



# Eurosystem contribution to the European Commission's targeted consultation on the functioning of the EU securitisation framework

## General remarks

### **The European Central Bank (ECB) welcomes the European Commission's targeted consultation on the functioning of the EU securitisation framework.**

Securitisation allows risk to be distributed across market participants, opening up investment opportunities for investors and freeing up capital for originators. After the progress made following the reforms implemented in the aftermath of the great financial crisis, this consultation is an important building block in the EU's plans to establish a capital markets union (CMU), with green securitisation playing a key role in unlocking funding for sustainable projects and contributing to the creation of a green CMU.<sup>1</sup>

In its CMU action plan published on 24 September 2020, the Commission committed to review the current regulatory framework for securitisations. **The review is an important opportunity to reflect on the lessons learned during the first years of the framework's application.** The experience gained by the ECB – as an investor in the asset-backed security (ABS) market through its asset purchase programmes, a collateral taker in its credit operations and as the competent authority for directly supervising significant credit institutions – suggests that improvements are needed to support a more effective securitisation market.

**A well-functioning securitisation market is crucial for European banks, as it enhances their capacity to channel lending to the real economy, provides them with additional funding and allows risk to be transferred to investors.** European banks use securitisation as a strategic tool to manage both capital and funding. To achieve capital relief, securitisations require a positive significant risk transfer (SRT) assessment from the competent authority. Funding securitisations, on the other hand, provide liquidity to originators while giving them room to retain the risk and rewards of the underlying exposures. Originators are constantly innovating to make securitisation a more effective and efficient tool to manage capital and funding. This calls for an enhanced regulatory framework that strikes the right balance between business viability and prudential aspects and incentivises prudentially robust securitisations.

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<sup>1</sup> The current regulatory framework applicable since January 2019 consists of the [Securitisation Regulation](#) – which sets out a general framework for all securitisations in the EU and a specific framework for simple, transparent and standardised securitisations – and the prudential requirements for securitisation positions laid down in the [Capital Requirements Regulation](#) and in Solvency II. The framework was complemented on 6 April 2021 by some amendments to foster the post-coronavirus (COVID-19) economic recovery through the extension of the simple, transparent and standardised label to synthetic securitisations and by addressing regulatory obstacles to securitising non-performing exposures.

**The ECB recognises the importance of the Commission’s strategic objective to scale up the securitisation market.** To achieve this, the regulatory framework should be flexible enough to accommodate the diverse securitisation business models followed by European banks. This would support a deeper pool of originators on the supply side of the market and ultimately unlock the potential of this market to better support lending to the real economy.

**The new prudential regulatory framework might include targeted improvements of the framework’s risk sensitivity to further enhance the differentiation between the actual risk profile of underlying asset pools, structural features and model and agency risks stemming from information asymmetries.** Many technical and structural features can affect securitisation performance and, in turn, the capital position of originators and the risk held by investors. A more risk-sensitive prudential treatment would better reflect risks and thus enable better calibration of capital requirements.

**The Eurosystem maintains its general stance of supporting the transparency of the securitisation market and continues to see strong merits in the existing loan-level data disclosures.** As a reminder, the ECB has led the way in introducing loan-level data templates, which have been, and will continue to be, a key requirement for ABSs to be eligible as collateral for Eurosystem credit operations and for purchases under its asset purchase programmes. From October 2021 compliance with Eurosystem loan-level requirements will be assessed using European Securities and Markets Authority (ESMA) loan-level templates. At this stage it seems premature to significantly modify these requirements given the limited experience gained by investors and issuers alike. Conversely, in the light of the objective to scale up the securitisation market, it is also important to find a balance between regulatory stability and additional data requirements, so as not to deter potential issuers from (re-)entering the securitisation market.

**The Eurosystem supports the Joint Committee of ESAs’ recommendation to carry out further analysis on the requirements to report required disclosures to securitisation repositories in the case of private securitisations.** In its supervisory capacity, the ECB will begin to exercise its prudential powers in relation to the disclosures of significant credit institutions and would welcome clarifications to make it as efficient and risk-based as possible.

**Notwithstanding the above, the Eurosystem sees merit in improving the disclosure of sustainability information on securitisations.** The Eurosystem considers that current sustainability disclosures have quality issues owing to poor data quality and a lack of standardisation, making it difficult to analyse and compare the environmental performance of the underlying assets in different securitisations. Reliable and harmonised information on the environmental performance of securitisations will become even more valuable for the Eurosystem in the future. Following the recent strategy review, climate change considerations will be further incorporated into the monetary policy framework.

