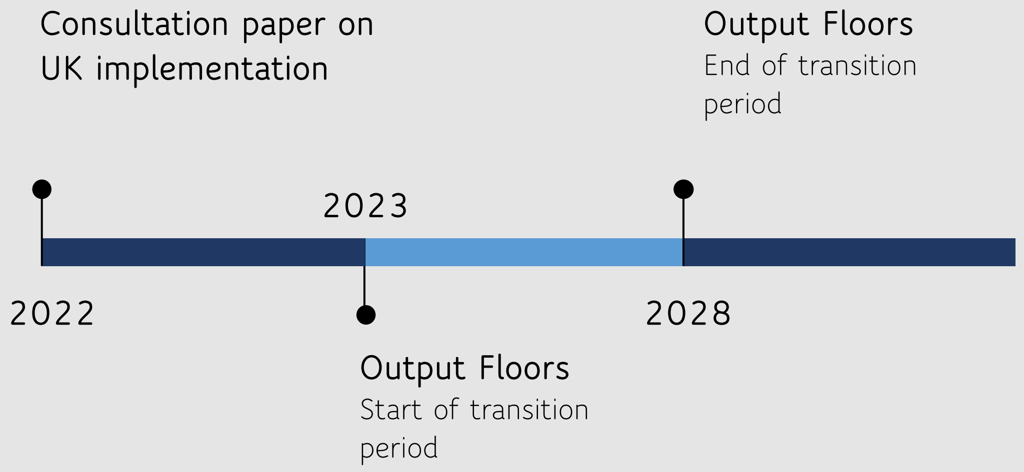
They should operate in the same way as in the EU

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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Setting the Standard for Securitisation

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:

Nature of the Risk	Current State
Assets vs proceeds	Proceeds appear to be winning
Bespoke and idiosyncratically onerous disclosure requirement	Not out of the woods with some additional disclosures but not crucially onerous
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 securitisations	Both the EBA and the Commission have rejected and neither Parliament nor Council seem inclined to go down that route

Securitisation needs a level playing field!

And may well almost get it

Green and securitisation

EU General Legislation

- The European Commission issued draft Green Bond Standard legislation on 6th July 2021
- The EUGBS is currently in trilogue between the Council, Parliament and Commission.
- Many big battles are being fought and securitisation is somewhat of a sideshow – but one that has attracted its champions
- Timing remains difficult to predict but we still anticipate a result by end of 2023, maybe even by June – end of the Swedish presidency

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?

EBA report of developing a green securitisation framework

- Published in March 2022
- Very helpful contribution in rejected a bespoke regime for green securitisation
- This allows green securitisation to be folded into the EU GBS – a line followed by the Commission and currently not challenged at its core by the Parliament or Council

