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Review of the legal framework for securitisation in the EU

(own-initiative opinion)

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1. Conclusions and recommendations

1.1. The EESC believes that further improving the functioning of the securitisation market could broaden investment opportunities for investors and expand access to credit for households and businesses. Securitisation could help to advance the capital markets union (CMU) by cultivating deep liquidity pools, improving direct and indirect access to markets, and continuing to remove barriers that hinder the cross-border flow of capital.

1.2. Efforts to stimulate securitisation in the EU should concentrate on producing demonstrable benefits in terms of additional funding for the real economy, especially households and businesses. Securitisation should play a complementary role to other debt capital instruments, such as covered bonds, by providing refinancing options for certain asset categories, as well as a risk management tool. Securitisation could also be used to free up bank capital to make new loans to the real economy or distributions to investors.

1.3. The EESC notes that securitisation has been identified as a potential source of additional funding that would cover the substantial investment needs of the green transition. Extending the existing disclosure requirements on sustainability (e.g. to other asset classes) or introducing a dedicated framework for 'green securitisation' may add value for investors who would appreciate having such information to measure their own share of environmental, social and governance (ESG) investments, to assess ESG-related risks, and as a comparison tool.

1.4. Traditional securitisation in particular has the potential to mobilise additional funding from the capital markets. The EESC recommends assessing why traditional securitisations have seen a comparatively weak recovery in the market, and exploring possibilities for further developing the asset-backed securities (ABS) market for certain asset categories. Progress on harmonisation (e.g. of contract and insolvency law and taxation) would be important for improving the feasibility of the cross-border pooling and issuance of such securities.

1.5. An assessment of the securitisation market is recommended, in particular on market infrastructure, liquidity, efficiency and transparency, to make these instruments more attractive without compromising financial stability. Further adjustments to the regulatory framework regarding reporting and due diligence requirements should also be explored, as should efforts to streamline the disclosure templates of the European Markets and Securities Authority (ESMA).

1.6. The EESC notes that the prudential treatment of securitisation exposures by banks and insurance companies is governed largely by international standards. It also notes that the Financial Stability Board (FSB) has recently launched a consultation with stakeholders to evaluate the effectiveness of this regulatory framework. The EESC is of the view that the EU should closely cooperate with its international partners in this evaluation.

1.7. The EESC notes that it could be worth further streamlining the process whenever possible, for example by reducing the timeframes and further standardising and harmonising the requirements for significant risk transfer (SRT) recognition. Authorities should, however, continue to carefully monitor where these risks are distributed in order to prevent a concentration of systemic risks, both within the banking sector and among non-bank financial intermediaries (NBFIs).

1.8. The EESC recommends that evaluations be carried out by EU institutions with the aim of exploring potential improvements in terms of market infrastructure, liquidity, efficiency and transparency, in order to render securitisation instruments more attractive for potential institutional investors without compromising financial stability. All reforms should be aimed at increasing the real financing of the economy with a view to fostering economic growth and job creation, wherever possible. The EESC calls on the Commission to ensure that ongoing evaluations of the implementation of the regulatory framework on securitisation include an analysis of the impact on the financing of the real economy.

2. **Background**

2.1. Securitisation contributes to the allocation of capital to businesses and households in an indirect way, primarily by allowing banks to transfer certain credit risk exposures to investors. Securitisation comprises two different instruments: traditional ('cash' or 'true-sale') and synthetic securitisation. The key technical difference is that in traditional securitisation, the actual assets are sold to investors, while in synthetic securitisation, the bank retains the assets but transfers the risk to institutional investors through financial guarantees and credit derivatives.

2.2. The European Council ([1]), the Letta ([2]) and Draghi ([3]) reports, and ESMA ([4]) have all highlighted the need to relaunch the securitisation market, whether to increase EU competitiveness, to develop EU capital markets or to increase bank funding capacity. This opinion aims to promote a review of the legal framework for securitisation in the EU in a way that improves the competitiveness of the EU economy and the working conditions in the European labour market, while maintaining financial stability.

