VIEWPOINT

SECURITISATION: A TOOL FOR EUROPEAN GROWTH

MARCH 2014

Securitisation, the bundling of income-yielding assets into tradeable securities, is critical to the effective operation of deep and liquid capital markets. It facilitates the adequate flow of financing to a wide range of industry sectors and businesses of all sizes. At a time when it is critical to spur and sustain economic growth, especially against a backdrop of bank deleveraging in Europe, policymakers are keen to stimulate securitisation markets in the European Union (EU) in order to increase the range of financing opportunities available. However, widely reported problems related to securitisation during the 2007-2008 financial crisis, coupled with some common misconceptions about the practice, have given securitisation a bad name. While securitisation was closely linked with the crisis, it was only certain practices and misuses of securitisation that were the problem. It is important to note that the vast majority of securitisations in Europe performed as expected during the crisis. Lessons have been drawn from this experience – and principles developed – which address these issues. EU law has also taken important steps to tackle a number of the issues. However, further reform should protect the rights of investors and promote economic growth through the use of securitisation.

> *"Reshaping securitisation markets could help unlock additional sources of long-term finance. Subject to appropriate oversight and data transparency, they can help financial institutions free capital, which can then be mobilised for additional lending, and [to] manage risk."*
>
> *— European Commission, Green Paper on "Long-term Financing of the European Economy," published in March 2013*

Securitisation markets have always been considerably smaller in Europe than in the US (see Figure 1 on next page) and have shrunk significantly since the crisis (see Figure 2 on next page). The growth in securitisation structures in the recent past has largely been used by banks to obtain funding from other banks and central banks. We believe it is important to rehabilitate healthy securitisation as a valuable financing tool for European companies, consumers and investors.

SUMMARY OF BLACKROCK'S VIEWS AND RECOMMENDATIONS

Securitisation alone is not a panacea for the European corporate funding gap. However, along with other sources, such as the corporate bond and equity markets, securitisation can be an additional tool for funding European companies.

Healthy securitisation that promotes economic growth can be realised if:

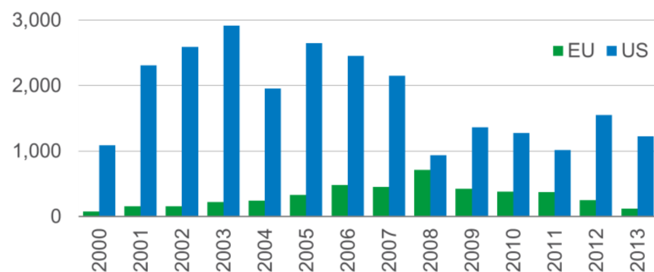
- Securitised product offerings consider and protect the needs of investors as well as those of the originator and sponsors.
- The various policy measures that affect securitisation in Europe are consistent and do not deter the responsible use of securitisation.
- Regulation properly accounts for differences between securitisation and other types of assets.

BlackRock recommends the following global guiding principles for policymakers to both protect the rights of investors in securitised assets and promote economic growth through use of securitisation:

1. Set out high-quality, prudent underwriting standards that are evaluated and administered properly.
2. Establish quality servicing standards.
3. Ensure transparent and accessible asset and transaction information.
4. Ensure conflicts of interest are identified and managed properly.
5. Ensure structures are clear, complete and presented in an understandable manner.
6. Appropriately align originator, sponsor or original lender and investor interests (with originator, sponsor or original lender risk retention, where applicable).

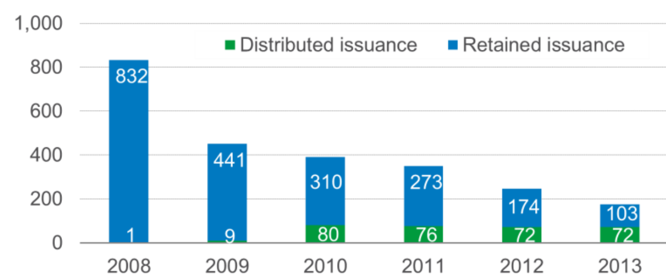
The opinions expressed are as of March 2014 and may change as subsequent conditions vary.

Figure 1: EU AND US HISTORICAL ISSUANCE
(€ billions)



Source: AFME Securitisation Data Report Q4:2012

Figure 2: VOLUME OF SECURITISED ISSUANCE IN THE EU
(€ billions)



Source: JP Morgan

NOTE: Distributed issuance is the volume of issuance placed with end investors Retained issuance is where transactions are structured and retained for actual or potential use as liquid collateral to obtain funding from other banks / central banks

BlackRock has extensive expertise in the fixed income markets and significant client holdings in securitised assets and serves as collateral manager to certain securitised products. Accordingly, we understand the importance of securitisation, not only to our clients, but to global markets broadly. The need to balance stakeholder interests with the orderly functioning of the asset-backed securities markets is critical. This *ViewPoint* seeks to: (i) provide a brief overview of securitisation; (ii) highlight its benefits for companies, investors, banks and the economy; (iii) identify some of the misuses of securitised instruments and the degree to which industry practice and regulation have addressed concerns; and (iv) recommend guiding principles to stimulate the re-emergence of high-quality securitisations.