**The ECB would welcome an assessment of the track record of market liquidity for simple, transparent and standardised (STS) securitisations and asset-**

**backed commercial papers (ABCPs) for the liquidity coverage ratio (LCR).** This track record could be analysed with a view to revising the existing criteria for including this type of asset in the LCR buffer in the light of the new European securitisation framework.

**Work should continue on prudent safeguards for robust SRT securitisations to avoid so-called flowback risk.** Banks under European banking supervision rely on the capital benefits achieved via securitisation programmes. In synthetic transactions, the originator willing to obtain SRT retains a thick senior tranche while selling a thin junior or mezzanine tranche(s) (i.e. the protected tranche(s)). If losses exceed the size of the protected tranche(s), the capital position of originators can be quickly eroded, as losses would start affecting the senior tranche. The speed of the capital impact on the senior tranche could be very high considering the non-linearity and leverage of securitisation structures. This calls for prudent SRT tests to insulate the senior tranche from losses while maintaining a margin of transferred losses over capital relief. Furthermore, ensuring that originating banks in the securitisation market have a robust capital position requires not only a positive SRT assessment at origination but also that banks carry out ongoing monitoring of SRTs to track any impact on their capital position, business viability and risk management.

**The changing nature of structural features in SRT securitisations calls for an enhanced regulatory framework that provides sufficient room for supervisors to review these transactions without being constrained by overly rigid fixed timelines.** On the supervisory side, securitisation is considered as part of the broader Supervisory Review and Evaluation Process (SREP). Securitisations can affect a bank's risk profile, capital, liquidity and governance as assessed by bank supervisors through the SREP. SRT assessments **should not follow a “one-size-fits-all” approach.** Supervisors should be able to conduct case-by-case assessments within a general regulatory framework while also considering both the role of securitisations in the comprehensive bank-level supervisory analysis and all relevant risk information about the securitisation transaction.

## Specific remarks

### 1 Investor due diligence

**As an investor in ABS transactions under its asset-backed securities purchase programme (ABSPP), the Eurosystem follows a due diligence procedure<sup>2</sup> before investing, similar to the procedure required of European financial institutions by the Securitisation Regulation.** It conducts due diligence to ensure that its purchase decisions are taken based on thorough analysis and in line with best market practices, just like any other ABS investor.

**Against this background, the due diligence requirements set out in the Securitisation Regulation appear proportionate and ensure that a conscious and informed investment decision is taken before a potential purchase of an ABS.** At the same time, the Securitisation Regulation provides for enough flexibility to adjust the analysis to the risks which are most relevant to a particular transaction.

**As the competent authority, the ECB assesses how significant institutions conduct due diligence when acting as investors.** Before investing in securitisations, banks under European banking supervision conduct due diligence analysis comprising a wide range of elements, from risk, return and structural features to liquidity and capital consumption. Potential concentration limits are also reviewed. Furthermore, banks critically review the information on the underlying assets and run stressed cash flow analyses. Therefore, it appears that banks acting as investors in securitisations are complying with the current due diligence requirements.

#### 1.1 Loan-level data requirements

**The ECB considers the ESMA loan-level data disclosure requirements to be in line with the Eurosystem's loan-level data requirements, and therefore supports the requirements foreseen in the Securitisation Regulation.** In this context, the Eurosystem loan-level data requirements will converge towards the disclosure requirements specified in the Securitisation Regulation, namely by

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<sup>2</sup> The Eurosystem follows a two-step assessment approach before conducting any ABS purchase. First, an ABS needs to meet the Eurosystem's collateral eligibility criteria. If it does, a due diligence assessment is carried out. The documentation requirements and due diligence procedures are laid down in the ECB Guideline (ECB/2014/60) and the ECB Decision on the ABSPP (ECB/2014/45). Several documents and sources of information are needed, including but not limited to the prospectus, the loan-level data file, two public ratings with the new issue report, the modelling in a standard third-party ABS cash-flow modelling tool, regular surveillance reports and investor reports.