2.3. In 2022, total new issuances of securitisations in the EU reached EUR 135 bn, and the total nominal value of outstanding securitisations was estimated at EUR 930 bn ([5]). On both metrics the market remains significantly below its peak in 2008. The Joint Committee of the European Supervisory Authorities (Joint Committee of ESAs) ([6]) observed that the introduction of the Securitisation Regulation and the prudential framework in 2019 had resulted in a market that was smaller but of a higher quality, and that pre-crisis levels should not be a benchmark to be targeted. However, it noted that

([1]) European Council, Special Meeting of the European Council – Conclusions, 18 April 2024.
([2]) Letta, E., *Much More Than a Market*, 18 April 2024.
([3]) Draghi, M., *The Future of European Competitiveness*. Part B: In-depth Analysis and Recommendations, September 2024.
([4]) ESMA, *Building More Effective and Attractive Capital Markets in the EU*, Position Paper, 22 May 2024.
([5]) ESMA, *The EU Securitisation Market – An Overview*, 21 September 2023.
([6]) Joint Committee of ESAs, *Joint Committee Advice on the Review of the Securitisation Prudential Framework*, 12 December 2022.

the post-crisis market had fallen short of the objective to generate EUR 100-150 bn of additional funding. Traditional securitisation in particular has been more subdued than synthetic securitisation, which has experienced strong growth in recent years following the inclusion of synthetic transactions into the simple, transparent and standardised (STS) framework in April 2021 ([7]).

2.4. Available data from ESMA ([8]) and the Association for Financial Markets in Europe (AFME) ([9]) indicate that securitisation markets in the EU are heterogeneous and fragmented along national lines, with 80 % of securitisation issuances concentrated in four Member States ([10]). Market fragmentation reduces the potential for originators and issuers to achieve economies of scale, and limits the liquidity of the market for investors. For traditional securitisations, asset pools tend to be concentrated in one single country, and the asset classes securitised differ between countries. These differences are attributable to a variety of factors, including the specificities of national economies and capital markets, different taxation, corporate law and insolvency regimes, and the availability of alternative funding instruments, such as covered bonds. To date, the contribution of securitisation to accessing incremental pools of capital is moderate: unlike in other markets, EU banks themselves continue to be the largest holders of securitisations by a large margin, with most of the volume issued in 2023 retained by the issuers, mainly for use as collateral in central bank operations ([11]).

2.5. In many EU Member States, collateralised loans are refinanced using alternative instruments, in particular covered bonds. As of the end of 2022, the three largest global issuers of covered bonds are Denmark, Germany and France ([12]). In comparison, in the US, covered bonds do not play a significant role, particularly due to the role of agency-backed securitisation in residential mortgages. Securitisation and covered bonds share similar structures, but they also differ in various aspects, such as risk profile and usage. The differences in risk profile are also reflected in their prudential treatment. However, the EESC notes that covered bonds do not allow banks to free up capital, for example to make new loans or distributions to investors, since the credit risk of the loans covered remains on the balance sheet of the issuing bank.

2.6. The US market for securitisations is still substantially larger than that in the EU. This difference is attributable primarily to structural specificities, for example the availability of alternative funding instruments, such as covered bonds in Europe, and the presence of government-sponsored mortgage financing agencies in the US, which stand behind the vast majority (80 %) of mortgage-backed securities (MBS) ([13]). Excluding agency-backed issuance, the total amount of securitisation outstanding in the US amounts to ca. 8 % of all private-sector credit, compared to ca. 5 % in the UK, ca. 4 % in the EU, and ca. 3 % in Japan ([14]).

3. **General comments**

3.1. The EESC believes that securitisation could positively impact the completion of the CMU. While securitisation cannot substitute the development of deeper, more integrated European markets for corporate debt and equity securities, which depend on achieving multiple` long-term objectives (e.g. promotion of an equity culture, integration of securities markets and infrastructures, harmonisation of corporate and tax laws), securitisation could serve as an instrument to connect capital markets to corporate debt financing and, in certain markets, expand access to credit for households. Furthermore, cultivating deep liquidity pools, improving direct and indirect access to markets for investors, and continuing to remove barriers that hinder the cross-border flow of capital are highly relevant in advancing the CMU.