Overview of securitisation

How is securitisation defined?

This *ViewPoint* addresses term securitisations such as Asset-Backed Securities (ABS), Mortgage-Backed Securities (MBS), Collateralised Loan Obligations (CLO) and Collateralised Debt Obligations (CDO). Although Asset-Backed Commercial Paper (ABCP) is often discussed in the broader context of securitisation and shares many of its benefits, it has a different structure and characteristics (see Appendix A for a description of ABCP).

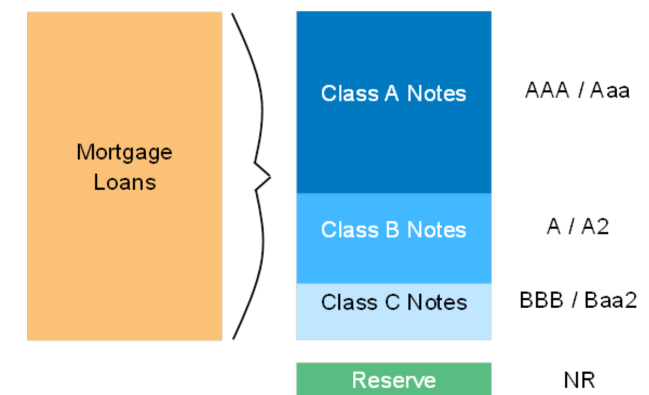
Term securitisation is the practice of repackaging income streams from assets with future cash flows as securities that can be redistributed to investors in tranches (or segments) with varying levels of risk and maturity (see Figure 3 at right).

In general, the higher the risk contained in the tranche, the higher the coupon paid to investors.

The Capital Requirements Directive IV (CRD IV), the Alternative Investment Fund Managers Directive (AIFMD) and the proposed Money Market Fund Regulation (MMFR) define securitisation as: “a transaction or scheme, whereby the credit risk associated with an exposure or pool of exposures is tranched, having both of the following characteristics:

- Payments in the transaction or scheme are dependent upon the performance of the exposure or pool of exposures;
- The subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme.”[1]

Figure 3: TYPICAL NOTE STRUCTURE



Source: BlackRock

1 ABCP does not qualify as securitisation according to this definition but nevertheless is considered as such by many, most notably in discussions on the proposal for **Money Market Fund Regulation**. See Appendix A for further details on the structure and benefits of ABCP.

How does securitisation work?

The process of securitising assets is relatively straightforward. In a typical deal structure, a company such as a bank or financial institution ("originator") sells a pool of assets with future cash flows (i.e., residential mortgages or auto loans) to a Special Purpose Vehicle (SPV). The SPV is typically created specifically for the purpose of the securitisation and is established such that its activities are limited to what is necessary to undertake the transaction. This seeks to ensure that it remains bankruptcy-remote. The SPV ("issuer") funds the purchase by issuing tradable securities, which are sold to institutional investors (e.g. pension funds). Investors receive interest and principal payments generated from the cash flows of the underlying assets.

