

Insurance Europe's key messages on the European Commission's proposal for a framework for simple, transparent and standardised securitisation

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Insurance Europe would like to take the opportunity to share its key messages and comments on the Commission's proposal for a framework for simple, transparent and standardised (STS) securitisation.

Insurance Europe supports the encouragement of good securitisation to help fund the European economy. Enhanced standardisation, transparency and quality of securitisations (including risk retention requirements) will support insurers' access and interest in this asset class. More risk-sensitive capital charges are needed in order to achieve a sustainable securitisations market in the EU. In this respect, the current Solvency II treatment of securitisations significantly exaggerates the risks that insurers are exposed to when investing in these assets.

Insurance Europe understands the need to ensure harmonisation across sectors and it supports the idea that, once a harmonised framework of qualifying securitisation is defined, it should be used as a reference across sectors, including the insurance sector and its regulatory framework Solvency II. More specifically, it is important that type 1 securitisations under Solvency II are replaced by STS securitisations.

While Insurance Europe generally supports the STS framework, several elements of it need further consideration and review, including:

- The **scope of the review of Solvency II capital requirements** should not only cover junior tranches of STS securitisations, but rather all tranches of STS securitisations, both senior and junior. The Commission's work should focus on changes to the current Solvency II approach, namely:
 - Capital charges for STS securitisations (currently type 1 securitisations under Solvency II) should be aligned to those for corporate bonds. This would be in line with a look through approach.
 - Capital charges for securitisations of residential loans should be capped at the level of charge applied to the underlying pool of residential loans. This would be in line with a look through approach.
 - All tranches of STS securitisations should receive a more risk-sensitive approach and avoid current cliff effects between the senior and junior tranches within the same STS transaction (junior tranches of high quality securitisations are currently treated as type 2 under Solvency II). The STS status will be a good indication for the qualitative aspects of the securitisation as a whole, while any rating differences

between the senior vs the junior tranches will implicitly impact the capital requirement. This means that the difference between the charges for junior and senior tranches of high quality securitisations can be significantly lowered, if not removed.

- High-quality, senior tranches of STS asset-backed commercial papers (ABCP) should have the same capital treatment as cash.
- **Accreditation of securitisations** which are in line with qualifying criteria should be done by an independent third-party to avoid any conflicts of interest and encourage investors' trust in the assessment.
- The **due diligence requirements**, as set out in the draft regulation, should be clarified to ensure that each third party involved in the process is not required to duplicate all due diligence and record keeping requirements, as this would significantly increase the cost of buying and holding securitisations without providing any added benefit to investors or financial stability.

Review of prudential treatment for STS securitisation under Solvency II

Insurance Europe welcomes the Commission's aim to review the capital charges for STS securitisations under Solvency II. However, a lack of clarity on the changes to the securitisations framework under Solvency II remains. The current reference to Solvency II in the explanatory memorandum seems to indicate a review for only junior tranches of STS securitisations. This would be a very limited scope of work and would not be enough to achieve a better risk-sensitive approach for the calibration of STS securitisation, which are currently unnecessarily penalised under Solvency II.

A more risk-sensitive approach, which would also be in line with a look-through methodology, would include the following revisions:

- Capital charges for STS securitisations (currently type 1 securitisations under Solvency II) should be aligned to those of corporate bonds of the same credit quality step as the STS.
- Capital charges for securitisations of residential loans should be capped at the level of charge applied to the underlying pool of residential loans.
- It should be clarified that a securitisation where the underlying collateral has a guarantee (eg, the US Department of Education can guarantee student loans) should be considered to meet the 5% retained economic interest requirement. Such structures provide investors with more security compared to an issuer retaining a 5% interest in the mezzanine or equity tranche.
- The new capital charges for junior STS securitisations should avoid cliff effects between the senior and junior tranche within the same STS transaction. Under the current Solvency II approach for securitisation capital requirements, the charges imply cliff effects between the senior tranches of high quality securitisations (which may qualify for type 1 securitisations) and a junior tranche of the same securitisation. These cliff effects should be avoided in the review of the securitisation capital charges. The STS status will be a good indication for the qualitative aspects of the securitisation as a whole, while rating differences between the senior vs the junior tranches will implicitly impact the capital requirement. Insurance Europe is, therefore, concerned that the Commission mentions a "non-neutrality factor" for the calibration of non-senior tranches. If the concept of a non-neutrality factor is maintained then, as previously mentioned, it is important that it does not lead to cliff effects, like those under the current Solvency II framework.
- High-quality, senior tranches of STS ABCP should have the same capital treatment as cash.