The Eurosystem due diligence is carried out on this documentation and follows the high-level principles published on the [ECB's website](#), which set out preferences regarding the asset pool, the underwriting criteria, the transaction structure, the originator, interest rate risk mitigation, transaction documentation provisions and transaction transparency.

accepting ESMA reporting templates and ESMA-registered securitisation repositories as of 1 October 2021 for all eligible ABS transactions issued on and after 1 January 2019.<sup>3</sup>

In line with the Eurosystem collateral framework, the ECB analyses six ABS categories as part of its due diligence: ABSs backed by residential mortgages, loans to small and medium-sized enterprises (SMEs), auto loans, consumer finance loans, leasing receivables and credit card receivables. **Generally, the loan-by-loan information disclosures are considered useful for all of these asset classes.** The standardised loan-level data templates allow for systematic analysis of the underlying pool and facilitate comparison across transactions and the identification of outliers. These data are not only used for due diligence assessments, they are also used for monitoring purposes following an ABS purchase under the ABSPP.

Of the asset classes considered, the disclosure requirements apply to all maturities. However, for longer maturities experts have raised concerns about whether all fields are always updated on time.

## 1.2 Private securitisations

**The ECB would welcome a European Banking Authority and ESMA assessment of the data disclosure requirements for private securitisations, which, unlike public transactions, are not required to be made available through a securitisation repository.** On the one hand, it could be argued that a different approach for private transactions may impede transparency, high-quality data and the supervision of compliance with Article 7 of the Securitisation Regulation. On the other hand, the market investors participating in single private transactions tend to be sophisticated and small in number, and normally require data disclosures that go beyond those prescribed by the Securitisation Regulation. The assessment should define what a private transaction is for the purpose of data disclosures required by the Securitisation Regulation.

The Eurosystem supports the Joint Committee of ESAs recommendations to carry out further analysis on the requirements on reporting to securitisation repositories for private securitisations.

From the perspective of monetary policy implementation, loan-level data and disclosure requirements will continue to be a key ECB collateral eligibility requirement for all securitisations.

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<sup>3</sup> See “[Changes to the Eurosystem’s loan-level data requirements](#)”, ECB press release, 28 June 2021.

## 1.3 Disclosures under Article 7 of the Securitisation Regulation

**The ECB considers that the disclosures under Article 7 are sufficient for an investor to independently assess a traditional ABS.** In particular, Article 7 largely covers the transaction documentation required to assess the eligibility of an ABS as Eurosystem collateral and for the ABSPP. In addition to the documentation set out in Article 7, the Eurosystem requires specific inputs, such as ratings and new issue reports from an agency recognised in the Eurosystem credit assessment framework or modelling in a third-party cash flow modelling tool.

**The ECB considers that the level of information required under the ESMA templates in relation to loan-level data is in line with the Eurosystem data requirements for ABSs submitted as collateral for Eurosystem credit operations.** These requirements have been carefully calibrated and have proved useful over the decade loan-level data have been required for ABSs. In addition, a lot of the documentation that has to be disclosed is also required by the Eurosystem for collateral eligibility assessments, such as transaction contractual documentation. Consequently, the Eurosystem has found many of the required disclosures useful, and indeed necessary, for its monetary policy operations, whether in collateral eligibility assessments or for due diligence purposes before ABSPP purchases.

The usefulness of the additional information required under the Securitisation Regulation beyond loan-level data has not yet been specifically assessed by ECB staff.

**The Eurosystem has led the way in establishing loan-level data requirements for the ABS asset class.** In this vein, the ECB has always welcomed further disclosures and greater transparency and it continues to believe that the data and documentation requirements help both investors and third-party assessment providers with their due diligence. In this context, simplifying this relatively new disclosure regime seems premature, especially as ESMA has only recently (in June 2021) registered the first two securitisation repositories. Therefore, the Securitisation Regulation transparency regime only became fully operational in mid-2021. Consequently, any limiting changes might lead to an unwarranted loss of transparency for this asset class, depending on how they are implemented.

## 2 Sustainability disclosure

**The ECB considers that there are still barriers to incorporating environmental, social and governance (ESG) considerations when investing in securitised products.** Relevant ESG information on underlying assets is often only available at the discretion of the originator, lacks uniformity and is not comprehensive. Owing to the lack of standardised information, the ECB observes that originators often refer to their own measures of environmental performance or try to refer to external labels to communicate the environmental qualities of the asset pool. The lack of standardisation makes it difficult to analyse and compare the environmental

performance of the underlying assets in different securitisations. This is sometimes exacerbated by the complexity and diversity of the underlying assets and the diversity of sectors, which makes it difficult to build proprietary ESG frameworks. The lack of coverage by third-party ESG information providers is also an obstacle. Finally, greater harmonisation in ESG disclosures for securitised products would aid the creation of a green CMU by facilitating the integration of securitised products in ESG investment strategies through enhanced transparency and comparability.