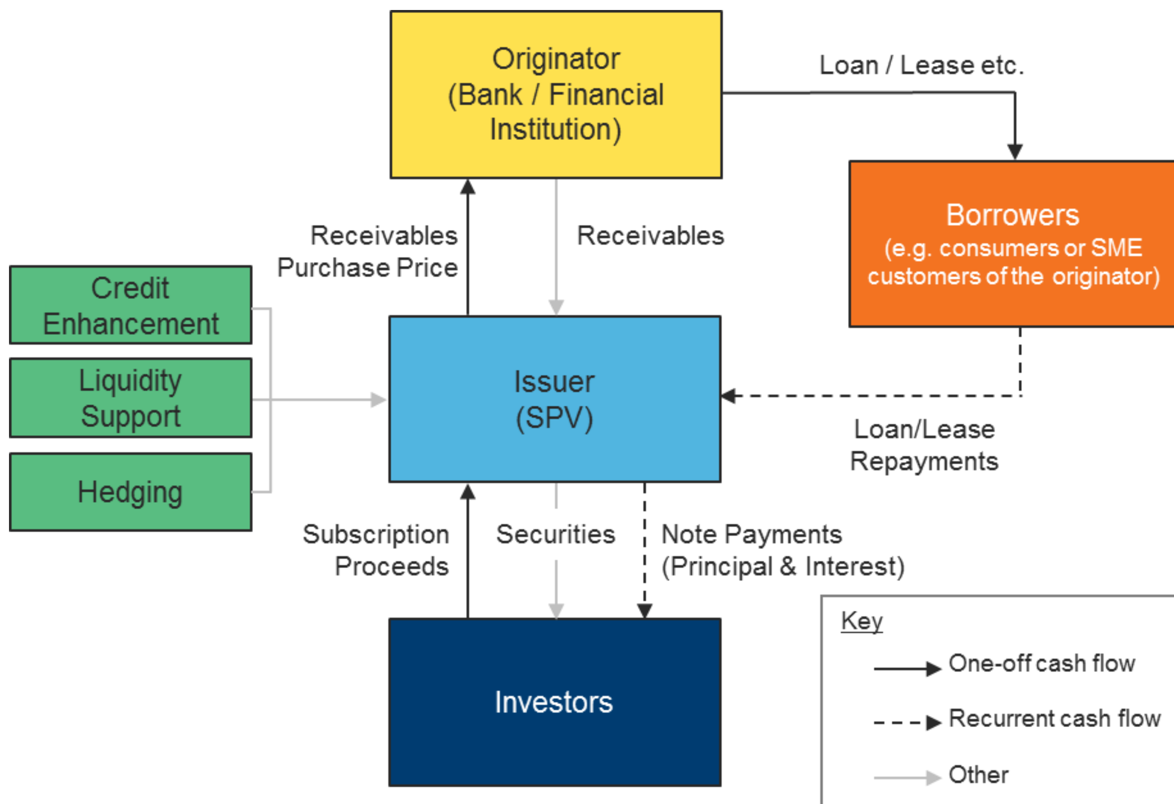
Figure 4 illustrates a typical deal structure. The cash received by the originator in return for the assets can be used to finance the originator's immediate capital needs. Importantly, repayment of securities is solely dependent upon the performance of the assets in the collateral pool – not the performance of the originator. As such, one of the key benefits of term securitisation is that it delinks the credit risk of the securitisation from that of the originator.

"Credit support" or "credit enhancement" is often made available in the structure in an effort to protect investors from some of the credit risk of the underlying assets. Credit enhancements might take the form of reserve funds, excess spread, over-collateralisation, or subordination.

While the process and high level structure of securitisation is similar from one type of securitisation to another, there are many different types of underlying assets that can be securitised – from residential and commercial mortgages and home equity loans, to auto loans, credit card receivables, student loans, equipment loans and more. The performance of these assets is affected by various factors and market dynamics. This results in a diverse range of securitised instruments, each with its own structures and intricacies, which must be understood and considered when formulating regulatory policy.

See Figure 5 on the following page for an overview of some common types of securitisations and their underlying assets and Figure 6 for an overview of current volumes of securitisations by asset type in the EU.

Figure 4: TYPICAL DEAL STRUCTURE



Source: BlackRock

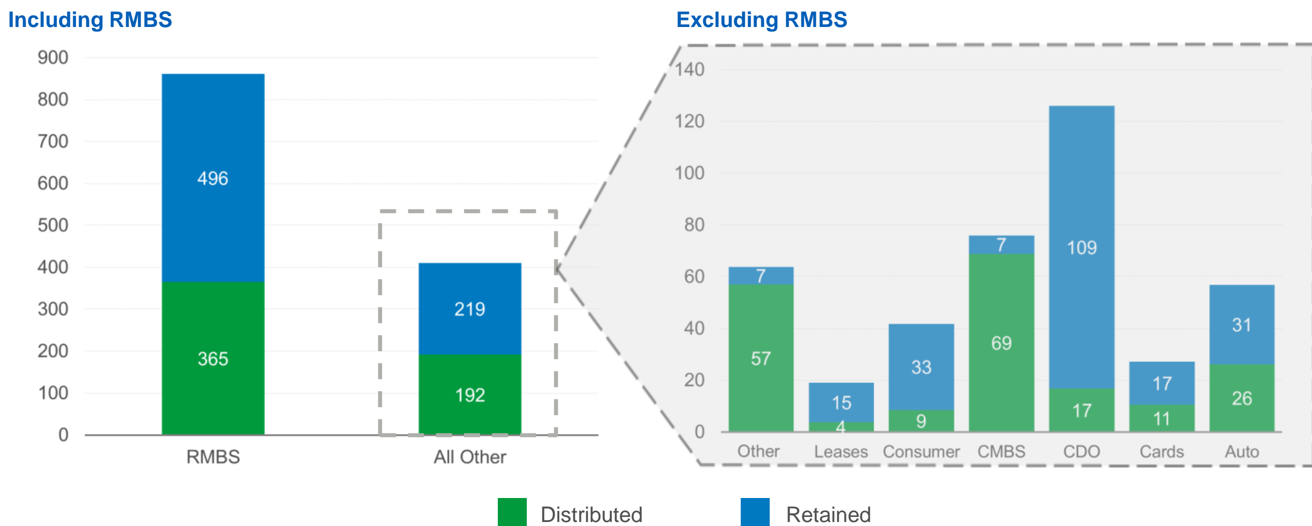
Note – structured credit products such as CDOs, CLOs have slightly different structures whereby assets can have various sources rather than a single origination as in the simplified diagram above.