Insurance Europe believes that the final agreement on the STS framework could take time. This must not be an excuse to delay the immediate review of the current prudential treatment of securitisations under Solvency II which, as it stands, is unnecessarily restrictive and punitive. In the short-term, a number of improvements in the Solvency II approach for qualifying securitisations are needed:

- Recognition of junior tranches as part of type 1, qualifying securitisations.
- Recognition of non-actively managed collateralised loan obligations (CLOs) as part of type 1, qualifying securitisations.
- Consideration of high-quality, senior tranches of short-term ABCP as cash instruments, with similar prudential treatment.
- Review of capital charges for securitisations of residential loans, to be capped at the level of charge applied to the underlying pool of residential loans.

- Review of the capital charges for type 1 securitisations, which should be aligned to the capital charges for corporate bonds.

Definition and scope of STS

The general approach in the STS framework is generally welcome. Insurance Europe particularly supports the aim to define STS securitisations at transaction level. This will ultimately improve the current Solvency II approach in which type 1 securitisations are only represented by senior tranches.

Insurance Europe notes that there is no separate treatment for securitisation transactions between entities of the same group. In such a case it seems appropriate to apply less strict requirements and allow a look through to the underlying assets when determining the capital charges.

In addition, it is welcome that CLOs are not excluded from the definition of STS securitisations. However, the intention of excluding any securitisations that buy or sell loans after the closing date of the securitisation seems too restrictive. Often, CLO managers have the discretion with predefined limits to buy and to sell loans for the first three to four years of the transaction. This discretion is a reason that CLO portfolios had historically lower default rates than the loan market. Therefore, it is necessary to refine the requirement under Article 8 (3) that specifies which CLOs may qualify as STS securitisations.

Accreditation of STS

Insurance Europe is also concerned that the development of a STS framework that does not require third-party certification may give rise to conflicts of interest among sponsors and originators, and would not give investors sufficient confidence in the STS framework.

Insurance Europe appreciates that the Commission proposes to address these conflicts of interest by making originators and sponsors jointly liable for any loss or damage resulting from incorrect or misleading notifications.

However, once the STS framework is designed to replace current Solvency II provisions, Insurance Europe believes that accreditation of securitisations which are in line with qualifying criteria should be done by an independent third-party to avoid any conflicts of interest and encourage investors' trust in the assessment. The ex-post supervisory regime also raises another concern. It is not clear what happens when the competent authority questions whether a securitisation, that an originator or sponsor has designated STS, fulfils the respective requirements. If this resulted in increased capital charges on the side of the investor then the investor would be exposed to the risk of cliff effects due to ex-post supervisory action.

Insurance Europe, therefore, believes that compliance with criteria that have a direct prudential impact should be checked and assessed by an independent, private or public body and could be rewarded by the granting of a label. Third parties should be liable for the assessment and there should be no further requirements for investors beyond the due diligence requirements. Accreditation should become compulsory and delivered before any new issuance.

Insurance Europe would like to stress that regardless of the method of certification selected, investors will continue to perform all necessary due diligence prior to investing in any STS securitisation. The role of the third party would be to limit the duplication of the same verification work by every participant from the investor community as a result of these proposals.

Due diligence requirements

Insurance Europe notes that, as currently drafted, Article 3 of the regulation does not provide sufficient certainty on how it would apply where asset managers act for investors.



The phrase “An institutional investor shall verify before becoming exposed to a securitisation” or “Institutional investors that are exposed to a securitisation shall” does not make it clear who does what when, for example, a Markets in Financial Instruments Directive (MiFID) portfolio manager (definition 8 in Article 4 of MiFID II) may buy a securitisation for an insurance company by exercising discretion.

To provide clarity, Insurance Europe proposes that a clause is inserted that explains how the Article 3 provisions apply where an AIFM, undertakings for the collective investment in transferable securities (UCITS) manager or MiFID portfolio manager is acting on behalf of a UCITS, AIF, insurance company, bank, investment firm or an institution for occupational retirement provision. Insurance Europe envisages that the arrangement would be that the entity making the decision to invest under discretion will need to have the systems and controls in place and carry out the due diligence, rather than the entity which (economically and beneficially) invests in the securitisation.

Such a clarification would help to ensure that each institutional investor client, their advisers, custodians and auditors will not need to duplicate all the due diligence and record keeping requirements as set out in Article 3. Without such clarification the cost of buying and holding securitisations would be significantly increased without any added benefit either to the investor or financial stability.

About Insurance Europe

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