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

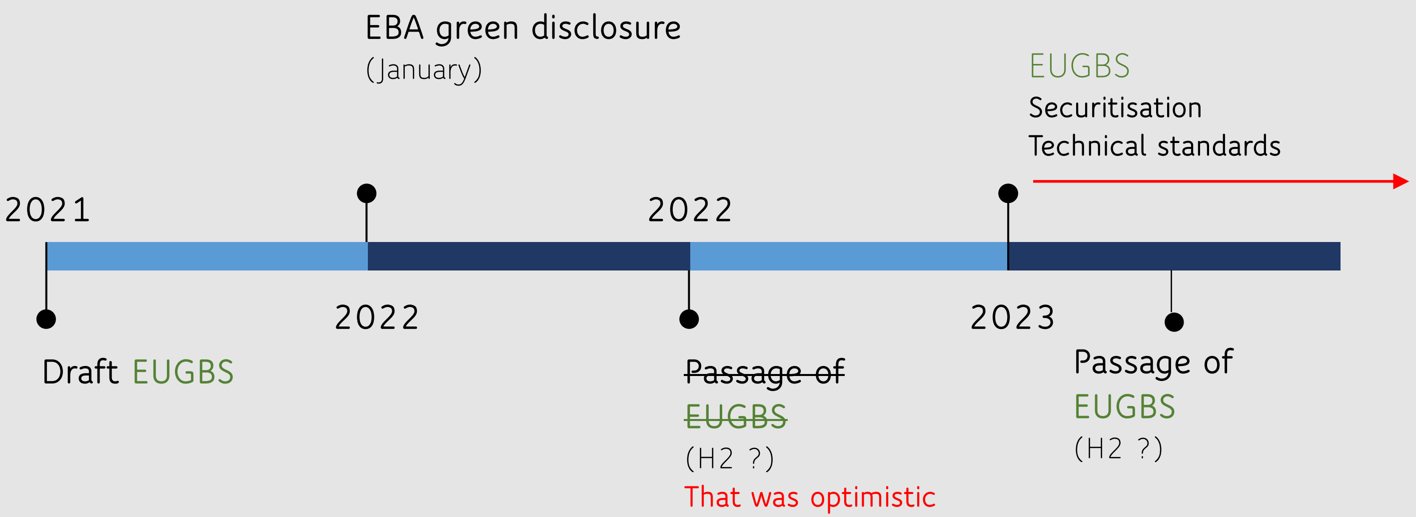
Best hope is that these proposals do not end with a “bespoke” and “idiosyncratic” regime for securitisation that imposes excessive disclosure requirements on the market compared to all equivalent markets

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

Green and securitisation

EU Timeline

Timeline



Green and securitisation

UK somewhat yet further behind (back in 2021)

- 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

Green and securitisation

UK somewhat yet further behind (and now)

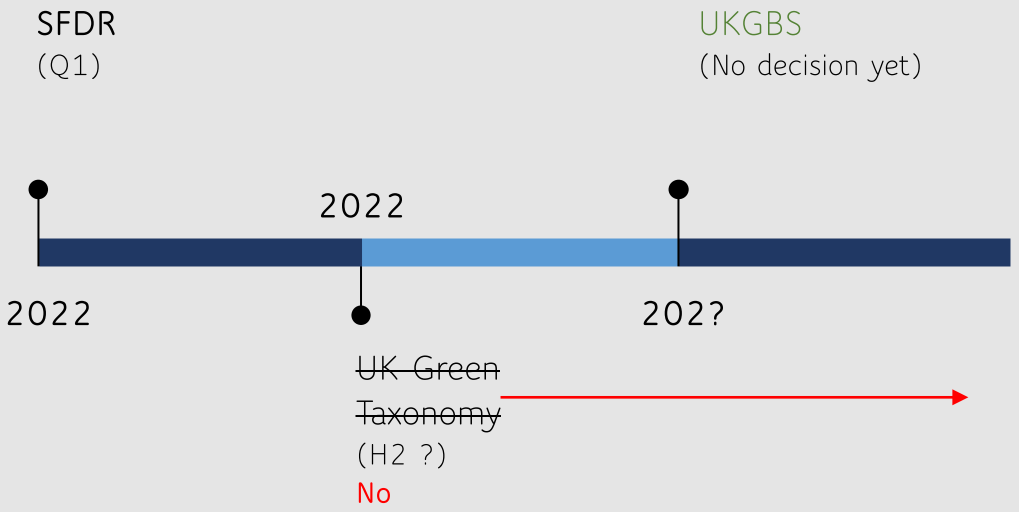
- UK Green Taxonomy likely by end of 2022
- No decision appears to have been made in respect of a UKGBS
- Even SFDR not yet in place with FCA disclosure requirements expected early 2022

"LONDON, Dec 14 (Reuters) - Britain on Wednesday paused its 'taxonomy' for guiding companies and investors on green investments, saying it was important to consider matters carefully before finalising its approach."