**The ECB believes that publishing information on the environmental performance of assets financed by residential, auto loans and leases should be mandatory, with a gradual transition arrangement for new deals and, for existing deals, taking into account that this information may not always be available.** Currently, ESMA's residential mortgage, auto loan and lease loan-level data templates contain an optional field for reporting on assets' energy performance. This information is not collected or provided by all originators in a comprehensive way despite being essential to understand the environmental impact of the pool, at least in relation to the asset's energy performance. Adjusting, for example, ESMA's loan-level templates for ABSs to make the respective fields on energy performance mandatory would incentivise originators to collect the relevant information at the time of loan origination and facilitate investors' assessment of the energy performance of ABSs backed by residential or auto loans. Consideration could also be given to how the templates could be expanded to include other information of relevance to environmental performance.<sup>4</sup> In addition, and in line with the European Commission recently published Strategy for Financing the Transition to a Sustainable Economy, increased disclosure on biodiversity aspects should also be considered as a area for further work.

**As part of its asset purchase programme, the Eurosystem has invested in green securitisations.**<sup>5</sup> These purchases have been conducted for broader monetary policy purposes and not specifically for environmental reasons. Nonetheless, information on environmental performance is valuable for investors in general and could be used to make more informed investment decisions and to improve investors' own financial sustainability disclosures. For the ECB, reliable and harmonised information on environmental performance will become even more crucial in the future as, following the recent strategy review, climate change considerations will be further incorporated into the monetary policy framework. One of the planned measures is for the ECB to introduce disclosure requirements for private sector assets as a new eligibility criterion or as a basis for differentiated treatment of collateral and asset purchases. Such requirements will consider EU

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<sup>4</sup> For example, field RREL27 in the RMBS template on the purpose of the loan includes "Renovation (RENV)" but does not specify whether the renovations are for improvements with positive environmental impacts, such as adding insulation, upgrading windows, adding solar panels or rainwater capture, or even improving resilience to extreme weather events by upgrading drainage systems, for example.

<sup>5</sup> The Eurosystem has invested in securitisations backed by green or sustainable underlying assets and transactions for which the proceeds are directed to green/sustainable projects. As part of the APP, the Eurosystem has invested in certain securitisations with recourse to green projects that have been grouped together (e.g. green mortgages). The selection criteria for the mortgage pool are based on the respective country's system of residential energy performance certificates.



policies and initiatives in the field of environmental sustainability disclosures and reporting and will promote more consistent disclosure practices in the market while maintaining proportionality through adjusted requirements for SMEs. The ECB will announce a detailed plan in 2022.<sup>6</sup>

**The ECB thinks that publishing information on both environmental performance and adverse impacts will be important.** The relative performance will depend on the nature of the asset class and the purpose of the securitisation. Disclosures on a securitisation with a green purpose will likely need to focus on measurable positive environmental performance to prove its green credentials, for example to demonstrate how it meets green bond criteria and requirements on an ongoing basis. By contrast, disclosures on a securitisation without a specific green purpose will likely need to focus on adverse impacts so that an investor can measure its environmental performance, for example loans funding sales of ESG detrimental activities. For other types of securitisations, positive environmental impacts and adverse impacts will both be important. This would be the case for a securitisation backed by environmentally harmful assets but with the intention of funding transitional activities, for example banks linked to automotive companies transitioning to electric cars. Given that most securitisations in the EU do not currently have a specific green purpose, greater emphasis should be placed on adverse impacts for the moment.

**Adverse impacts represent the consequences of investment decisions that have a negative impact on environmental, social and employee matters, respect for human rights and anti-corruption and anti-bribery matters.** With more comprehensive and detailed information available on adverse impacts, investors would be better able to take informed investment decisions and price them into their trading activities. Requiring originators to disclose adverse impacts allows investors to address and design internal policies and processes to minimise them. The management of adverse impacts on the environment could be achieved through the “do no significant harm” criteria enshrined in the EU taxonomy or by following the rules and regulations enshrined in Article 4 of the Sustainable Financial Disclosure Regulation relating to the principal adverse impacts of investment decisions. This would minimise the risk of regulatory misalignments and facilitate financial institutions’ environmental reporting of financial products that contain securitised assets.

