THE EUROPEAN SECURITISATION MARKET: EFFECTS OF AN UNEVEN REGULATORY PLAYING FIELD

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ABSTRACT

This article critically assesses the claim put forward by the European securitisation industry, about the existence of an uneven regulatory playing field for securitisation structures vis-à-vis other, 'neighbouring', financial instruments, such as whole loan pools, corporate bonds, and most importantly covered bonds. According to market participants, the adverse treatment of securitisation, on behalf of European regulatory authorities, is negatively affecting the European securitisation market, by pushing issuers and investors towards other financial instruments that are treated in a preferential regulatory fashion. Ultimately, this prevents the securitisation market from escaping the subdued state in which it has been ever since the Global Financial Crisis. To address this problem, a fundamental recalibration of the existing regulatory framework is needed. By comparing the regulatory framework that applies to securitisation structures, to the framework that applies to whole loan pools, corporate bonds, and covered bonds, this article confirms the existence of an uneven regulatory playing field in Europe. It also confirms that the adverse treatment of securitisation, and particularly RMBS structures vis-à-vis covered bonds, has had a negative impact on the European securitisation market, by fueling a 'crowding out' of RMBS by covered bonds.

1. INTRODUCTION

The new European regulatory framework for securitisation, consisting of Regulation 2017/2402[1] (the Securitisation Regulation or the 'SECR') and Regulation 2017/2401[2] (amending the Capital Requirements Regulation (the 'CRR')),[3] was launched in January 2019 with the aim of jump-starting the European securitisation market that had remained subdued ever since the 2007-09 global financial crisis (the 'GFC').[4] The same goal also underpinned

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[1] Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 [2017] OJ L347/35 (hereinafter the 'SECR').
[2] Regulation (EU) 2017/2401 of the European Parliament and of the Council of 12 December 2017 amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms [2017] OJ L347/1.
[3] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 [2013] OJ L176/1 (hereinafter the 'CRR').
[4] European Commission, 'Proposal for a Regulation of the European Parliament and of the Council laying down common rules on securitisation and creating a European framework for simple, transparent and standardised

the amendments to this new framework, introduced via Regulation 2021/557[5] and Regulation 2021/558,[6] as part of the European Union's (the 'EU') 'Capital Markets Recovery Package' (the 'CMRP').[7]

Today, three and a half years after the new framework came into force, and more than two years after its CMRP amendments became applicable, it is safe to say that the goal of reviving the European securitisation market has hardly been achieved.

Despite any claims to the contrary, on behalf of the European regulatory authorities,[8] the numbers leave little room for doubt: In 2019, the year that SECR became applicable, total European placed securitisation issuance was €119bn.[9] In 2020 this number dropped to €81.4bn, whereas in 2021 placed issuance was equal to €126bn.[10] In 2022, total placed issuance declined sharply to €79.7bn.[11] In Q1 2023, €19.9bn of securitised product was placed, compared to €32.7bn in Q1 2022.[12]

To put those numbers in perspective, the market is clearly in a better shape than 2009, when, amidst the GFC, total placed issuance fell to a record low of €25.2bn.[13] But compared to the period prior to the introduction of the SECR, things are looking rather bleak.[14]

A look at the outstanding amounts of European securitisation also serves as confirmation of the fact that the market is not faring well during the last few years: In 2018 the market for

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securitisation and amending Directives 2009/65/EC, 2009/138/EC, 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012' COM (2015) 472 final Explanatory Memorandum, at 2-3.

[5] Regulation (EU) 2021/557 of the European Parliament and of the Council of 31 March 2021 amending Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation to help the recovery from the COVID-19 crisis [2021] OJ L116/1.

[6] Regulation (EU) 2021/558 of the European Parliament and of the Council of 31 March 2021 amending Regulation (EU) No 575/2013 as regards adjustments to the securitisation framework to support the economic recovery in response to the COVID-19 crisis [2021] OJ L116/25.

[7] European Commission, 'Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation to help the recovery from the COVID-19 pandemic' COM(2020) 282 final Explanatory Memorandum, at 1.

[8] See for instance the European Commission's (the 'EC') comment about the European securitisation market faring relatively well, having stabilised after years of decline, in European Commission, 'Report From the Commission to the European Parliament and the Council on the Functioning of the Securitisation Regulation' (10 October 2022) (hereinafter the 'EC Report'), at 4-5, 25. cf also Joint Committee of the ESAs, 'Joint Committee Advice on the Review of the Securitisation Prudential Framework (Banking) – Response to the Commission's October 2021 Call for Advice to the JC of the ESAS – JC 2022 66' (12 December 2022) (hereinafter the 'ESA Joint Advice Banking'), at 7, where it is argued that the European securitisation market is now more robust in terms of quality, compared to the period of the GFC.

[9] AFME, 'Securitisation Data Report Q4 2020' <https://www.afme.eu/Publications/Data-Research/Details/AFME-Securitisation-Data-Report-Q4-2020> accessed 1 September 2023, at 12.

[10] AFME, 'Securitisation Data Report Q4 2021' <https://www.afme.eu/Portals/0/AFME%20Q4%202021%20Securitisation%20Report.pdf?ver=2022-03-15-105526-747> accessed 1 September 2023, at 16.

[11] AFME, 'Securitisation Data Report Q1 2023' <https://www.afme.eu/publications/data-research/details/securitisation-data-report-q1-2023-> accessed 1 September 2023, at 19.