Figure 5: TYPES OF TERM SECURITISATION

	Asset -Backed Securities (ABS)	Collateralised Debt Obligations (CDO)*	Commercial Mortgage-Backed Securities (CMBS)	Residential Mortgage-Backed Securities (RMBS)	SME Collateralised Loan Obligation (CLO)	Leveraged Loan CLO
Underlying Assets	Auto loans, credit cards, consumer and student loans	Non-mortgage corporate bonds and loans	Commercial mortgages	Large number of pooled residential mortgages	Term loans to SMEs (sometimes incl. revolving credit lines)	Senior secured leveraged loans (sometime more junior loans and bonds)
Structural Characteristics	• Exposure to consumer lending • Losses driven by consumer default or bankruptcies • Commercial leasing deals also offered • Usually limited to investment grade tranches	• Wide variety of underlying credit exposures • Highly tranched often including sale of equity tranche • Currently not generally offered and unlikely to reemerge in the near term	• Losses driven by poorly paying borrowers and falling property values increasing default on non-recourse loans • Structured to maximise upfront cash to sponsor/borrower • Fully tranched • Monetising of risk, including future profits	• Credit characteristics of underlying mortgages key • Losses driven by macroeconomic factors as well as residential property values and accrued interest rates • Typically senior/ subordinate investment grade structures	• Exposed to defaults in the SME market • Performance impacted by economic climate and loan availability & refinancing rate • Sponsor underwriting criteria critical • Typically tranched to investment grade	• Exposed to defaults in the leveraged loan market • Performance impacted by economic climate and loan availability & refinancing rate • Highly tranched often including sale of equity tranche

*Distinct from securitised product CDO
Source: BlackRock

Figure 6: AMOUNT OF SECURITISED ASSETS OUTSTANDING IN THE EUROPEAN UNION (as of December 2013)
(€ billions)



Source: JP Morgan

Benefits of securitisation

Healthy securitisation facilitates companies' access to capital markets.

Securitisation can allow companies access to capital markets at potentially attractive costs relative to other funding alternatives, as the rating on many of the securities issued is often higher than the rating of the originator of the securitisation. This is due to the collateralised nature of the securities issued, the credit enhancement, structural protections and the bankruptcy-remote nature of the issuer. In other words, securitisation allows companies to borrow at rates corresponding to the credit rating of their structured cash flows. Moreover, the benefits of securitisation related to credit risk transfer and cost of funding can often filter down to the underlying originator's customers in the form of more attractive borrowing costs.

Healthy securitisation stimulates investment, lending capacity and liquidity.

Securitisation makes cash flows that would otherwise arise in the future available for immediate re-investment. It also affords companies some relief from asset and liability management challenges for long-term, fixed-rate assets. By bundling up cash-flowing assets and selling them as securities to investors, banks free up capital for additional lending. High-quality securitised assets, either retained or purchased, also serve as liquid collateral for the banks to obtain funding from other banks and/or from the European Central Bank (ECB).

Securitisation potentially increases the availability of highly rated bonds by providing a mechanism to separate highly rated assets from a lower-rated originating entity. This presents investors that wish to (or are required to) invest in only highly rated assets with access to a larger and more diverse pool of investment options. It also allows investors to invest in diversified pools of assets (for example pools of mortgages) without having to bear the credit risk of the company or bank that originally made the loans.

Securitisation can serve as a tool to finance European economic growth.

Securitisation is an important source of market finance and as such can be a valid alternative to bank funding. Along with other sources of financing, such as the corporate bond and equity markets, securitisation could play a role in filling the corporate funding gap that currently exists in Europe. However, it will only do so if investor interests are appropriately considered and protected.

There has been much discussion about the need for small and medium-sized enterprise (SME) funding in the EU, and this discussion has considered securitisation as a way of channeling investor funding to SMEs. While securitisation is a useful tool, there are also a number of challenges that can deter investor interest in this space. For example, the features of SME loans are likely to differ widely across the EU (e.g., in terms of collateral and covenants). This makes credit analysis and the fungibility of securitisation of SME loans very challenging for investors because due diligence models are difficult to apply to the small size and volatile underlying performance of these assets. Information asymmetries are also an issue for investors because loans to SMEs can only be economically originated by banks, given their distribution network. For securitisation of those loans to function effectively, investors would need to have confidence that the asset originators will not adversely select assets against them – putting only lower quality assets into securitised structures.

We note that many securitisations of SME loans over the past few years have primarily focused on banks packaging loans as collateral in order to access the ECB funding window. Recently, there have been a handful of publicly placed deals. Even with increased interest by investors, however, greater standardisation, enhanced transparency and homogeneity in SME lending criteria and policies and less information asymmetry remain key to the growth of this market. Even with these improvements, however, it is important to recognise that securitisation alone will not meet all of the demand for SME financing in the EU.