Green and securitisation

UK Timeline

Timeline



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The Securitisation Regulation Review(s)

Securitisation Review
(ex-calibrations)

EU - Any meat? (back in 2021)

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)

EU - Any meat?
Well, no

The Commission report came out in October 2022

- Very much the fairly underwhelming result predicted in 2021
- Some good data, some odd conclusions

Key takeaways

- “Europe first” with no equivalence and full imposition of EU rules to non-EU issuance
- Some possible help with disclosure – ball in ESMA’s court

Report was a non-event for EU securitisation that will have no impact on future issuance

Securitisation Review (ex-calibrations)

UK (back in 2021)

- 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

Securitisation Review (ex-calibrations)

UK (and now)

- The UK government has now made those key post-Brexit strategic decisions on macro-principles of financial regulation.
- The UK will forge its own regulatory path without regard for EU rules
- The UK will revert to an older and very British approach – delegate almost all the rules to the regulators (PRA and FCA)
- The UK will remain open to the world

IMPORTANT NOTE: HMG's deregulatory aspirations may not be aligned with its chosen tool – in other words, not sure how deregulating the PRA and FCA are feeling.

Securitisation Review (ex-calibrations)

UK (and now)

- The HMT published a draft statutory instrument to regulate UK securitisations
- In line with its approach, all STS criteria are now in the hands of FCA
- UK rejected EU's "extra-territorial" imposition of own rules
- With so much back in hands of PRA/FCA, the future regulatory landscape for UK securitisation is very nebulous:
  - Big vs small changes
  - Tighter or looser rules – or a bit of both?

IMPORTANT NOTE: HMG's deregulatory aspirations may not be aligned with its chosen tool – in other words, not sure how deregulating the PRA and FCA are feeling – eg STS for synthetics

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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 bad news:

- the ESAs report when it landed in December 2022, was worse than even we expected
- EIOPA believes everything is for the best in the best of all worlds and no changes should be contemplated to Solvency II
- EBA believes that the only change that can be contemplated is a lowering of the floor for senior STS to 7% - a meaningless change whose small value will vanish as soon as the output floors are in place (Jan. 2025)
- EBA believes maybe something could be done with LCR eligibility rules but this should go through the Basel Committee where it will meander for many more years, at best

The Calibration Issues

EU
The unfinished reform

The good news:

- The Commission does not have to accept the ESAs report
- Parliament has chosen to ignore the Commission's separate securitisation process and MEPs are introducing pro-securitisation amendments in the scheduled review process of the CRR and Solvency II
- An amendment currently in the Parliament text would halve the "p" factor
- The political current is not aligned with the regulators' quietist positions

The Calibration Issues

Between the bad news and the good news and the duplication of processes – the Commission's timetable built around the ESAs technical advice vs the Parliaments desire to act now – 2023 has gotten very uncertain and quite difficult to read.

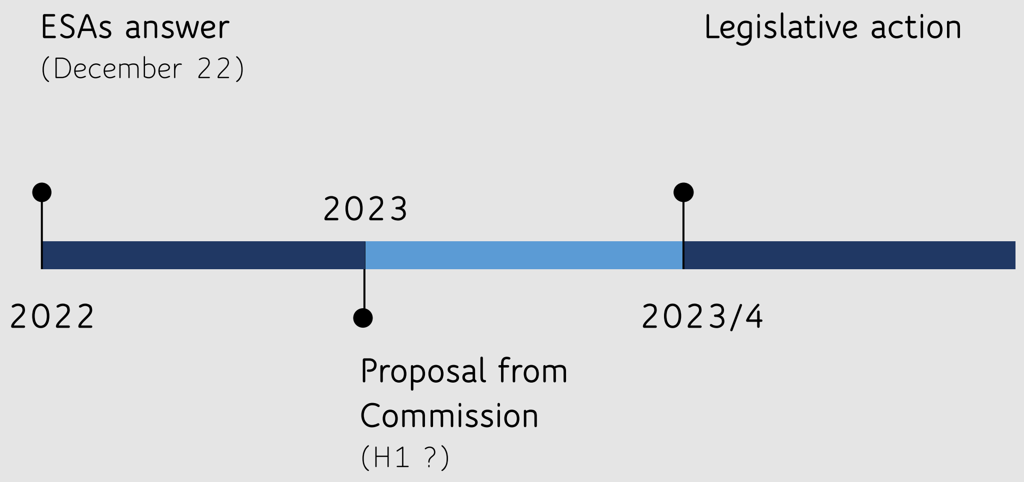
EU
Watch this space

NOTE: There is a race against the clock as no new initiatives or legislative projects are likely in the last year of the Commission. So April/May could be the deadline for anything new (but not the CRR/Solvency II reviews that are ongoing)