[12] ibid.

[13] AFME/ESF, 'Securitisation Data Report, 2010 Q4' <https://www.sifma.org/resources/research/afme-esf-securitisation-data-report-2010-q4/> accessed 1 September 2023, at 3.

[14] By way of example, in 2018, the last year prior to the introduction of the SECR, total European placed securitisation issuance was equal to €136.2bn, see AFME, 'Securitisation Data Report Q4 2018' <https://www.afme.eu/publications/data-research/details/securitisation-data-report-q4-2018> accessed 1 September 2023, at 7.

securitisation in Europe was worth €1,112bn,[15] significantly more than the €920.5bn it was worth in Q1 2023.[16]

Of course, the period that followed the introduction of the SECR in 2019 can hardly be described as 'normal'.

The Covid-19 pandemic and the very accommodative monetary policy of the European Central Bank (the 'ECB') and other central banks that aimed at mitigating the pandemic's effects (resulting in a very low interest rate environment) were followed by severe inflationary pressures and a policy of quantitative tightening that is still being unfolded.

Such extraordinary events have cast a heavy shadow on the wider European economy, including its financial market, and securitisation has hardly been an exception. [17]

Quantifying the effect of those events on the European securitisation market is evidently complicated. It is nonetheless clear that they alone cannot shoulder the entire blame for the aforementioned dire condition of the market.

As the securitisation industry points out, placed securitisation issuance in other major markets like the United States (the 'US'), that were equally affected by the pandemic and were faced with similar monetary policies, has been much more vibrant throughout this period, compared to Europe.[18]

The securitisation industry also points to other 'neighbouring' segments of the wider European financial market, like the covered bond market, which seem effectively to have withstood the turbulence that unfolded from 2020 onwards.

Despite contracting in 2020-2021, European placed (benchmark) covered bond issuance staged an impressive comeback in 2022, when more than €160bn of covered bonds were bought by investors, setting a record that greatly surpassed the issuance levels of 2018 and 2019.[19] In 2023 covered bond supply is expected to be above €150bn.[20] In terms of outstanding amounts, the European covered bond market had a size of €2.25tn in 2018.[21] By the end of 2021, that market was worth €2.45tn.[22]

The conclusion is evident according to the securitisation industry: Unlike the European securitisation market that has experienced a severe and prolonged contraction, the covered bond market showed remarkable resilience during the pandemic and the other extraordinary events mentioned above, and has even managed to grow.

What is it then that makes the European securitisation market so distinct, and prevents it from flourishing, unlike its US counterpart, and the neighbouring market for covered bonds?

In the securitisation industry's view, the new regulatory framework has played a crucial role in that regard. In fact, not only has the SECR and its amendments failed so far, regarding their aim to revitalise the subdued European securitisation market, but they also seem to be functioning as an effective roadblock to securitisation, by creating even greater distortions than their predecessors.

[15] Excluding collateralised debt obligations ('CDOs') and collateralised loan obligations ('CLOs'), see AFME Q4 2018 (n 14) 11.
[16] AFME Q1 2023 (n 11) 27.
[17] cf ESRB, 'Monitoring Systemic Risks in the EU Securitisation Market' (July 2022), at 26 footnote 47.
[18] PCS, 'Response to the Consultation on the Securitisation Regulation' (26 September 2021), at 4-5.
[19] S&P Global, 'Covered Bonds Outlook 2023: Sailing Through Choppy Waters' (December 2022), at 7.
[20] ibid.
[21] Otmar Stöcker and Cristina Costa, 'Overview of Covered Bonds' in *ECBC European Covered Bond Fact Book* (2019), at 158.
[22] Joost Beaumont, Cristina Costa, and Otmar Stöcker, 'Overview of Covered Bonds' in *ECBC European Covered Bond Fact Book* (2022), at 150.

Indicatively, in the industry's response to the consultation regarding the functioning of the new European securitisation framework, launched by the EC in July 2021,[23] more than 70% of the respondents argued that the new framework has been unsuccessful in improving access to credit for the real economy, and in particular for small and mid-size enterprises ('SMEs'); in widening the investor base for securitisation products in Europe; and in convincing financial institutions to increase their engagement in issuing and originating securitisations. As a matter of fact, the only objective that the SECR has been somewhat successful in achieving so far, according to market participants, is providing a high(er) level of investor protection.[24]

Market participants point to various shortcomings of the new framework, in order to explain why it has so far been unsuccessful. Among them, the uneven regulatory playing field that the new framework creates for European securitisation structures vis-à-vis other 'neighbouring' financial instruments, such as whole loan pools, corporate bonds, and especially covered bonds, features prominently in the list of market participants' concerns.

In particular, they claim that the regulatory disadvantages that European securitisation faces are discouraging potential issuers and investors from engaging in relevant securitisation transactions. At the same time, those disadvantages are prompting active market participants to migrate to other financial instruments that receive a more favourable regulatory treatment, in the sense that they impose less stringent obligations to issuers and investors, and/or the prudential treatment they receive is more advantageous to the interests of those who hold such financial instruments in their books.

