Position Paper

Response to consultation on EC call for feedback on securitisation framework

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General comments

Insurance Europe welcomes the opportunity to provide comments on the European Commission's consultation on the functioning of the securitisation framework in the EU.

European insurers are Europe's largest institutional investors, with over €10tn of assets under management. In their role as investors, insurers need a wide range of appropriate assets to invest to achieve good returns, portfolio diversification and appropriate liability matching to benefit their policyholders. This includes investments in securitisation. The insurance sector therefore supports the promotion of sound securitisation and appropriate prudential treatment, in line with the objectives of the Capital Markets Union (CMU) project.

The European Commission has already taken helpful steps in recent years, but significant barriers remain for insurers to invest and, as a result, the level of investment by insurers in securitisations remains very low and below the levels seen before the financial crisis.

Further policy actions are therefore needed to increase the attractiveness of this asset class and, by so doing, help fund the European economy.

Insurance Europe has identified the following areas where policy action is needed and justified on an economic and risk bases:

- **The solvency capital requirements (SCR) for securitisations under Solvency II remain too high relative to the real risk** and relative to the yield that can be earned. As a result, the yield that can be earned by an insurer investing in securitisations is not usually high enough to cover both the risk and the additional capital that needs to be set aside by the insurer. This problem arises because the current Solvency II framework ignores the actual risk involved in investing in securitisation: ie the risk of actual losses from extreme level of defaults. Instead, Solvency II assesses risk and capital by assuming the insurer would sell all their securitisation after a huge change in market spreads.
    - The solution: Allow insurers to apply the dynamic VA (DVA) to value liabilities. This recognises the fundamental Solvency II principle that the extreme scenarios used to determine the SCR should be applied to both assets and liabilities. Doing so would result in a more economically correct and appropriately lower level of capital requirements.

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- **The mandatory "due diligence" actions issuers and investors are required to undertake is disproportionate and excessive.** While appropriate due diligence is vital, the current requirements are not linked to the risk and complexity of the securitisation and are very onerous, creating further disincentives.
  - The solution: Due diligence requirements should be simplified and allow for proportionality. The outcome should be that the requirements are similar to those required for other instruments, such as covered bonds.
- **Other issues** to address:
  - As well as the absolute level of capital being too high, the differences in capital requirements between senior and non-senior tranches of a securitisation remain too high: eg a senior five-year AA STS securitisation now has a capital charge of 6%, while the junior tranche with same AA rating has it at 17%.
  - Non-STS securitisations remain significantly penalised, without this being justified by historical performance data.
  - There is inconsistency in the treatment between a whole mortgage loans pool versus residential mortgage-backed securities (RMBS), the latter being heavily penalised in terms of capital.

1. Effects of the Regulation

Question 1.1
Has the Securitisation Regulation (SECR) been successful in achieving the following objectives:

	1 (fully agree)	2 (somewhat agree)	3 (neutral)	4 (somewhat disagree)	5 (fully disagree)	Don't know – No opinion – Not applicable
Improving access to credit for the real economy, in particular for SMEs				X		
Widening the investor base for securitisation products in the EU					X	
Widening the issuer base for securitisation products				X		
Providing a clear legal framework for the EU securitisation market		X				
Facilitating the monitoring of possible risks	X					
Providing a high level of investor protection			X			

	1 (fully agree)	2 (somewhat agree)	3 (neutral)	4 (somewhat disagree)	5 (fully disagree)	Don't know – No opinion – Not applicable
Emergence of an integrated EU securitisation market			X			

Question 1.2
If you answered 'somewhat disagree' or 'fully disagree' to any of the objectives listed in the previous question, please specify the main obstacles you see to the achievement of that objective.

Capital (Solvency II) and operational costs (due diligence requirements) are unnecessarily high, and this creates unnecessary barriers for insurers to invest in securitisations. The capital requirements under Solvency II for securitisations should therefore be adjusted to reflect the real risks of securitisation.