The Calibration Issues

EU - Timetable

Timeline



The Calibration Issues

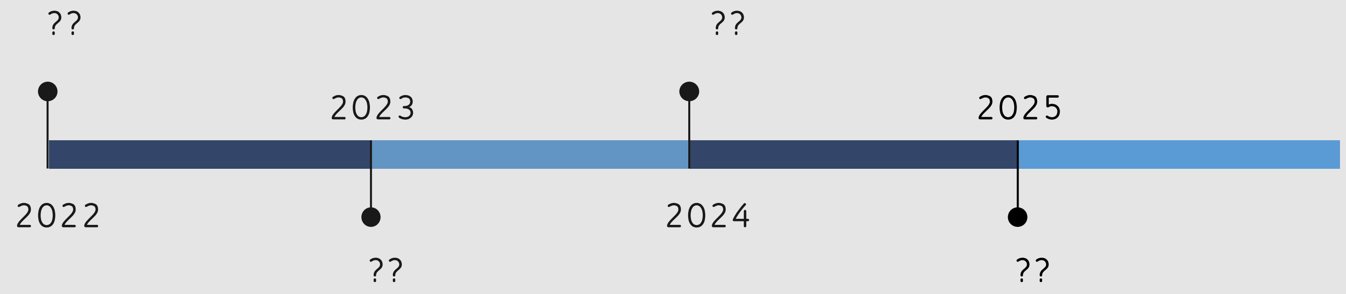
UK – STILL no visibility yet

- Currently, no discussions appear to be taking place

The Calibration Issues

UK – Timetable

Timeline



Much can still happen, but patience will be required

EU - Timetable

- The calibration issues are on a knife's edge with the two ongoing processes, uncertainty as to political appetite and a looming deadline – 50%/50% that there will be resolution in 2023
- The ECB reduction of its balance sheet should favour more cash securitisations (especially if the impact of the APP reductions hits covered bond prices more strongly) but probably not a game-changer
- Basel III implementation will continue to drive capital trades but many in synthetic format

So many questions, so few answers

UK – Timetable

- UK remains behind in timing so not much expected to have a meaningful impact on 2023
- As the key decisions will now be in the hands of the PRA and FCA, they will shape the market in the medium and longer term but their views are yet to emerge publicly