In order to reverse this trend, and allow the securitisation market to flourish, to the benefit of the wider European economy, market participants have been consistently pushing for a fundamental reform of the new securitisation framework, which will lead to a level regulatory playing field.[25]

The present article critically assesses this claim put forward by the European securitisation industry, by examining, in *Section 2*, the specific regulatory areas in which the playing field is uneven according to market participants, and by comparing the provisions that apply to securitisation structures with the provisions that apply to 'neighbouring' financial instruments, namely whole loan pools, corporate bonds, and covered bonds.

This analysis confirms that European securitisation structures receive an adverse regulatory treatment vis-à-vis the aforementioned financial instruments, in respect of four main regulatory areas: i) disclosure and due diligence obligations imposed on sell-side entities and buy-side entities respectively under the SECR; ii) regulatory capital requirements imposed on credit institutions under the CRR; iii) inclusion of assets in the liquidity portfolios of credit institutions under the liquidity coverage ratio (the 'LCR'); and iv) capital requirements imposed on (re)insurance undertakings under Solvency II.[26]

Section 3 explores the response of the European regulator to the industry's concerns, by assessing its view on the currently applicable regulatory framework. More precisely, it examines whether the regulator agrees with market participants that securitisation is indeed being treated adversely vis-à-vis other 'neighbouring' financial instruments and, if so, whether

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[23] European Commission, 'Targeted Consultation on the Functioning of the EU Securitisation Framework' (23 July 2021).
[24] EC Report (n 8) 6, fig 1.
[25] See for instance the recommendations put forth by the High Level Forum (the 'HLF'), an expert group comprising industry executives and international experts and scholars that was created in 2019 under the auspices of the EC: High Level Forum, 'Final Report of the High Level Forum on the Capital Markets Union – A New Vision for Europe's Capital' (10 June 2020), at 52-54.
[26] Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (recast) [2009] OJ L335/1, and associated legislation.

a leveling of the playing field, through a fundamental recalibration of the existing framework, is ultimately warranted.

It is pertinent to note at the outset the significant divergence in opinion between the regulator and market participants. Indeed, in the former's view, the existing regulatory playing field is sufficiently leveled, whereas any disparity in the way that securitisation is being treated vis-à-vis other financial instruments is entirely justified, given that securitisation is inherently riskier than whole loan pools, corporate bonds, and covered bonds.

For those reasons, and notwithstanding some proposed 'targeted' amendments that could indirectly help level the regulatory playing field, no fundamental recalibration of the existing framework is warranted, according to the European regulator.

In the backdrop of this divergence in opinion, *Section 4* examines the effects that the uneven regulatory playing field has had on the European securitisation market, both historically and today, in order to gauge whether a leveling of the playing field could realistically contribute to the revival of the market, as the securitisation industry claims it would.

This analysis is conducted by examining whether a competitive dynamic exists between specific securitisation structures and whole loan pools, corporate bonds, or covered bonds and, therefore, whether it is accurate to claim that the adverse treatment that securitisation receives has been prompting market participants to migrate to other 'neighbouring' financial instruments, since the latter are directly competing with securitisation structures.

Such a competitive dynamic is identified in the relationship between residential mortgage-backed securities ('RMBS') and covered bonds collateralised by residential mortgage loans. More specifically, existing academic literature and empirical findings confirm that covered bonds have historically functioned as a substitute for, and have effectively 'crowded out', European RMBS, because of, inter alia, the preferential regulatory treatment that covered bonds have received vis-à-vis RMBS.

In other words, the uneven regulatory playing field for RMBS vis-à-vis covered bonds is found to have had an adverse effect on the European RMBS market, because it has incentivised issuers and investors to switch to covered bonds.

Crucially, this 'crowding out' of RMBS is observed to be still taking place today. Therefore, a leveling of the regulatory playing field could help revive the European RMBS market, by mitigating the effects of this 'crowding out', since it would allow RMBS to compete more effectively, and would increase its attractiveness in the eyes of market participants.

Most importantly, the significance of RMBS for the wider European securitisation market means that a more favourable treatment of RMBS has the potential to help the entire market to experience a revival.

Finally, *Section 5* provides some concluding remarks.

2. THE SECURITISATION INDUSTRY'S CONCERNS REGARDING THE UNEVEN REGULATORY PLAYING FIELD

As mentioned in the introduction, the uneven regulatory playing field for securitisation vis-à-vis other 'neighbouring' financial instruments is not the only source of concern and frustration for the European securitisation industry.

To give just a few examples, the complexity and narrowness of scope that characterise the 'simple, transparent, and standardised' ('STS') regime introduced via the SECR; the jurisdictional scope of the new framework and in particular the hurdles created by article 5, paragraph 1(e) of the SECR, when it comes to investing in third-country securitisations; and the system of ex-ante assessment by competent authorities regarding the significant risk

transfer ('SRT') process, have consistently been the subject of severe criticism by market participants.[27]

In the industry's view, all the above constitute important shortcomings of the existing regulatory framework that prevent the latter from functioning as a springboard for the revival of the European securitisation market.

Nevertheless, the adverse treatment that securitisation receives vis-à-vis whole loan pools, corporate bonds, and covered bonds, features prominently in the market participants' list of concerns, and thus warrants a separate analysis.

The four main regulatory areas in which this adverse treatment of securitisation is most obvious are disclosure and due diligence obligations; capital requirements imposed on credit institutions under the CRR; inclusion of assets in the LCR's liquidity portfolios; and capital requirements imposed on (re)insurance undertakings under Solvency II.

This section examines each of those regulatory areas in turn.