**Finally, it would be necessary to clarify how the EU green bond standard would be applied to green transition securitisations where the underlying assets are not aligned with the taxonomy but the purpose of the financing is with respect of green transition technologies.** The Commission’s proposal currently indicates in the explanatory notes that this is intended, but the draft active provisions are not easily applied to securitisations or, in particular, transitional securitisations.

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<sup>6</sup>See “[ECB presents action plan to include climate change considerations in its monetary policy strategy](#)”, ECB press release, 8 July 2021



### 3 Treatment of STS securitisations and ABCPs for the LCR

**Demonstrating sufficient market liquidity is the key consideration determining whether assets qualify as liquid for the purpose of the LCR.** The issuance of STS securitisations since 2019 allows regulators and legislators to look into the track record of market liquidity for this type of security. The track record could be analysed with a view to revising the existing criteria for including this type of asset in the LCR buffer in the light of the new European securitisation framework. In particular, the ECB is of the opinion that the analysis could identify high-quality securitisations that proved liquid during the crisis and could be treated in a similar way to other fixed income instruments. An empirical analysis of market data and other evidence provided by market participants would also aid the consideration of appropriate provisions (e.g. caps and haircuts, rating requirements, minimum issue size, seniority requirements) that could be applied as additional safeguards to (i) ensure that the liquidity buffer fulfils its purpose in the event of stressed circumstances, and (ii) reduce concentration risk in the LCR buffer. However, it is acknowledged that an upgrade of STS securitizations could present further deviations from the Basel framework and that therefore any such upgrade should be considered only if there is a strong analytical and empirical evidence of high liquidity and credit quality of such assets.

These considerations apply both to the potential inclusion of STS securitisations in the level 2A buffer and to the inclusion of ABCPs in the level 2B buffer.

### 4 Prudential treatment of securitisations

#### 4.1 Capital charge of securitisations

**Although in substance current STS risk weightings might be proportionate to the risk of the underlying pool and overall securitisation structures as considered by legislators, the methodologies used to calculate capital charges for securitisations should be further enhanced to better differentiate between the risk profile of underlying asset pools, structural features and model and agency risks.** Under the current SEC-IRBA methodology, the so-called p factor discriminatory power against different asset classes is limited (only retail and non-retail). The p factor seeks to prevent cliff effects (i.e. an abrupt decrease of the risk weighting for senior tranches compared with non-senior tranches). The ECB would see merit in reviewing how and in which cases the p factor calibration can better reflect risks in relation to (i) granularity, including non-granular/concentrated pools; and (ii) flawed risk parameters owing to weak IRB models. A one-size-fits-all p factor for all non-retail exposures is questionable, considering the high heterogeneity of exposures in this category, spanning from medium and large corporates to SMEs, or from project finance to wholesale large corporations. Furthermore, a senior tranche referencing a pool with a high risk of correlated defaults, which could be further

affected by modelling issues, would draw a risk weighting of 10%/15%/20%, which might be significantly lower than the effective risk profile of the underlying pool. In any case, it is acknowledged that any modification or adjustment of the non-neutrality p factor included in the securitisations framework could imply a deviation from the framework agreed in Basel.

## 4.2 SRT tests and process

**The ECB is conducting further analyses based on its practical supervisory experience to assess SRT standards that ensure transaction resilience over time.** This includes additional work on: (i) the calibration of the commensurate risk transfer test on the appropriate margin between Ratio 2 (transferred losses) and Ratio 1 (capital relief), facilitating higher transferred losses compared with the capital relief; (ii) the characteristics of the principle-based approach test in the light of the inherent high flowback risk (capital impact on senior tranche); and (iii) the methodology for the allocation of lifetime expected losses and unexpected losses to the securitisation tranches.

**It is in the interest of the ECB and market participants that SRT assessments are performed promptly but also to a sufficient standard.** An in-depth supervisory review of securitisations with complex features increases SRT robustness, which enhances the financial resilience of supervised banks. Notwithstanding inherent challenges after the launch of European banking supervision, the ECB's SRT assessment process has improved notably over time, as acknowledged by the industry during recent interactions between the ECB and market participants. Supervisory dialogue has matured over the last two years, producing an assessment process that is well understood by banks. In addition, the time needed by supervisors to assess transactions has been reduced considerably, particularly for repeat or standard transactions. In this context of enhanced supervisory dialogue, a fundamental reshape of the SRT process, with rigid structures and excessive automation would not be justified and could be counterproductive. The ECB is working on how to provide certainty to banks and a clear process for their SRT submissions while retaining room to detect complex features.

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