3.2. While there is broad agreement that the post-crisis reforms of the prudential framework for banks were warranted and necessary to address systemic risks, the EESC notes, however, that an assessment of the effectiveness of the legal framework in place is appropriate. The EESC also notes that the international standards on this matter are currently subject to an evaluation by the FSB. The EESC considers that re-calibrating prudential requirements would not, by itself, ensure the

([7]) ESMA, *The EU Securitisation Market – An Overview*, 21 September 2023.
([8]) ESMA, *The EU Securitisation Market – An Overview*, pp. 9-12.
([9]) AFME, *Securitisation Report: Q4 2022 and 2022 FY*, 14 March 2023.
([10]) ESMA, *The EU Securitisation Market – An Overview*, 21 September 2023.
([11]) ESMA, *The EU Securitisation Market – An Overview*, 21 September 2023; ESRB, *Monitoring Systemic Risks in the EU Securitisation Market*, July 2022.
([12]) European Covered Bond Council (ECBC), *European Covered Bond Factbook 2023*, September 2023.
([13]) Levitin, A. J., *Report on the Institutional and Regulatory Differences between the American and European Securitization Markets*, German Council of Economic Experts Working Paper 3/2023, November 2023.
([14]) FSB, *Evaluation on Effects of G20 Reforms on Securitisation*, Consultation Report, 2 July 2024.

revival of the securitisation market ([15]), and recommends that any recalibration of the prudential treatment of securitisation is based on the evaluation made by experts appointed by relevant institutions, and should effectively link capital requirements to real risk. In addition, other adjustments to the regulatory framework should be explored, such as streamlined reporting, disclosures and due diligence requirements, including ESMA's disclosure templates, provided that the safeguards mentioned above are respected.

3.3. The EESC recommends that regulators, supervisors and market participants monitor where risks are distributed. Significant progress has been made since 2008-2009, especially regarding the supervision of rating agencies and, to a lesser extent, NFBIs. However, systemic vulnerabilities continue to exist. In particular, the accumulation of securitisation-related risks in less strictly supervised areas of the intermediation chain must be avoided. Supervisors should also cooperate more closely, for example by collecting and exchanging relevant data and risk assessments.

3.4. The EESC reiterates that efforts to stimulate securitisation in the EU should concentrate on producing demonstrable benefits in terms of additional funding for the real economy, especially to households and businesses. Supply-side and demand-side measures should be given equal attention in order to develop healthy and sustainable markets. When considering incentives to promote securitisation, both the differences in the risk profiles of structured securities and existing debt capital market instruments should be taken into account. Possible overlaps with established, well-functioning markets that already contribute to funding the EU economy, such as covered bonds for mortgage lending, should be carefully assessed. In this sense, securitisation should play a complementary role alongside other debt capital market instruments, such as covered bonds, by providing refinancing options for certain asset categories, as well as a risk management tool.

3.5. The EESC recommends that the EU institutions carry out an assessment to explore potential improvements in terms of market infrastructure, liquidity, efficiency and transparency in order to render securitisation instruments more attractive for potential institutional investors without compromising financial stability. All reforms should be aimed at increasing the real financing of the economy with a view to fostering economic growth and job creation, wherever possible. The EESC calls on the Commission to ensure that ongoing evaluations of the implementation of the regulatory framework on securitisation include an analysis of the impact on the financing of the real economy.

3.6. With regard to prudential treatment, the EESC notes that the prudential treatment of securitisation exposures by banks and insurance companies is governed largely by international standards. It also notes that the FSB has recently launched a consultation with stakeholders to evaluate the effectiveness of this regulatory framework. The EESC is of the view that the EU should closely cooperate with its international partners in this evaluation. The EESC also notes that European insurers are only marginally engaged as investors in the securitisation market. This trend could partially be explained by the calibration of regulatory requirements. The EESC would therefore welcome a review by the European Insurance and Occupational Pensions Authority (EIOPA), as was recently suggested by its chair ([16]).

3.7. The EESC is mindful of the constraints regarding the potential of traditional securitisation to mobilise incremental funding for SMEs. Inherent practical limitations (issuance volumes and availability and heterogeneity of available collateral) have limited the size and relevance of this market. SME loans have proven to be less suitable collateral for economically meaningful issuances of ABS: collateral is scarce and often has little or no alternative use; tenors are non-standardised and often scarce; and terms and conditions are bespoke. The EESC recommends assessing why traditional securitisations have seen a weak recovery compared with synthetic securitisation, and how to further develop the ABS market, especially for larger, cross-border SME loan portfolios. Progress on harmonisation, for example of contract and insolvency law and taxation, would be a prerequisite for improving the feasibility of the cross-border pooling and issuance of such securities.

([15]) Joint Committee of ESAs, *Joint committee Report on the Implementation and Functioning of the Securitisation Regulation* (Article 44), 17 May 2021.

