GDV German Insurance Association

POSITION PAPER

Reviving the Securitisation Market

The European securitisation market is still very small compared to the USA and the supply volume of European securitisations has remained low in recent years. Even though the proportion of securitisations in insurers' investments has been very low to date, securitisations could become more interesting for investors as a covered asset class. In order to give the securitisation market the right impetus for strong growth, we believe that fundamental improvements in investment conditions are required in four areas.

- Risk-adequate reduction of the capital requirements for securitisations under Solvency-II
- Reducing the requirements for securitisation investors and the STS-reporting
- Improving liquidity of securitisations
- Remove fragmentation of investor landscape in the STS market

We also believe that, in addition to easing demand by improving investment conditions for investors, the supply of securitisations in Europe should also be expanded. In this sense, it should be examined whether there are sensible simplifications for issuers without restricting investors' need for information. In this context, it should also be examined to what extent there are obstacles to UCITS investing in securitisations and whether improvements would be useful here, taking into account the interests of other stakeholders like investors.

Risk-adequate reduction in capital requirements for investors in European securitisations under Solvency II

Capital requirements for securitisations under the Solvency II standard formula are too high in relation to the actual risks and the achievable returns. The historical default experience for European securitisations is very good. Compared to

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European public debt exposure there have been considerably more[1]. These rating agency studies show that historical losses in North America are 10x higher than in EMEA (4,2% vs. 0,42%)

- **Non-STS securitisations are disadvantaged compared to STS securitisations.** It should be reviewed thoroughly in how far a different treatment under the Solvency II standard formula is justified by historical performance data. In our view the riskiness of an investment is not convincingly correlated with the STS-Label. The risk charges for non-STS securitisations are an order of magnitude greater. For AAA respectively AA non-STS securitisations the risk charges are 12.5% respectively 13.4% and duration 1, and 37.5% and 40.2% for duration 3. By comparison corresponding risk charges for STS senior securitisation tranches with an AAA (AA) and duration 1 respectively 3 are 1% (1.2%) respectively 3% (3.6%). To stimulate the securitisation market, disadvantages stemming from overly high-risk charges of non-STS securitizations in comparison to STS securitizations should be eliminated.
- **Review and risk-adequate reduction of capital requirements between senior and non-senior tranches.** In addition to the level of capital requirements, the differences in capital requirements between senior and non-senior tranches of a securitisation seem not risk adequate and should be reviewed and adjusted. For example, a senior 5-year AA STS securitisation has a capital requirement of 6%, while the subordinated tranche with the same AA rating has a capital requirement of 17%. Default studies suggest that this material difference between senior and non-senior tranches is not justified.
- **Level playing field with other asset classes.** The Solvency Capital requirements (SCR) for securitisations under Solvency II appear to be too high not only relative to the real risk but also notably in comparison with equally rated corporate or covered bonds. This is illustrated by a comparison of the capital requirements for senior tranches of STS securitisations that are ranked with AAA and AA and a duration under 5 years with comparable bonds. The corresponding risk charges for an AAA (AA) investment with duration 1 respectively 3 is 1% (1.2%) respectively 3% (3.6%). By comparison, corporate bonds ranked with AAA (AA) and duration 1 and 3 have risk charges of 0.9% (1.1%) and 2.7% (3.3%) and the comparable covered bonds have risk charges of 0.7% (0.9%) and 2.1% (2.7%). **Capital charges should be in line with corporates** when the securitisation is based on a corporate pool and it should be in line with **covered bonds** when securitisation is based on granular mortgage or consumer loan pools.

1. [1] e. g. S&P “2023 Annual Global Structured Finance Default And Rating Transition Study, 18 March 2024; Fitch “Global Structured Finance Losses 2020-2020 Issuance – 3 March 2021” or Moody’s “Impairment and loss rates of EMEA structured finance securities: 1993 - 2021 – 30 June 2022

Reducing of requirements for securitisation investors and STS-reporting

Art. 5 of the STS Securitisation Regulation provides for a large number of requirements for institutional investors in securitisations. The individual measures are understandable, but as a whole they lead to disproportionately high costs. This is particularly true in light of the fact that there are no comparable requirements for investors in other asset classes such as equity or covered bonds. These additional requirements make securitisations less attractive for investors and put them at a disadvantage compared to other asset classes.