2.1. Disclosure and Due Diligence Obligations

As market participants point out, 'securitisation legislation imposes the heaviest burdens on both securitisation issuers in terms of disclosure and investors in terms of due diligence'.[28]

It is important to bear in mind that such obligations are not a novelty of the SECR. In fact, disclosure and due diligence requirements were first imposed on sell-side entities and buy-side entities respectively in the immediate aftermath of the GFC. Along with 'skin-in-the-game' requirements for sell-side entities, disclosure and due diligence obligations were introduced in the context of the second Capital Requirements Directive ('CRD II'),[29] as part of a bundle of rules that aimed at tackling the 'perverse incentives' that the originate-to-distribute ('OTD') model of securitisation was thought to have fueled, by more closely aligning the interests of originators and investors.[30]

Nevertheless, the introduction of the SECR signified a considerable reinforcement of both disclosure and due diligence obligations.

Regarding disclosure, the relevant requirements imposed on sell-side entities are reinforced in substance, as well as in scope: The relevant information now has to be made available not just to holders of a securitisation position (as was the case under the previous framework),[31] but also to the competent authorities and, upon request, to potential investors.[32] In the case of STS securitisations, disclosure requirements are even more extensive, in order

[27] For a more comprehensive analysis of those concerns, see European Commission, 'Summary Report: Targeted Consultation on the Functioning of the EU Securitisation Framework 23 July 2021 - 17 September 2021' (29 September 2022) (hereinafter the 'EC Targeted Consultation Summary'); High Level Forum (n 25); and EBF, 'Relaunching the European Union's Securitisation Market: What Needs to be Done in the Context of the Capital Markets Union' (2 September 2021) (hereinafter 'EBF Relaunching').

[28] PCS (n 18) 14.

[29] Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management [2009] OJ L302/97.

[30] See Graham Penn and Thomas Papadogiannis, 'Regulating Securitisation in the Aftermath of the Global Financial Crisis: Lessons from Europe' (2021) 36(6) Journal of International Banking Law & Regulation 225, at 231-233 and 236-238 for a detailed analysis of the 'perverse incentives' criticism leveled against securitisation in the aftermath of the GFC, and the measures adopted by the European regulator as a response to that criticism.

[31] cf CRR art 409 (now deleted via Regulation 2017/2401).

[32] SECR art 7 para 1.

for a relevant transaction to be deemed ‘transparent’,[33] especially if it is a balance sheet ‘synthetic’ STS transaction.[34]

So far as due diligence is concerned, obligations imposed on buy-side entities in the pre-investing and post-investing stage of the transaction are extended, compared to the obligations originally imposed under the previous framework,[35] as they are now directly linked to, and therefore cover the entirety of, disclosures made by sell-side entities.

Considering how much criticism disclosure and due diligence obligations had received even in their earlier, more ‘limited’, version introduced in the immediate aftermath of the GFC,[36] the massive frustration that the securitisation industry has been expressing in the context of the SECR should come as no surprise.

2.1.1. *Disclosure Obligations*

To elaborate, market participants claim that the information required from sell-side entities under article 7 of the SECR is both gravely disproportionate and unfit for purpose, especially so far as private securitisation deals are concerned.[37]

More precisely, market participants argue that article 7 obliges originators and other entities to disclose information that is too granular and excessive, considering that, especially in private deals,[38] investors are usually able to obtain all the data they need in order properly to conduct their due diligence by requesting it directly from the originator. By forcing sell-side entities to produce and then disclose information that is irrelevant to investors, the SECR ends up significantly elevating the cost of setting up a securitisation transaction, whilst increasing inefficiency.[39] Ultimately, this creates artificial barriers to entry into the market, that stifle market growth.[40]

At the same time, the format in which information has to be disclosed under article 7, ie the standardised templates that the SECR has mandated the European Securities and Markets Authority (‘ESMA’) to develop, has also been heavily criticised, to the extent that the use of said templates is also mandatory for private securitisations.

Indeed, the industry considers the current ESMA templates inappropriate for use in private deals, given that they involve a number of unnecessary elements, whereas some of the fields included in those templates require sell-side entities to provide data that is sometimes confidential.[41]

This is hardly surprising, considering that, according to some market participants, the original intention of the SECR co-legislators was to limit templated disclosure to public

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[33] ibid art 22.

[34] Mayer Brown, ‘Amendments to the EU Securitisation Regulation – the New Synthetic STS Framework and Adjustments in Relation to Non-Performing Exposures’ (April 2021), at 2; Allen & Overy, ‘The New EU STS Framework for On-Balance Sheet (Synthetic) Securitisations’ (January 2021), at 26. By way of example, art 26c of the SECR, introduced via Regulation 2021/557, provides for extended disclosures on credit risk and currency risk mitigants for synthetic STS, compared to the requirements under art 21 of the SECR for ‘true sale’ STS.

[35] Compare the (now deleted) art 406 of the CRR with SECR art 5.

[36] See Penn (n 30) 239 and the authorities mentioned therein.

[37] EC Targeted Consultation Summary (n 27) 13.

[38] In the context of the SECR, private deals are those securitisations for which no prospectus has to be drawn up in compliance with Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC [2003] 0J L345/64 (see SECR art 7 para 2).

