

Finance Watch response to EBA's consultation on simple, standard and transparent securitisations

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Finance Watch is an independent, non-profit public interest association dedicated to making finance work for society. It was created in June 2011 to be a citizen's counterweight to the lobbying of the financial industry and conducts technical and policy advocacy in favour of financial regulations that will make finance serve society.

Its 70+ civil society members from around Europe include consumer groups, trade unions, housing associations, financial experts, foundations, think tanks, environmental and other NGOs. To see a full list of members, please visit www.finance-watch.org.

Finance Watch was founded on the following principles: finance is essential for society and should serve the economy, it should not be conducted to the detriment of society, capital should be brought to productive use, the transfer of credit risk to society is unacceptable, and markets should be fair and transparent.

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Only the questions that are relevant to Finance Watch are reproduced here.

For further questions, please contact Frédéric Hache, head of policy analysis at Finance Watch, at frederic.hache@finance-watch.org.

Question 1:

Do you agree with identified impediments to the securitisation market?

We do agree with the identified impediments to the securitisation market, although we do not see all of these as problematic.

Some of these impediments are positive developments in our view, such as *“the increased share of customer deposits in funding the balance sheet [that] has contributed to reducing the need for market-based funding”* and the decline of leveraged money investors and maturity transformation.

Question 2:

Should synthetic securitisations be excluded from the framework for simple standard and transparent securitisations? If not, under which conditions/criteria could they be considered simple standard and transparent?

Yes, synthetic securitisations should be excluded from the framework for simple, standard and transparent securitisations.

Question 8:

Do you agree with the proposed criteria defining simple standard and transparent securitisations? Do you agree with the proposed credit risk criteria? Should any other criteria be considered?

We do agree with the proposed criteria defining simple standard and transparent securitisations. In particular we welcome the non-reliance on external ratings and the absence of maturity transformation.

We hope that criterion 4 *“the securitisation should be backed by assets that are homogeneous in terms of asset type, currency and legal system under which they are subject”* will be interpreted in such a way that there can be only one type of asset in the pool of qualifying securitisations, in order to ensure homogeneous cash flows. This would also be consistent with the definition adopted in the recent European Commission Delegated Act on Solvency II.

We believe, however, that one other criterion should be added: qualifying securitisations should not be allowed to use tranching. As discussed in our recent position paper¹ (cf. pages 35, 42, 43, 59) tranching creates model uncertainty and manufactures complex risks that are very hard to assess. It amplifies the impact of mistakes in the assessment of underlying asset default risk and correlation. It also creates additional procyclicality, enables more risk taking and reduces banks' ability to play a countercyclical role. It increases the length of credit intermediation chains and creates conflicts of interests. Lastly, it attracts as well less informed investors who are more likely to neglect tail risks.

¹ A missed opportunity to revive “boring” finance? <http://www.finance-watch.org/our-work/publications/998>

A recent BIS paper² called “Securitisations: tranching concentrates uncertainty” found that “*even when securitised assets are simple, transparent and of high quality, risk assessments will be uncertain. (...) Substantial uncertainty would remain and would concentrate in particular securitisation tranches. Despite the simplicity and transparency of the underlying assets, these tranches would not be simple.*”

Lastly, on the argument that tranching enables the creation of securities that fit investors' preferences, we accept that non-tranched securitisations might find less appetite from institutional investors due to the lower proportion of investment grade securities created. However this would raise the case to refocus, where needed, investment mandates on the true drivers of risk and return, which would admittedly be a more ambitious undertaking but a much healthier one. The less that assets are transformed, the lower the risk that investors suddenly doubt the quality of their assets in times of stress.

Question 9:

Do you envisage any potential adverse market consequences of introducing a qualifying securitisation framework for regulatory purposes?

A potential adverse market consequence of introducing a qualifying securitisation framework for regulatory purposes could be to indirectly strengthen the central role of collateral in our financial system: a renewed popularity of securitisation would create more assets that can be used as collateral and promote securities financing. In turn this could lead to additional procyclicality, interconnectedness and negative externalities, as discussed (on page 77-80) in our recent position paper³.

As there are still no credible countercyclical private backstops and as it would not be desirable to extend public safety nets any further to avoid increasing moral hazard, we should be wary of such a development.

More generally as much as collateralised funding is useful in times of stress when trust disappears very quickly, it would be very unhealthy in our view to make collateralised funding the new norm. We should work instead to promote unsecured lending.

Question 10:

How should capital requirements reflect the partition between qualifying and non-qualifying?

While we understand the objective of limiting the non-neutrality of capital charges, we believe that the capital charge on the most senior tranche at the Credit Quality Step 1 level should remain substantially higher than that of CRR-compliant covered bonds, to reflect their higher risk, not for only an individual institution but also for the financial system.

² BIS, Antoniadou, A. and Tarashev, N., *Securitisations: tranching concentrates uncertainty*, BIS Quarterly Review, December 2014f, pp. 37-53

³ A missed opportunity to revive “boring” finance? <http://www.finance-watch.org/our-work/publications/998>
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