- The requirements in Art. 5 of the STS Securitisation Regulation should therefore be critically reviewed and significantly reduced. This applies in particular to the requirement to establish written procedures for due diligence, to ensure internal reporting to management bodies or the obligation to be able to provide evidence of compliance with all requirements at any time at the request of the competent authority. As a result, additional documentation and internal monitoring processes are required for the securitisation asset class in addition to the normal regulatory requirements under S-II.

Investors are fundamentally reliant on detailed information in order to be able to carry out an adequate review of the securitisation, including its risk.

- The **review and adjustment of the securitisation regulations** should therefore not be aimed at a general reduction in the scope of information requirements, but rather at the actual information requirements of investors and facilitating the availability of data.
- In this respect, it should be reviewed whether the **ESMA templates regarding STS securitisation** with their large number of data points are justified or whether they should be reduced to the essential data points. In principle, the development of an industry standard with the involvement of issuers and investors may be an option here.

Improving liquidity of securitisations

Securitisations are often treated as illiquid assets due to the low liquidity in the secondary market. Against this background, consideration should be given to targeted measures to improve liquidity. Possible proposals could include:

- **The reduction and simplification of STS requirements** for issuers and the reduction of due diligence requirements to the points relevant for investors should have a fundamentally positive effect on the supply of and demand for securitisations and thus directly ensure more liquidity for securitisations.
- In addition, consideration could be given to whether the **establishment of a trading platform for securitisations** is necessary and sensible in order to

make securitisations more tradable. The aim should not only be to create more liquidity and transparency, but also to reduce valuation discounts for securitisations.

However, we are critical of the establishment of a securitisation platform with state guarantees in a private market, as proposed in the Noyer report. In this case, there would be a risk that established, functioning assets such as Pfandbriefe, covered bonds and securitisations with high ratings would be negatively affected.

- To prevent crisis situations in the event of a tense securitisation markets, consideration could be given to the introduction of **a 30-day period for due diligence**. Institutional investors could be granted a 30-day period for due diligence in accordance with Article 5 of the STS Securitisation Regulation so that more investors can be found on the market at short notice. However, the detailed design would have to be carefully scrutinised and an obligation to sell if the due diligence obligation is not fulfilled would have to be avoided.

Remove fragmentation of investor landscape in the STS market

Credit insurers, on the liabilities side of their balance sheet, are usually not funded and offer insurance contracts to assume risk without providing security. Before the introduction of the STS synthetic framework in 2021, implemented as part of the Capital Markets Recovery Package (CMRP), credit insurers were able to participate in the synthetic risk transfer market, providing 'capital velocity' to banks (i.e., the capacity for banks to redeploy their capital relief for new lending). The introduction of the new framework fragmented credit insurers' investment landscape, as the newly introduced regulation in the Securitization Ordinance currently does not allow them to participate as protection providers in synthetic STS securitisations in the form of an unfunded and unsecured guarantee. Protection providers for STS have been limited to public sector actors with a risk weight of zero in accordance with (Art 26e (8) (a) SecReg) and is thus mainly reserved for multilaterals such as the European Investment Fund (EIF) with strong activities to stimulate the market (especially in the wake of COVID19).

All non-public sector guarantors need to be collateralised, but only for STS securitisations. Naturally, multiline insurers guarantee their solvency through the insurance principle based on the law of large numbers and the diversification of risks with sufficient equity capital under rigid regulation. A collateral position represents excessive friction for insurers because liquid assets are held by insurance companies for potential claims payments and are linked to the opportunity costs of the illiquidity premium. Providing collateral or taking on capital-backed risks in securitizations is therefore associated with significantly higher costs for such covers.

Suggested solutions are therefore in order of priority:

- Adaptation of the Level 1 text in Art 26e (8) (c) SecReg so that insurers are exempt from the obligation to provide collateral or capital coverage.
- Introduction of a bank letter of credit as an alternative to providing cash collateral with third-party banks in Art. 26e (10) (b) SecReg.

Berlin, 29. August 2024