2007-2008 securitisation experience

Credit troubles in securitisations, which began prior to the 2007-2008 financial crisis, largely stemmed from "originate to distribute" business models where a focus on volume rather than quality resulted in poor underwriting and lending decisions. This was exacerbated by "ratings shopping" among issuers – a practice where sponsors solicit feedback from rating agencies prior to engaging the agency to rate the issue – coupled with some investors relying too heavily upon credit ratings as an indicator of the empirical risk of securities. The result was poor-quality securitisations created and purchased.

Another major problem pertained to certain structured securities which had features such as maturity mismatches with limited liquidity facilities and market value triggers. These structures represented a significant part of the securitisation marketplace before the crisis. During the financial crisis, market liquidity dried up and some types of structured securities could not be refinanced and were forced to sell large volumes of assets to pay investors at maturity, significantly depressing prices. With falling prices, many vehicles breached market value triggers, forcing further asset sales. As securities became less liquid, the result was higher losses for investors, who were unable to realise what they believed to be their fair value. These types of structured vehicles no longer exist. Additionally, structures such as securitised product CDOs, which allowed for the

Figure 7: GLOBAL STRUCTURED FINANCE LOSSES (2000–2011 ISSUANCE) AT YEAR-END 2012

Sector	Sub-sector	Original balance ($bn)	Loss realised	Loss expected
US	ABS	1,782.5	0.06%	0.38%
	CMBS	652.7	0.93%	4.52%
	RMBS	2,686.8	3.49%	6.36%
	SC	372.6	9.03%	23.70%
EMEA	ABS	307.6	0.11%	0.11%
	CMBS	262.9	0.60%	2.76%
	RMBS	2,311.8	0.00%	0.24%
	SC	622.9	0.77%	1.11%
APAC	ABS	44.8	0.05%	0.00%
	CMBS	57.5	0.40%	2.85%
	RMBS	377.8	0.00%	0.00%
	SC	16.5	14.37%	1.00%
Global	All	9,496.2	1.52%	3.34%

SC = Structured Credit – CDO, CLO etc.
Source: Fitch Ratings

Regulation, sound credit underwriting, greater transparency and increased investor focus on credit analysis reduces the risk of poor standards re-emerging in the future.

re-securitisation of lower-rated securities into more highly rated bonds, proved to be very opaque due to multiple layers of risk, which led to somewhat unanticipated losses on highly rated securities. These types of structures are also now obsolete.

Although the US experience with securitisation is well documented, the experience in Europe differs in many ways. Leading up to the 2007-2008 financial crisis, many banks in the US originated and underwrote poor-quality loans (e.g., pools containing subprime and Alt-A mortgages of poor quality) and ABS CDOs that were collateralised with RMBS with the same underlying loans. The performance of these securities has been the key source of concern related to the securitised sector overall.

In contrast, the term ABS and RMBS securities whose underlying loans were made to European consumers did not suffer from the same levels of poor performance, material ratings downgrades or defaults that were experienced in the US. In fact, during and following the market distress from 2007 to 2008, defaults on loans remained low in Europe compared with the US (see Figure 7). For example, Fitch estimates the losses from RMBS issued between 2000 and 2011 to total 0.2% for European-issued RMBS once all the deals mature, compared to 6.4% for US deals.[2] This difference can, at least in part, be attributed to the Consumer Credit Codes established by EU governments, which provided consumers with an incentive to meet their obligations in full.

As such, BlackRock believes that while the US experience is instructive, regulating European securitisations solely on the basis of the poor performance of certain US securitisations is a flawed approach that would unnecessarily and disproportionately impair the European economy. Regulation, sound credit underwriting, greater transparency and increased investor focus on credit analysis reduces the risk of poor standards resurfacing in the future.

In addition, the Regulation on Credit Rating Agencies III (CRA III) regulates the CRAs to ensure they do not come under pressure from sponsors. Finally, re-securitisation (where it is permitted) comes under great scrutiny and is subject to risk retention by the originator, sponsor or original lender .

EU regulatory framework for securitisation

BlackRock supports the public policy aim of retooling securitisation to encourage sustainable and inclusive growth. We broadly commend the positive steps policymakers are taking. These include:

- The European Commission's Green Paper on "Long-term Financing of the European Economy," which argues for rehabilitation of securitisation as a valuable tool for the real economy. Specific measures to achieve this are expected in the Long-Term Investment Plan, which the European Commission is expected to publish in March 2014.
- The SME and Infrastructure Financing report drafted by the ECOFIN High Level Expert Group.
- The ECON's initiative report on the Long-Term Financing of the European Economy.
- The ECB's review of its risk-control framework, which allows for a new treatment of and reduced haircuts for ABS eligible under the permanent and temporary Eurosystem collateral framework.
- The European Commission Liikanen working group initiative on bank structure, which defines criteria for safe securitisation.