([16]) Fausto Parente, 'Insurance Regulatory Framework for Securitisation', Eurofi Magazine, February 2024.

4. **Specific comments**

4.1. The EESC is of the view that reviving the securitisation market might be a way to broaden investment opportunities for investors and boost lending to Europe's households and businesses. It also believes that 'green securitisation' in particular could play a positive role in funding the green transition, for instance to refinance loans for property renovation and to increase investment in mobility and energy. The current framework imposes only a limited obligation on originators of securitisation transactions to make sustainability disclosures. Extending the existing ESG disclosure requirements to other asset classes in a proportionate way or introducing a dedicated framework for 'green securitisation' may add value for investors who would appreciate having such information to measure their own share of ESG investments, to assess ESG-related risks, and as a comparison tool.

4.2. The EESC maintains that future reviews of the regulatory framework should include careful considerations of: a) the agency problem inherent in the 'originate to distribute' model ([17]); and b) systemic risks, such as concentration risks. Such considerations should be based on adequate empirical evidence only, and be conducted in line with recommendations from the international standard-setters, while also addressing European specificities.

4.3. Structured securities comprise large portfolios of assets, rendering it difficult for investors to assess their quality in detail. They are highly structured ('tranching'), meaning they rely on the originator's assumptions about asset quality and cash flow, expressed in complicated 'waterfall' models. Investors must undertake extensive due diligence or rely on ratings provided by rating agencies. Rating agencies continue to be paid by the originator. Conflicts of interest, which may arise as a result, and which were one of the main contributing factors of the global financial crisis, were identified once again as a potential risk by ESMA in its recent report on collateralised loan obligations ([18]). The EESC recommends that these considerations be borne in mind, in particular when assessing the feasibility and desirability of marketing structured, asset-/mortgage-backed securities to less sophisticated investors.

4.4. The EESC notes that the requirement for originators or sponsors of a securitisation to retain a material economic interest in the transaction (risk retention) represents an important safeguard against 'moral hazard'. The EESC agrees with the Joint Committee of ESAs ([19]) that retention obligations have proven successful and should be maintained unaltered.

4.5. The EESC is of the view that the EBA's 2021 report on SRT ([20]) has contributed materially to harmonising the application of the capital relief framework by EU supervisors ([21]). The EESC notes, however, that market participants deem the timeframes for assessing and recognising SRT transactions to be too long. In addition, the SRT tests set out in the EBA report can be complex and may render some transactions uneconomical, especially where capital relief has been the primary objective of the originating bank. The EESC agrees that possible measures should be explored to further streamline the SRT approval process (possibly by using more standardised templates) in order to simplify the work of supervisors and enable faster approval of the SRT requirements, especially for simpler products.

([17]) Which are the focus of many provisions in the current legal framework, such as risk retention, credit granting standards and the STS label.

([18]) ESMA, *EU CLO Credit Ratings – Risk of Conflicts of Interests Relating to Methodology Changes*, final report, 21 September 2023.

([19]) Joint Committee of ESAs, *Joint Committee Report on the Implementation and Functioning of the Securitisation Regulation* (Article 44), 17 May 2021.

([20]) EBA, *Report on Significant Risk Transfers in Securitisations under Articles 244(6) und 245(6) of the Capital Requirements Regulation*, 23 November 2020.

([21]) Gonzalez, F., and Morar Triandafil, C., 'The European Significant Risk Transfer Securitisation Market, European Systemic Risk Board (ESRB)', *Occasional Paper Series No. 23*, ESRB, p. 35.

4.6. According to a recent study published by the European Systemic Risk Board (ESRB) ([22]), the majority of SRT transactions are conducted using synthetic securitisation with a limited pool of counterparties (usually professional credit risk managers). The ESRB study points out that a significant downturn in the credit cycle could reveal excessive risk-taking by investors participating in the SRT market. The EESC supports the authors' suggestion to carry out further analyses into how SRT risk transmission affects the European banking system, and how it shifts risks to other areas of the financial system ([23]).

Brussels, 4 December 2024.

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([22]) Gonzalez, F., and Morar Triandafil, C., 'The European Significant Risk Transfer Securitisation Market', *Occasional Paper Series No. 23*, ESRB, p. 35.

([23]) Aliaj, O., Gara, A., and Platt, E., 'Blackstone Snaps Up "Circular" Private Equity Credit Risk', *Financial Times*, 3 July 2024.