Proper consideration should be given not only to the risk aspect, but also to appropriate equal treatment vis-à-vis similar asset classes. The current securitisation SCR, especially in comparison to, for example, those for loan pools or covered bonds, limits the attractiveness of securitisations for insurers.

In addition, "due diligence" measures required by investors should be simplified to find the right balance between such requirements and the risk of securitisation.

An integrated market has not yet been created and STS issues are still few, and often unlisted. There may be no adequate incentives for issuers of securitisations to work towards a specific EU "label". While legislation has helped to make the market more transparent, it still remains complex for investors to independently assess the value and associated risk.

In particular, with respect to the above questions, the sector notes that:

- On improving **access to credit for the real economy and SMEs:**
  - The Securitisation Regulation (SECR) does not seem to have led to significantly broader and better financing of the real economy. Evidence of the specific impact of the SECR is little and the new issuance volumes on SME asset-backed security (ABS) are relatively small. The securitisation market has so far played only a minor role in financing the SME sector. Not only are SME securitisations rare, but they are almost never offered in the primary market.

- On widening the **investor base** for securitisation products in the EU:
  - The overall direct investor base appears not to have significantly grown in recent years, while EU ABS dedicated professionals have decreased. More disclosures and supervision, as well as extended geographical reach of the SECR, make securitisations less attractive for investors. The high regulatory requirements for investing in securitisations limit the number and types of investors that can participate in this market: eg the high SCR faced by insurers (especially when compared to capital charges for other asset classes such for loan pools or covered bonds).

- On widening the **issuer base** for securitisation products:
  - As mentioned, the regulatory burden for securitisation issuance limits the number and types of issuers. For example, when looking specifically at STS ABS, issuances have tended to involve mostly originators with programmes existing already before the SECR implementation.

- On **providing a clear legal framework for the EU securitisation market:**
  - The EU securitisation framework, as consolidated and extensively detailed, is overall clear for market participants.

- On **facilitating the monitoring of possible risks:**
  - The detailed and extensive disclosures required by ESMA templates allows to access to a lot of information, although not necessarily always usable in its current format or even needed. Some requirements on exposures, aside from general performance monitoring, also help monitor risks.

- On providing a high level of **investor protection:**
  - The SECR eventually results in a good level of investor protection, although this alone has not been enough to significantly widen the investor base and significantly increase risk taking on non-senior securitisations in Europe compared to the US market.

- On emergence of an **integrated EU securitisation market**
  - Preliminary evidence suggests that an integrated EU securitisation market comparable to the US one, has not emerged.

Question 1.3
What has been the impact of the SECR on the cost of issuing / investing in securitisation products (both STS and non-STS)? Can you identify the biggest drivers of the cost change? Please be specific.

From an investor perspective, the general impact of the SECR on costs has been related to the need to ensure, through the several internal functions involved, adequate due diligence on investments both before purchase and on an ongoing basis. Compliance with the information requirements has created a higher cost burden compared to the analysis required on comparable products, such as covered bonds.

From an issuer perspective, it appears that additional costs have also been driven up: eg by governance and compliance with transparency requirements and the STS designation.

2. Private securitisations

Question 2.4
Do investors in private securitisations get sufficient information to fulfil their due diligence requirements?
- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

- Insurance Europe response: Yes

Overall, investors in private securitisations receive sufficient information to fulfil their due diligence requirements. However, this does not represent a major change in comparison with before the introduction of the SECR.

ESMA templates for private transactions are usually made available indirectly through reporting websites. However, the typical information provided in every deal is already sufficient to investors.

For insurance investors, private and public securitisations are not very different, as the parties involved typically are the same (eg trustee, services, risk retention provider etc).

3. Transparency and due diligence

Question 3.1 *Do you consider the current due diligence and transparency regime proportionate?* - *Yes* - *No* - *Don't know / no opinion / not applicable*

- Insurance Europe response: No

The current due diligence and transparency regime is appropriate in principle, but not in relation to other comparable instruments (eg loan pools, covered bonds, etc.). Therefore, they are excessive in practice, both for the issuer and the investor.