2 This is illustrated by a July 2013 S&P report on European Structured Finance in which a historical record of the performance of European consumer obligations was compiled showing that European consumer ABS pools have performed at a very high level unlike pre-financial crisis US non-agency RMBS pools and securitisations (including ABS CDOs collateralised by US non-agency RMBS). The report states that consumer-related securitisations in the EU have had cumulative default rates since mid-2007 of just 0.04%, compared with 4.68% for corporate loans.

However, the regulatory framework around European securitisation is very complex and fragmented. The originators/sponsors of and potential investors in securitisations are faced with the immense logistical challenge of implementing a myriad of new regulations. Securitisation is regulated in no fewer than 10 pieces of European legislation (see Appendix B) in ways that are sometimes inconsistent from one piece of legislation to another. The result is not supportive of relaunching securitisation.

We recommend policymakers to focus on creating a comprehensive and consistent regulatory framework to both protect investors and to spur healthy securitisation markets. We believe that regulation should recognise that securitisation is a funding method as well as a diverse asset class and, as such, must properly account for differences between securitisation and other types of assets. It is key that policymakers provide properly calibrated incentives for investors to allocate capital to securitised instruments, in the area of prudential capital.

For example, Solvency II rules for insurance companies will significantly increase the amount of capital that such companies are required to put aside for certain securitised exposures. This is likely to deter investors from allocating capital to securitisation structures.

Similarly, under Basel III, the Liquidity Coverage Ratio (LCR) allows for the inclusion of highly rated RMBS as long as the underlying loans have a Loan to Value Ratio (LTV) that is below 80% and all the loans are full recourse. This will help stimulate securitisation. However, the requirement of an LTV below 80% is a rather arbitrary measure of risk, focusing on just one predictor of default out of many. This rule has the effect of excluding pools (such as Dutch RMBS) that historically have low losses, but potentially allowing pools of borrowers with impaired credit who may have lower LTV loans but are arguably higher risk.

Another concern for investors is related to the AIFMD requirement for managers of Alternative Investment Funds (AIFs) and, potentially in the future, UCITS managers to ensure that securitisations in which they invest meet the 5% retention limit. Compliance with this requirement becomes problematic for non-EU issued securitisations where there are not equivalent retention rules. Managers will not be allowed to buy non-EU securitised notes without an equivalent regime. This will be detrimental from an investment diversification perspective. In case managers are holding securitisations that do not meet the 5 % retention limit, managers need to undertake ‘corrective action as is in the best interests of the AIF’ amongst which are hedging and selling at a time when price is not too far from what they perceive to be their fair value. All of this is likely to deter managers from investing in securitisations.

We applaud the steps that have been taken so far by regulators to encourage the reemergence of securitisation. We have noted, however, that there are still a number of inconsistencies within the securitisation regulatory framework that are being debated currently. BlackRock calls on regulators to streamline future reforms related to securitisation and develop them in accordance with a set of global guiding principles, which we highlight below.

Global guiding principles for securitisation

While we recognise that there is variation in the existing regulatory framework across EU jurisdictions and between the regional markets for securitised products, we believe the guiding principles outlined below can serve as a useful tool for policymakers to promote a sound, consistent and streamlined regulatory framework that protects the rights of investors and preserves the practice of securitisation as a valuable tool to promote economic growth in Europe and globally. Nevertheless, these principles cannot be a substitute for investors’ robust credit evaluation and structural analysis. Investors should still continue to do their own due diligence.

1. **High-quality, prudent underwriting standards that are evaluated and administered properly.**

   The funding and securitisation process must start with the introduction of high-quality underlying receivables. Underwriting standards must be prudent, as well as evaluated and administered properly and disclosed.

2. **Quality servicing standards should be established.**

   Servicing agreements should clearly lay out the responsibilities of the servicer in ensuring the receivables are serviced in accordance with good market practice and all relevant regulatory requirements and codes of conduct. Clear reporting requirements are needed for all aspects of asset performance (including borrower and/or originator fraud in addition to the regular arrears/loss, etc. detail) and cash flows.

3. **Transparent and accessible asset and transaction information.**

   Investors should have timely and accurate information on the composition and performance of the asset pool, both at the point of issuance and on an ongoing basis. Investor reports should include detailed liability side reporting, allowing all cash flows to be reconciled, as well as details on how the securitisation satisfies any specific regulatory requirements. All underlying transaction documents should be freely available to current and prospective investors.

The availability of information on an ongoing basis is critical to developing a liquid secondary market to allow future purchasers to adequately assess securitisation programmes. It is critical that information be made available on a timely basis through means that are not impacted by any conflict with or control by the sponsor, the servicer or other parties to the transaction.