[39] EBF Relaunching (n 27) 27-28; Australian Securitisation Forum, ‘Targeted Consultation on the Functioning of the EU Securitisation Framework’ (30 September 2021), at 5-8; AFME, ‘Targeted Consultation on the Functioning of the EU Securitisation Framework’ (30 September 2021) (hereinafter ‘AFME Response’), at 25.

[40] EC Targeted Consultation Summary (n 27) 10.

[41] ibid 14.

securitisations. In fact, that was the basis on which the securitisation industry was consulted when the new securitisation framework was being developed. Eventually however, ESMA changed course and opted for the mandatory use of templates in all types of transactions, both public and private.

Notwithstanding the significance of this decision, the regulator did not deem it necessary to involve market participants. As a result, the templates developed by the regulator do not accurately reflect the needs of investors, and are instead based on the templates that the European Central Bank (the 'ECB') uses in its liquidity operations.[42] The latter however are inappropriate for private deals, in which confidentiality often plays a crucial role.

2.1.2. *Due Diligence Obligations*

Regarding the due diligence obligations that the SECR imposes on institutions investing in securitisations (STS or non-STS) under article 5, the industry has consistently complained that those requirements create an unnecessary and costly burden.

More specifically, market participants point out that the very concept of standardising due diligence obligations is problematic, given that the due diligence that each institution conducts prior to investing in a securitisation is tailor-made, so as to reflect the specificities of each specific transaction. In other words, the information that will be requested from sell-side entities will differ from case to case, exactly because the needs of each individual investor will differ.[43] This is especially the case in private deals, where investors are often able to request specific data directly from the originator.

Despite the above, article 5 of the SECR obliges investors across the board to include in their due diligence exercise all the information that sell-side entities are required to disclose under SECR article 7.[44] Investors also have to verify that sell-side entities have made this information available in accordance with the stipulated frequency and modalities.

By leaving no room for discretion to investing institutions, and forcing them to review a significant number of documents, regardless of whether the information included therein is actually useful to them, the SECR creates an unnecessary and costly burden. At the same time, investors continue to request all the information they *actually* need, in order to assess the risks they assume, even if this information is not contained in the templates that sell-side entities use to disclose information, as per article 7. This further increases costs for buy-side and sell-side entities alike.

Even worse, by standardising due diligence obligations, and forcing investors to review documents that are more or less irrelevant to them, the SECR effectively dilutes the critical information, and creates a risk that important documents will not receive the necessary attention.[45]

2.1.3. *Industry Recommendations*

According to some market participants, the aforementioned problems arising from the extensive disclosure and due diligence obligations imposed under the SECR could be mitigated through a clearer differentiation between public and private securitisation deals.

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[42] AFME Response (n 39) 17; Deutsche Bank, 'Deutsche Bank Response to the European Commission Targeted Consultation on the Functioning of the EU Securitisation Framework' (28 September 2021), at 11.
[43] EC Targeted Consultation Summary (n 27) 11; Fédération Bancaire Française, 'FBF Response to the Targeted Consultation on the Functioning of the EU Securitisation Framework' (30 September 2021), at 10.
[44] This is the effect of art 5 para 1(e) cross-referring to art 7 of the SECR.
[45] EBF Relaunching (n 27) 27.

To elaborate, they suggest making templated disclosure obligations[46] applicable solely to public securitisations. Regarding private deals, sell-side entities should disclose, on a case-by-case basis, the amount of information which is deemed sufficient by investors in order to conduct their due diligence.[47]

A variation of this recommendation involves amending the definition of 'private deal' for the needs of the SECR, so as to exclude intragroup securitisation transactions, bilateral deals, and potentially other transactions currently falling under the definition of 'private deal', from the obligation to make templated disclosures.[48]

Other market participants however focus less on the divergence in treatment between public and private securitisation deals, and more on the lack of a level playing field between securitisation transactions and other 'neighbouring' financial instruments, especially covered bonds, when it comes to disclosure and due diligence obligations.[49]

Indeed, a quick glance at the way in which the European regulator deals with disclosure and due diligence obligations for covered bond issuers and investors respectively illustrates just how adverse the treatment of securitisation is.

Admittedly, the new regulatory covered bond framework, introduced via Directive 2019/2162[50] and Regulation 2019/2160[51] (amending the CRR), imposes more comprehensive disclosure obligations to issuing credit institutions, compared to the previous regime.[52]

For instance, issuers are now under an obligation to inform investors about the market risk, credit risk, and liquidity risk that the relevant covered bond transaction entails. They also have to disclose information about the levels of required and available coverage, including overcollateralisation.[53] In addition, such information needs to be provided to investors on at least a quarterly basis, instead of an at least semi-annual basis, as was previously the case.

Finally, it is worth noting that under the new covered bond framework, the disclosure obligations of the issuer are no longer owed solely to credit institutions and investment firms, nor are they a mere condition that needs to be met in order for the relevant bonds to be eligible for preferential prudential treatment. Instead, those obligations are applicable vis-à-vis every covered bond investor, regardless of its status, and they are no longer linked to the prudential treatment of the financial instrument.[54] In that sense, the covered bond issuer's obligations are indeed wider.

However, even the more comprehensive requirements of the new covered bond framework pale in comparison to what the sell-side entities in a securitisation transaction have to disclose.