An appropriate due diligence is vital for insurance investors. The transparency regime in the SECR requires that the originator and sponsor make a range of information available to the holders of a position and to potential investors. So, while due diligence and transparency may seem adequate, they are not proportionate compared to other fixed income asset classes.

This puts securitisations at a disadvantage compared to equally risky or riskier asset classes. The SECR should address this inconsistency with respect to other comparable instruments (eg loan pools, covered bonds, etc.).

Question 3.2 *What information do investors need? How do investors carry out due diligence before taking up a securitisation position?*

To perform due diligence, investors need pool level data, including historical performance and stratifications, data on structure, data on originator and data on servicing. Overall, insurance investors are satisfied with the information/data that they receive. This allows them to evaluate the securitisation position.

4. Jurisdictional scope

Question 4.1 *Have you experienced problems related to a lack of clarity of the Securitisation Regulation pertaining to its jurisdictional scope?* - *Yes* - *No* - *Don't know / no opinion / not applicable*

- Insurance Europe response: Yes

There are barriers for EU-regulated investors when investing in securitisations from non-EU countries. These barriers should be identified and addressed in the review of the jurisdictional scope of the SECR.

It would be appropriate for EU regulated investors to face minimal regulatory hurdles when investing in securitisations from non-EU jurisdictions. While US, Japanese and Australian investors are flexible in accessing other securitisation markets, this is not the case for European investors. European investors therefore compete at a disadvantage with respect to their global peers (ie EU insurers cannot access non-EU markets while competitors can easily enter the EU market).

Question 4.2
Where non-EU entities are involved, should additional requirements (such as EU establishment/presence) for those entities be introduced to facilitate the supervision of the transaction?

- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

- Insurance Europe response: No

Additional requirements or costs for non-EU investors do not seem helpful to develop and expand the European securitization market.

To ensure a level playing field between EU regulated and non-EU investors, EU regulated investors should be allowed to invest or face minimal regulatory hurdles to invest in securitisations in non-EU jurisdictions.

Question 4.3
In transactions where at least one, but not all sell-side entities (original lender, originator, sponsor or SSPE), is established in the EU:

A) Should only entities established in the EU be eligible (or solely responsible) to fulfil the risk retention requirement under Article 6?

- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

- Insurance Europe response: No

The risk retention should not be dependent on nationality and membership of the EU. Any distinction should be justified from a risk perspective.

5. Equivalence

Question 5.1
Has the lack of recognition of non-EU STS securitisation impacted your company?

- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

- Insurance Europe response: No

In principle, the sector would welcome the introduction of an equivalence regime to avoid any uncertainty. If a non-EU country has an STS regime, then equivalence by the EU regulation would be very much needed.

Question 5.2
Should non-EU entities be allowed to issue an STS securitisation?

- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

- Insurance Europe response: Yes

There is no economic rationale to stop STS being issued by non-EU entities. Article 18 of the SECR should therefore be changed accordingly to allow such issuances.

Question 5.3
Should securitisations issued by non-EU entities be able to acquire the STS label under EU law?
- *Yes, in case the securitisation is issued in a jurisdiction that has a regime declared to be equivalent to the EU STS regime;*
- *Yes, in another way, for example by other mechanisms used in financial services legislation like recognition or endorsement;*
- *No*
- *Don't know / no opinion / not applicable*

- Insurance Europe response: Yes

The insurance sector would welcome it if securitisations issued by non-EU entities could acquire the STS label under EU law. However, for this to be possible, the establishment of an equivalence regime would not be necessary, as it would be sufficient that the individual securitisation meets the STS requirements, also as verified by an STS verification agent.