Transparency of information will benefit investors, sponsors and servicers by equalising the data evaluated as part of the investment decision-making process at issuance and during the ongoing servicing of the assets. While we understand the need to protect the confidentiality of certain asset data, this need for protection should be balanced against investors' need for accurate information.

4. Conflicts of interest should be identified and managed properly.

Any potential conflicts between the sponsor and/or the servicer and investors should be clearly identified and their impact should be mitigated through careful commercially documented terms that are fully disclosed. The potential conflicts that may arise over time between different classes of holders in the asset-backed transaction should be recognised and contractual procedures to address such conflicts should be identified and clearly disclosed. This includes full and democratic dissemination of information to decrease the impact of any information arbitrage between the parties.

5. Structures should be clear, complete and presented in an understandable manner.

Excessive tranching and complicated payout rights make it difficult for investors to assess likely risk and return, especially in times of market stress, and should be mitigated. Given that the ability to analyse and demonstrate understanding of securitised vehicles is a fundamental requirement for investors (as made more explicit in EU regulations such as AIFMD, Solvency II and the latest Basel rules), disclosure of all structural characteristics to investors should be clear and complete. Credit enhancement and structural features such as hedging and liquidity provision should be appropriately designed to mitigate the risks in the transaction.

6. Appropriate alignment of originator, sponsor or original lender and investor interests.

Recognising that securitisation is a risk transfer between the sponsor and the investors in the resultant securities, it is critical to have full and clear disclosure of the nature of all risks being transferred, both at the asset level and as a consequence of the structural characteristics of the securitisation's terms. Accountability has been promoted to some extent through the implementation of credit risk retention by originator, sponsor or original lender.

These principles for sound regulation are not a substitute for investors' robust credit evaluation and structural analysis nor will they prevent losses on securities that do not perform as anticipated. However, they do provide a framework that ensures investors have protections against potential abuses as well as the tools necessary to understand the risks involved. We believe this will, in turn, encourage greater investor interest in securitisation.

Importantly, there is no one-size-fits-all approach. Differences exist between securitised products, and flexibility in the rules is required to account for these differences so as not to inhibit the emergence of new types of securitisations. Different jurisdictions will also require there to be differences in structures.

Conclusions

The experience of 2008 and the events leading up to it point to the fact that securitisation as a technology was not ever broken but that sound due diligence principles were lacking or not adhered to. When deployed appropriately, securitisation is an important tool that facilitates sound, robust and efficient capital markets. It affords significant benefits to originators, sponsors and investors, with positive implications accruing to the real economy. Securitisation can play a key role in financing growth in Europe. Going forward, securitisation practices should reflect the lessons learned and incorporate sound principles that properly align all stakeholders' interests and protect investors. It is vital that policies and the regulatory framework be coordinated and consistent to facilitate the relaunch of a healthy securitised products market.

RELATED CONTENT

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ViewPoint - Credit Rating Agencies: Reform Don't Eliminate, July 2013
Green Paper on Long Term Financing of the European Economy, European Commission, June 2013
Credit Risk Retention, Letter to Regulators, July 2011

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APPENDIX A: ASSET-BACKED COMMERCIAL PAPER (ABCP)

ABCP shares some similarities with term securitisations in certain structural characteristics and assets in the underlying pool as well as in the benefits it affords to the capital markets and overall economy. However, according to the CRD IV definition of securitisation, ABCP does not qualify as securitisation because the primary reliance for repayment of the notes is not on underlying assets but on the bank sponsor. More importantly, the notes issued by the conduit are not tranched. The main characteristics of ABCP are:

- The underlying assets are highly diverse and can comprise commercial and consumer receivables arising from trade, auto loans/leases, equipment loans/leases, and prime residential mortgages.
- The primary credit consideration for an investor is the strength of the sponsor who provides a liquidity facility to ensure timely repayment of principal and interest. This allows the pools to include assets with longer maturity than the ABCP conduits, for example five-year auto loans and leases, with important benefits for the real economy.
- The bank that sponsors the ABCP programme dynamically manages the asset pools with the asset pool seller (such as a car manufacturer) to ensure the pools are of very high quality (typically deemed or actual rating of "AA-" or higher)

ABCP is a capital-efficient way for banks to provide working capital finance to their corporate clients. The type of companies typically benefitting from funding via ABCP conduits are SMEs and non-rated firms with limited direct access to capital markets. ABCP allows banks to finance the loans and receivables of SMEs from a broad range of countries in which they might find difficult to lend to directly. The significance of this role is demonstrated by the fact that some ABCP conduit pools benefit from supranational guarantees.

It is important to distinguish ABCP as described above from those structures that experienced significant issues during the financial crisis, such as Structured Investment Vehicles (SIVs) and SIV-Lites, which largely no longer exist.

APPENDIX B: OVERVIEW OF THE REGULATORY FRAMEWORK COVERING SECURITISATIONS

Following is an overview of the 10 different pieces of legislation covering securitisation. We outline whether and how each promotes the emergence of healthy securitisation and how our guiding principles can be fit for purpose for each of them.