And when it comes to due diligence obligations, the difference between the two regimes is even more striking: Under the original article 129 of the CRR, covered bondholders were required to demonstrate to the competent authorities that they had received portfolio information on a number of matters (in that sense the disclosure obligations of the issuer were

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[46] Developed by the European Supervisory Authorities (the 'ESAs'), as mandated by SECR art 7 paras 3-4.
[47] High Level Forum (n 25) 64. cf also FBF (n 43) 11-12.
[48] AFME Response (n 39) 17-19.
[49] PCS (n 18) 11.
[50] Directive (EU) 2019/2162 of the European Parliament and of the Council of 27 November 2019 on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU [2019] OJ L328/29.
[51] Regulation (EU) 2019/2160 of the European Parliament and of the Council of 27 November 2019 amending Regulation (EU) No 575/2013 as regards exposures in the form of covered bonds [2019] OJ L328/1.
[52] Compare Directive 2019/2162 art 14 with CRR art 129 para 7 (prior to its amendment via Regulation 2019/2160).
[53] Directive 2019/2162 art 14 para 2 (c), (f).
[54] This is the case because the covered bond issuer's disclosure obligations are no longer provided for in the CRR (the scope of which is limited to credit institutions and investment firms), but rather in Directive 2019/2162, which creates a substantive covered bond framework, and therefore has a much wider scope.

indirect). This provision was understood to create a (minimum) due diligence obligation for those investing in covered bonds.[55]

Directive 2019/2162 on the other hand, makes the disclosures obligations of the covered bond issuer direct, and omits any reference to the requirement, on behalf of investors, to demonstrate that portfolio information has actually been received. In that sense, investors no owe no due diligence obligations under Directive 2019/2162. Compared to that, the stringent requirements of article 5 of the SECR are another clear indication of the adverse treatment that securitisation receives.

As market participants argue, this difference in regulatory treatment effectively means that a covered bond can receive an AAA rating, even if the information on the underlying assets, eg mortgage loans, that the issuer discloses to covered bondholders is just a *small fraction* of the information that would have to be disclosed to investors by sell-side entities in a securitisation transaction, if the same mortgage loans were instead backing an AAA senior securitisation tranche. And this is despite the fact that, similar to securitisation, covered bonds also (partially) depend on the pool of assets that backs them for the repayment of investors.[56]

The risk of regulatory arbitrage, stemming from the higher burden that investing in securitisation entails, is evident. So is the risk of investors migrating to lower-due diligence financial instruments, just like covered bonds, and thus creating additional hurdles to the revival of the European securitisation market. In fact, according to some market participants, such a migration is already underway.[57]

In view of that imbalance in treatment, and the risks it entails for the securitisation market, the industry is pushing for a fundamental recalibration of disclosure and due diligence obligations imposed under the SECR. In their opinion, such a readjustment should aim at making the relevant obligations simpler, whilst allowing for greater proportionality. The benchmark for those objectives should be the disclosure and due diligence obligations imposed on covered bond issuers and investors respectively, therefore the two regimes should ultimately become more closely aligned to each another.[58]

2.2. Regulatory Capital Requirements under the CRR

Moving on to regulatory capital requirements under the CRR, the most pressing concern of the industry in that regard seems to be revolving around the capital non-neutrality rules created by the new securitisation framework.[59]

The concept of 'non-neutrality' stems from the idea that securitised assets are inherently riskier than non-securitised assets, due to the modelling and agency risks that are thought to arise in securitisation. In order to tackle those perceived risks, capital non-neutrality rules, originally conceived by the Basel Committee on Banking Supervision (the 'BCBS'), impose a capital surcharge (the so-called 'p' factor) on capital requirements for banks, when the latter invest in securitisation positions.

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[55] cf Fritz Engelhard, Florian Eichert, and Richard Kemmish, 'Regulatory Issues' in *ECBC European Covered Bond Fact Book* (2013), at 156.

[56] PCS (n 18) 14.

[57] ibid 11.

[58] Groupe Crédit Agricole, 'GCA Response to the European Commission's Targeted Consultation on the Functioning of the EU Securitisation Framework' (27 September 2021), at 5; Paris EUROPLACE, 'Paris EUROPLACE's response to the European Commission's targeted consultation on the functioning of the EU securitisation framework' (17 September 2021), at 4; Insurance Europe, 'Response to Consultation on EC Call for Feedback on Securitisation Framework' (September 2021) (hereinafter 'Insurance Europe'), at 2. cf PCS (n 18) 15.

[59] EBF Relaunching (n 27) 11.

This surcharge is embedded in the formula used to calculate capital requirements, when either the Internal Ratings-Based Approach (the 'SEC-IRBA') or the Standardised Approach (the 'SEC-SA') are applied. In addition, capital non-neutrality rules set a minimum risk weight on (senior) securitisation positions, which is known as the 'risk weight floor'.[60]

At the European level, the 'p' factor is set by the CRR at a minimum 0.3 when calculating capital requirements using the SEC-IRBA.[61] This effectively translates into a 30% capital surcharge on securitisation tranches. When capital requirements are calculated using the SEC-SA, the 'p' factor is set at 0.5 for STS securitisations and at 1 for non-STS securitisations.[62] The risk weight floor on the other hand is set at 10% for senior STS tranches and at 15% for non-STS tranches.[63]

According to market participants, the current calibration of capital non-neutrality rules at the European level is unduly harsh and ultimately unjustifiable, since it does not constitute an accurate reflection of European securitisation and its performance, past or present.[64]

As they point out, even if modelling and agency risks were significant in the past, when the BCBS first conceived the concept of non-neutrality, an idea that is in and of itself controversial, today those risks have clearly lost their significance. After all, bank models have improved significantly, whereas rules that aim at tackling 'perverse incentives' and complexity have been applied across the board.[65] The fact that European securitisation, and especially simpler, benign, forms, performed very well during the GFC, whilst remaining resilient during the Covid-19 pandemic, is another clear indication that current capital non-neutrality rules are unwarranted and ought to be reassessed.