6. Sustainability disclosure

Question 6.1
Are there sufficiently clear parameters to assess the environmental performance of assets other than auto loans or mortgages?
- *Yes, for all asset classes*
- *Yes, but only for some asset classes*
- *No*
- *Don't know / no opinion / not applicable*

- Insurance Europe response: No

For sustainability-oriented long-term investors such as insurers, the availability of sustainability data is essential, but unfortunately currently insufficient to meet investors' needs. Several insurers are already working to close this data gap with securitisation issuers. However, legislative regulation to improve data availability would be very helpful for all sustainability-oriented investors.

Data availability needs to improve across sectors (ie energy efficiency ratings for houses, engine characteristics for car loans, etc.) both for securitisations and for comparable asset classes, such as covered bonds or loan pools (other asset based financings).

Question 6.2
Should publishing information on the environmental performance of the assets financed by residential loans and auto loans and leases be mandatory?
- *Yes, the information is currently available*
- *Yes, but with a transitional period to ensure the availability of information*
- *Yes, with a grandfathering arrangement for existing deals*
- *No*
- *Don't know / no opinion / not applicable*

Insurance Europe response: Yes, with a transitional period to ensure the availability of information and a grandfathering arrangement for existing deals.

Publication of information on the environmental performance of assets financed with housing loans and auto loans and leases should be mandatory after a sufficiently long transition period. In addition, a grandfathering provision for existing transactions would be sensible. While many issuers do not currently have the necessary sustainability data available, they should be encouraged to collect the data and make it available by a medium-term date, without excluding them from the ESG market.

Question 6.3
As an investor, do you find the information on environmental performance of assets valuable?
- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

Describe the use you have made of it?

- Insurance Europe response: Yes

For sustainability-oriented long-term investors, such as insurers, information on the environmental performance of assets is key. Insurers use this kind of data for an ESG assessment of securitisations. This allows insurers to form an independent opinion on the ESG impact.

Question 6.4
Do you think it is more useful to publish information on environmental performance or on adverse impact and why?

Robust, comparable and reliable ESG data is important for a number of reasons, including to:
- Assess ESG impact and enable financial institutions and investors to steer their portfolios towards the objectives of the Paris Agreement and of the European Green Deal.
- Identify and assess sustainability risks in business activities.
- Comply with the increasing expectations and new regulatory requirements in the context of the EU Sustainable Finance agenda due to apply shortly.
  - For example, compliance with the new sustainable finance disclosures regulation (SFDR) requires financial market participants to have access to comparable robust and reliable ESG data for their portfolios. From the perspective of the EU taxonomy Regulation, companies subject to the non-financial reporting directive (NFRD) will also be required to disclose how and to what extent their activities qualify as environmentally sustainable as per the taxonomy.

Question 6.5 (a)
Do you agree that these asset specific disclosures should become part of a general sustainability disclosures regime as EBA is developing?
- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

- Insurance Europe response: Yes

Question 6.5 (b)
Should ESG disclosures be mandatory for (multiple choice accepted):
- *Securitisation that complies with the EU green bond standard*
- *RMBS*
- *Auto loans/leases*
- *ABS*

Insurance Europe response:
- Securitisation that complies with the EU green bond standard and RMBS.

ESG disclosures should be mandatory for all securitisations, but optimally a transitional period should apply (see Question 6.2).

Question 6.6
Have you issued or invested in a green or sustainable securitisation? If yes, how was the green/sustainability dimension reflected in the securitisation? (multiple choice accepted):
- *Green or sustainable underlying assets*
- *Use of proceeds for green/sustainable projects. If so, please describe how the use of proceeds principle is applied*
- *Green/sustainable collateral AND use of proceeds for green/sustainable projects. If so, please describe how the use of proceeds principle is applied*
- *Other*

Insurance Europe response:
- Green or sustainable underlying assets
- Green/sustainable collateral and use of proceeds for green/sustainable projects.

European insurers already have experience in investing in green or sustainable securitisations. In these cases, they have assessed these transactions with regards to ESG aspects based on available information.