REGULATION OF SECURITISATION IN EUROPE

INITIATIVES PROMOTING HEALTHY SECURITISATION	
CRD II	▸ Allows credit institutions to invest in securitisations only: (i) if they gain evidence that the originator, sponsor or original lender will retain at least 5% of the net economic interest; (ii) if it has a thorough understanding of all structural features of the transaction and, (iii) if it has undertaken specific due diligence, has processes in place to analyse and record information on positions and monitors and stress-tests its positions on an ongoing basis. ▸ **This is in line with our guiding principles and promotes healthy securitisation and ensures alignment of interests.**
Long-Term Financing Green Paper	▸ Aims to rehabilitate securitisation's capacity to free up bank balance sheets and asks how the securitisation market in the EU might be revived in order to achieve the right balance between financial stability and the need to improve maturity transformation by the financial system. ▸ **Our guiding principles encourage healthy securitisation that finances EU economic growth**.
Bank Structure	▸ Banking groups allowed to continue engaging in sponsorship of securitisation that fulfills certain minimum criteria to be considered as high quality based on the following: 1. the structural features, such as the embedded maturity transformation and simplicity of the structure 2. the quality of the underlying assets and related collateral characteristics 3. the listing and transparency features of the securitisation and its underlying assets 4. the robustness and quality of the underwriting processes ▸ **The criteria are in line with our guiding principles and promote healthy securitisation. However, we question the definition of "simplicity of the structure" in the first criterion. Simplicity of structure does not necessarily make securitisation safer, and complexity as opposed to simplicity does not necessarily mean risky or not understandable for investors as long as disclosure of all structural characteristics and embedded results to investors are clear and complete.**
ECB collateral rules on hair-cuts for ABS	▸ Allows for a new treatment of ABS in their risk control framework and reduces the haircuts applicable to ABS eligible under the permanent and temporary Eurosystem collateral framework. ▸ **Encourages the rehabilitation of securitisation**.

APPENDIX B: OVERVIEW OF THE REGULATORY FRAMEWORK COVERING SECURITISATIONS

REGULATION OF SECURITISATION IN EUROPE (continued)

INITIATIVES THAT NEED FURTHER REVIEW	
AIFMD	• An AIFM and, potentially in the future, a manager of UCITS will only be permitted to assume exposure to the credit risk of a securitisation on behalf of one or more AIFs it manages if the originator, sponsor or original lender for that securitisation has explicitly disclosed to the AIFM that it retains, on an ongoing basis, a material net economic interest, which in any event, shall not be less than 5%; it has ensured that the sponsor and originator meet certain qualitative requirements; and it is able to demonstrate that it has a thorough and comprehensive understanding of the securitisation. • This is in line with all our principles. However, there is a need for the implementation or recognition of an equivalent regime in third countries for non-EU issued securitisations in which managers of AIFs and UCITS invest.
CRD4/R **EBA Level 2 measures on LCR**	• 'AA'-rated or higher RMBS eligible for the LCR as long as underlying loans have a LTV that is < = 80% and all the loans are full recourse. • This helps stimulate securitisation as a safe tool to increase liquidity. However, obligation to have a Loan to Value Ratio (LTV) that is below 80% is arbitrary. There are many factors that determine risk, of which LTV is just one. This rule has the effect of excluding pools (such as Dutch RMBS) that have historically low losses, but potentially allowing pools of borrowers with impaired credit who may have lower LTV loans but are arguably higher risk.
Risk Weighted Asset (RWA)/ Basel III	• RWA calibration in credit institutions' balance sheet has an overly broad "one-size-fits-all" approach, treating securitisation as an asset class rather than a financing method that can be used for different types of risks. • Potential adverse impact on investment in securitisations. Policymakers should consider our guiding principles when deliberating on the RWA calibration for securitisations.
Solvency 2/ EIOPA	• Increases significantly the amount of capital that insurance companies will have to put aside for certain securitised notes. • Likely to disincentivise insurance companies from investing in securitisations.
Money Market Funds (MMFs)	• MMFs would only be able to invest in securitised assets where underlying exposure consists exclusively of corporate debt, and with a legal maturity at issuance of 397 days or less and a residual maturity of 397 days or less. This prohibits MMFs from investing in ABCP as they invest in both corporate and consumer debt. • If this strict interpretation is maintained, then EU Bank-sponsored ABCP conduits will cease issuing any ECP and flip all funding to the USCP market as IMMFA MMFs represent over 75% in ABCP, an important and growing form of working capital support for companies in the EU.
Shadow Banking	• The intensifying focus on "shadow banking" could easily have indirect consequences on securitisation volumes, by limiting the attractiveness of repo of ABS or the investment appetite of MMFs. • Policymakers should take all our principles into consideration when deliberating on a regulation of securitisation as part of the "shadow banking" debate.

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