As one market participant puts it, 'a starting point of any discussion on the proportionality of the current levels of capital required by the CRR ought to be the acknowledgement that existing levels have no anchor or justification in data'.[66]

Focussing on the 'p' factor, the industry has consistently highlighted how important it is to recalibrate it, especially in the context of the SEC-SA, in view of the upcoming output floor introduced in the Basel III framework. As the industry notes, when coupled with the output floor which will be calibrated on the standardised approach, the currently punitive calibration of the 'p' factor under the SEC-SA is expected to have a severe negative effect on securitisation, especially retained tranches in synthetic SRT deals, and significantly discourage its use.[67] This will be due to an effectively double layer of conservatism that will be introduced once the reforms of Basel III come into force.[68]

It is important to note that capital non-neutrality rules are a 'peculiarity' of the securitisation framework, since they aim at addressing the specific modelling and agency risks that are thought to arise when assets are securitised. Therefore, they do not apply to other financial instruments, putting securitisation at a considerable disadvantage.

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[60] European Commission, 'Call for Advice to the Joint Committee of the ESAs for the Purposes of the Securitisation Prudential Framework Review' (18 October 2021), at 3.

[61] CRR new arts 259 para 1, and 260, introduced via Regulation 2017/2401.

[62] For STS securitisations, see CRR new art 262, introduced via Regulation 2017/2401. For non-STS securitisations see CRR new art 261 para 1, introduced via Regulation 2017/2401.

[63] For STS tranches see CRR new arts 260, 262, 264, introduced via Regulation 2017/2401. For non-STS tranches see CRR new arts 259, 261, 263, introduced via Regulation 2017/2401.

[64] EC Targeted Consultation Summary (n 27) 47.

[65] EBF, 'Annex to the EBF Response to the European Commission's Targeted Consultation on the Functioning of the EU Securitisation Framework' (1 October 2021) (hereinafter 'EBF Response') 4-6.

[66] PCS (n 18) 32.

[67] EC Targeted Consultation Summary (n 27) 47. See also FBF (n 43) 29; EBF Response (n 65) 4.

[68] The phase-in of Basel III reforms in the EU is now expected to begin in 2025, see Lorenzo Migliorato, 'EU's Basel III Delay Invites All to Play for Time' (15 November 2021) <https://www.risk.net/our-take/7897626/eus-basel-iii-delay-invites-all-to-play-for-time> accessed 1 September 2023.

A comparison to covered bonds suffices to illustrate this disadvantage: Using the SA, highly-rated (AAA to AA) covered bonds are assigned a 10% risk weight.[69] So are unrated covered bonds, provided that senior unsecured exposures to the covered bond issuer are assigned a 20% risk weight.[70] In that regard, risk weights for covered bonds seem to be aligned with risk weights applicable to securitisation, or at least senior STS tranches (that are subject to a 10% risk weight floor).[71] For all other securitisations however, the risk weight floor is set at 15%.

The effect of the inapplicability of non-neutrality rules in the case of covered bonds (and thus the divergence in treatment vis-à-vis securitisation) becomes even more striking when the IRBA is applied to calculate capital requirements. Based on calculations by the European Covered Bond Council ('ECBC'), when using the IRBA, covered bonds with a short maturity can be assigned a risk weight as low as 2.01%.[72]

In light of the above, it becomes evident that capital non-neutrality rules put securitisation at a considerable disadvantage vis-à-vis covered bonds, as they significantly increase the cost of investing in, or holding (in case of retained tranches), a securitisation position, compared to investing in, or holding, a covered bond.[73]

Faced with this adverse regulatory treatment, market participants are pushing for a recalibration of capital requirements for senior securitisation tranches, in order to bring them in line with capital requirements for covered bonds, and make them reflective of the actual risk profile of securitisation.[74]

Although the specifics of such a recalibration vary from recommendation to recommendation, a number of them seem to be in accord with the proposal included in the HLF's final report.

According to that proposal, a distinction should be drawn between STS and non-STS securitisation, concerning the applicable 'p' factor. Thus, the 'p' factor for STS securitisation should range from 0.1 to 0.3, whereas for non-STS securitisation, the range should be between 0.25 and 0.75.[75]

Regarding risk weight floors, market participants suggest a return to the previous floor of 7% for senior securitisation tranches, especially when those are retained by originating banks or sponsor banks (given the good knowledge of underlying assets and relevant risks, that such institutions typically have when they retain tranches). For other (non-retained) senior tranches the risk weight floor should be maintained at 15% (non-STS) and 10% (STS).[76]