Question 6.7
According to the Commission proposal for a European green bond standard, a securitisation bond may qualify as EU green bond if the proceeds of the securitisation are used by the issuing special purpose vehicle to purchase the underlying portfolio of Taxonomy-aligned assets. Is there a need to adjust this EuGB approach to better accommodate sustainable securitisations or is there a need for a separate sustainable securitisation standard?
- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

- Insurance Europe response: No

8. Supervision

Question 8.2
Have you observed any divergences in supervisory practices for securitisation?
- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

- Insurance Europe response: Yes

Question 8.4
Should the Joint Committee develop detailed guidance (guidelines or regulatory technical standards) for competent authorities on the supervision of any of the following areas:
A) the due diligence requirements for institutional investors (Art 5)
- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

- Insurance Europe response: No

B) risk retention requirements (Art 6)
- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

- Insurance Europe response: No

D) credit granting standards (Art 9)
- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

- Insurance Europe response: No

E) private securitisations
- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

- Insurance Europe response: No

F) STS requirements (Articles 18 – 26e)
- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

- Insurance Europe response: No

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15. Solvency II

Question 15.1

Is there an appetite from insurers to increase their investments in securitisation (whether a senior tranche, mezzanine tranche, or a junior tranche)?

- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

- Insurance Europe response: Yes

European insurers appear to have an appetite to invest in this asset class, but there is evidence (eg sourced via Bank of America Global Research Structured Finance Europe, July 2021) that securitisations have become a less attractive investment for EU insurers and that EU insurers' securitisation exposure has fallen significantly in the last decade and is currently stabilising at a lower level than before.

While there is willingness to invest in this asset class, the capital intensity of securitisation in Solvency II has clearly been one of the key obstacles to invest in this asset class (this is also shown by the fact that there is a different degree of participation between insurers using internal models, who can appropriately reflect the risks of investing in securitisations, and insurers using standard formula, who are generally much less present in this market).

Insurance companies need to look for investments based on several factors, including the risk-return profile, the level of market risk, the sustainability aspects and the matching of assets and liabilities. This also holds true for securitisation. A good level of revenue and a reasonable level of required own funds are therefore key aspects to investing in securitisation. However, Solvency II's SCR for securitisation are too high, notably in comparison with equally rated corporate or covered bonds.

If this level of capital is corrected, insurers will be able to look for securitisation investments with returns and liquidity commensurate to their risk appetite. This would likely make insurers' investment in securitisation increase.

Question 15.2

Is there anything preventing an increase in investments in securitisation by insurance companies?

- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

- Insurance Europe response: Yes

As noted before, and highlighted by analysts for several years now, it is clear that EU investors' participation in the securitisation market is "well below their potential and appetite for yield", as structured assets account for not more than 2% of the overall investment mix.

While each insurer has its own investment strategy in securitisations, there is general consensus among insurers that the cost of capital is one of the most important factors driving such strategy. It is clear that the capital charges and regulatory burdens for securitisations are too high, especially when considering the excellent credit performance of European securitisations. The conservatism of Solvency II's SCR for securitisation, especially in comparison with the ones for similar exposures or relative to US NAIC's capital charges, may explain such low investment levels.

Participation is particularly limited for non-STS and non-senior STS, where the asymmetry in capital treatment between selected RMBS tranches and whole loan mortgage pools (as well as between selected collateralized loan obligations (CLO) tranches and pools of leveraged loans) can create further disincentives for standard formula users to invest.

Question 15.3
*Is the current calculation for standard formula capital requirements for spread risk on securitisation positions in Solvency II for the **senior tranches of STS securitisations** proportionate and commensurate with their risk, taking into account the capital requirements for assets with similar risk characteristics?*
- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

- Insurance Europe response: No

Please be specific in your reply and, where relevant, provide a comparison, including where appropriate with internal models and their relative impact on the share of securitisation investments:

Solvency II's SCR for securitisation are unnecessarily punitive and there is a need for more risk-sensitive capital charges, especially \ considering the good historical default experience for European securitisations and existing measures to mitigate agency and modelling risks (eg risk retention requirements, transparency requirements including the mandatory publication of cashflow models for STS, due diligence requirements etc). As such, past volatility (eg 2008/2009) is not seen as an appropriate guide for future volatility and hence risk charges.