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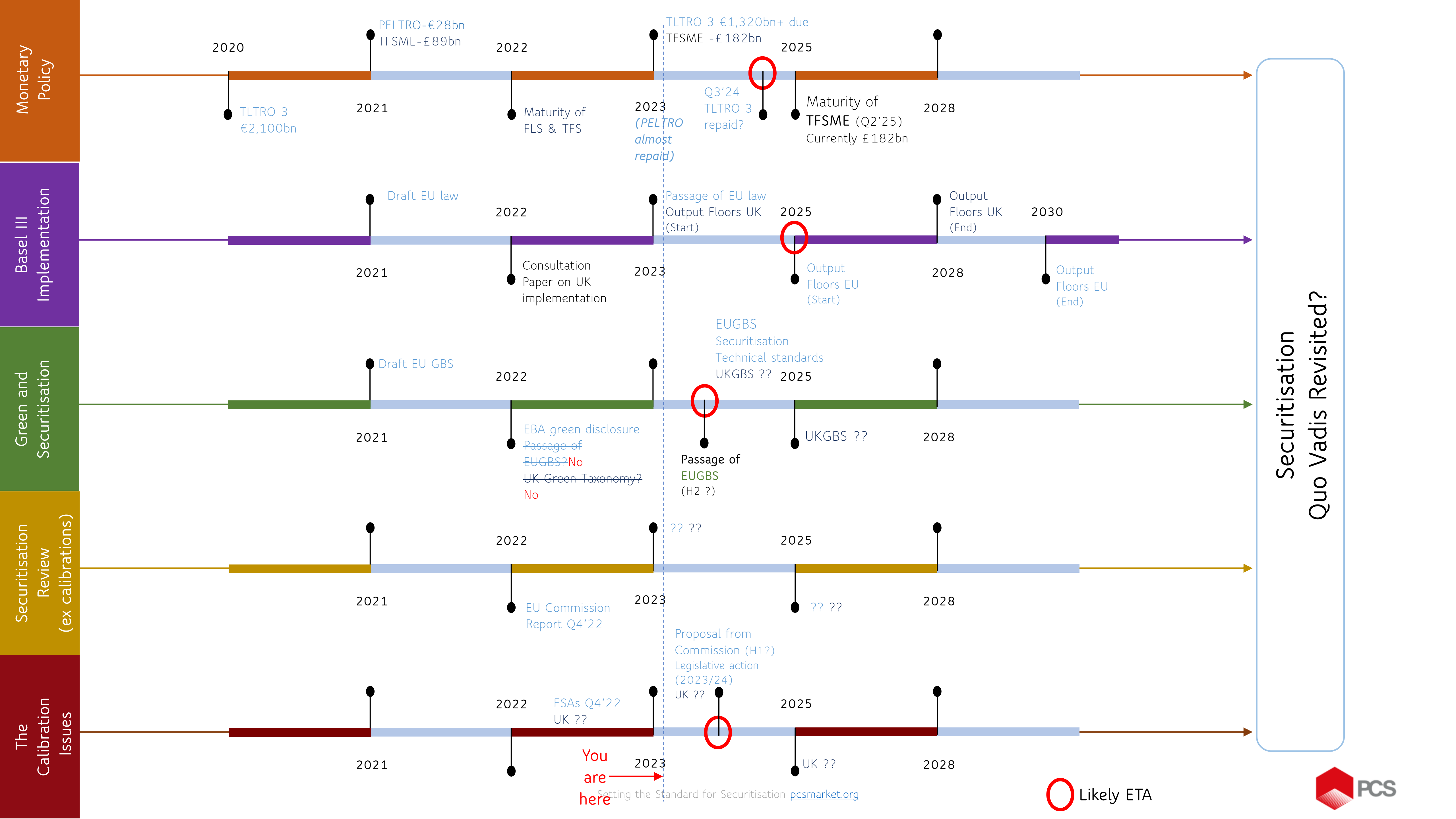
Quo Vadis Revisited?

Where all roads lead to…..



Monetary Policy
2020
TLTRO 3 €2,100bn
PELTRO-€28bn
TFSME-£89bn
2021
2022
Maturity of FLS & TFS
2023
(PELTRO almost repaid)
TLTRO 3 €1,320bn+ due
TFSME -£182bn
Q3'24 TLTRO 3 repaid?
2025
Maturity of TFSME (Q2'25) Currently £182bn
2028
Basel III Implementation
Draft EU law
2021
2022
Consultation Paper on UK implementation
2023
Passage of EU law
Output Floors UK (Start)
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?~~No
~~UK Green Taxonomy?~~ No
EUGBS Securitisation Technical standards
UKGBS ??
Passage of EUGBS (H2 ?)
2025
UKGBS ??
2028
Securitisation Review (ex calibrations)
2021
2022
EU Commission Report Q4'22
2023
?? ??
2025
?? ??
2028
The Calibration Issues
2021
2022
ESAs Q4'22
UK ??
You are here
2023
Proposal from Commission (H1?)
Legislative action (2023/24)
UK ??
2025
UK ??
2028
Securitisation Quo Vadis Revisited?
Likely ETA
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Thank you for your attention

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