In Insurance Europe's view, capital charges for securitisations should be consistent with corporate bonds when the securitisation is based on a corporate pool or should be in line with covered bonds when securitisation is based on granular mortgage or consumer loan pools.

The unjustified differences in risk charges are shown, for example, by a comparison of the capital requirements for senior tranches of STS securitisations that are ranked with AAA and AA and a duration under five years with comparable bonds.

- The corresponding risk charges for an AAA (AA) STS securitisation with credit assessment with duration one and three years are 1% (1.2%) and 3% (3.6%) respectively. By comparison, corporate bonds ranked with AAA (AA) and duration one and three years have risk charges of 0.9% (2.7%) and 1.1% (3.3%) respectively. The comparable covered bonds have risk charges of 0.7% (0.9%) and 2.1% (2.7%).

Question 15.4
*Is the current calculation for standard formula capital requirements for spread risk on securitisation positions in Solvency II for the **non-senior tranches of STS securitisations** proportionate and commensurate with their risk, taking into account the capital requirements for assets with similar risk characteristics?*
- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

- Insurance Europe response: No

Please be specific in your reply and, where relevant, provide a comparison, including where appropriate with internal models and their relative impact on the share of securitisation investments:

The industry notes that the differences in capital requirements between senior and non-senior tranches of a securitisation remain high – eg a senior five-year AA STS securitisation now has a capital charge of 6%, while the junior tranche with same AA rating has it at 17%. Insurers take the view that the rating is already encompassing the level of risk, whether the concerned tranche is senior or non-senior, so that a factor of one to three in the capital charge appears much too high.

In addition, the SCR for securitisation appears significantly more punitive when compared to equally rated covered bonds and, although to a lower extent, corporate bonds, and also shows an increasing penalisation as ratings decline. See also previous response on required due diligence.

Question 15.5
Is the current calculation for standard formula capital requirements for spread risk on securitisation positions in Solvency II for ***non-STS securitisations*** *proportionate and commensurate with their risk, taking into account the capital requirements for assets with similar risk characteristics?*
- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

- Insurance Europe response: No

Please be specific in your reply and, where relevant, provide a comparison, including where appropriate with internal models and their relative impact on the share of securitisation investments:

The industry notes that non-STS securitisations remain significantly penalised, without this being justified by historical data. While the STS label brings some guarantees to investors, non-STS tranches, when benefiting from an identical rating to STS tranches, should be treated in a similar way, and in any case should not have a capital charge more than 10 times higher. There are cases when the riskiness of an investment is not really correlated with the STS label, meaning that the difference in the credit performance between STS and non-STS securitisations does not justify the huge difference in risk charges.

In addition, there is inconsistency in treatment between a whole mortgage loans pool versus RMBS, the latter being heavily penalised in terms of capital.

Question 15.6
Should Solvency II standard formula capital requirements for spread risk differentiate between ***mezzanine and junior tranches of STS*** *securitisations?*
- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

- Insurance Europe response: Don't know

In principle, regulation should avoid being too complex: ie through the introduction of too many refinements. In the case of mezzanine versus junior tranches, the rating could a priori be enough to differentiate between different levels of risks.

Question 15.7
Should Solvency II standard formula capital requirements for spread risk differentiate between senior and non-senior tranches of non-STS securitisations?
- *Yes*
- *No*
- *Don't know / no opinion / not applicable*

- Insurance Europe response: Don't know

As mentioned in Questions 15.4, 15.5 and 15.6, the rating of a securitisation could be enough to differentiate between different levels of risks, so that the differentiation between senior and non-senior tranches of non-STS securitisation does not appear a priori relevant. However, there is some ground to assess the possibility to better differentiate capital requirements for spread risk between senior and non-senior tranches of non-STS securitisations, where senior tranches benefit from the first losses taken by non-senior tranches.