2.3. Inclusion in the LCR's Liquidity Portfolios

[69] CRR art 129 para 4, table 6a.
[70] ibid arts 129, 120-121.
[71] Surprisingly, the introduction of the STS regime led to an overall increase of the risk weight floor for securitisation: Under the previous framework, the floor for all securitisations was set at 7% (cf CRR arts 261-262 (prior to any amendment via Regulation 2017/2401)). Now however the floor has increased by more than 100% for non-STS tranches, and more than 40% for STS tranches.
[72] Frank Will, 'Regulatory Issues' in *ECBC European Covered Bond Fact Book* (2022), at 161.
[73] Moreover, it is pertinent to note that current calibrations also put European securitisation at a disadvantage vis-à-vis US securitisation, since the US regulator has made use of the discretion provided under Basel rules to assign a 'p' factor of 0.5 when using the SEC-SA, instead of a factor of 1, as chosen by the European regulator (regarding non-STS securitisations), see PCS (n 18) 32.
[74] EBF Relaunching (n 27) 14; FBF (n 43) 31. See also High Level Forum (n 25) 52-53.
[75] High Level Forum (n 25) 61-62; EBF Relaunching (n 27) 14-16; PCS (n 18) 34.
[76] High Level Forum (n 25) 61-62.

The frustration of market participants regarding the way that securitisation is treated under the currently applicable LCR rules permeates their responses to the EC's targeted consultation, as well as other industry reports.[77]

Focussing on the shortcomings of the current calibration, it is important to note at the outset that the introduction of the STS regime in the context of the LCR resulted in an exclusion of (previously eligible) non-STS tranches from all levels of the liquidity ratio, and the replacement of those tranches by STS senior tranches at the same LCR level (Level 2B).

Adding insult to injury, in order to qualify for inclusion in Level 2B, a securitisation tranche now needs to meet a much more stringent and comprehensive standard, compared to the previous regime.[78] At the same time, the applicable haircuts remain unchanged. Thus, STS senior tranches backed by residential loans and auto loans and leases are subject to a minimum haircut of 25%,[79] whereas tranches whose underlying assets are SME-heavy loans and consumer loans are subject to a minimum 35% haircut.[80] There is also a 5-year maturity cap applicable to securitisations that aim at qualifying for the LCR, introduced under the previous framework, and maintained following the introduction of the STS regime.[81]

As the industry argues, this adverse prudential treatment of securitisation under the LCR is plainly unjustifiable, because it fails to acknowledge the performance of European securitisation structures from a liquidity perspective since the GFC and until today.

Beginning with the period of the GFC, market participants claim that, quite contrary to the findings of the European Banking Authority (the 'EBA'),[82] simple securitisation structures exhibited a liquidity performance that was equally good, and in certain respects superior, to the performance of other financial instruments, including covered bonds.[83]

To elaborate, for certain securitisation structures, such as auto loan-backed securities, deemed by the EBA as completely illiquid, studies have illustrated that from 2010 onwards, the most senior AAA tranches exhibited liquidity that was comparable to that of covered bonds. In early 2012, during the peak of the sovereign debt crisis in Europe, the most liquid AAA auto loan securitisations are found to have been more liquid than top-rated covered bonds.[84] During the same period, the most liquid AAA RMBS in countries with an active securitisation market like Spain and the UK, appeared to perform on par with, and at times even better than, similarly rated covered bonds, even though RMBS spreads did exhibit a long tail with some particularly illiquid issues.[85]

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[77] cf High Level Forum (n 25); and EBF Relaunching (n 27).

[78] Prior to the introduction of the STS regime, securitisations could qualify for inclusion in Level 2B of the LCR, provided they met a number of requirements included in art 13 paras 2-14 of Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for Credit Institutions [2014] OJ L174/16. Today, this set of requirements has been replaced with the requirement to qualify as STS, see Regulation 2015/61 art 13 (as amended via Commission Delegated Regulation (EU) 2018/1620 of 13 July 2018 amending Delegated Regulation (EU) 2015/61 to supplement Regulation (EU) No 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for credit institutions [2018] OJ L271/10). Qualifying as STS however, means complying with more than 100 separate criteria, set out in the new securitisation framework. As such, the bar for inclusion in the LCR is now much higher than it was before.

[79] Regulation 2015/61 art 13 para 2 points g(i), (ii) and (iv), and para 14(a).

[80] ibid art 13 para 2 points g(iii) and (v), and para 14(b).

[81] ibid art 13 para 12. See also PCS (n 18) 35.

[82] EBA, 'Report on appropriate uniform definitions of extremely high quality liquid assets (extremely HQLA) and high quality liquid assets (HQLA) and on operational requirements for liquid assets under Article 509(3) and (5) CRR' (December 2013).

[83] Bill Thornhill, 'Covered Bond Lobbyists 1, ABS Market 0' *Global Capital* (25.10.2013).

[84] William Perraudin, 'Covered Bond versus ABS Liquidity: A Comment on the EBA's Proposed HQLA Definition' (Risk Control Limited, January 2014), at 21 (fig 8), 24 (fig 11).

[85] ibid 4, 18 (fig 6 for the UK, and fig 7 for Spain).

In the same vein, ever since 2016, and including the period of Covid-19 pandemic, senior RMBS and auto loan securitisations appear to have been consistently more liquid than covered bonds.[86] Crucially, this observation is not limited to highly-rated securitisations, but also applies to senior securitisations of all ratings.[87]

However, this robust liquidity performance of securitisation vis-à-vis covered bonds (and other financial instruments) is hardly reflected on the current LCR framework.

More specifically, covered bonds are eligible for inclusion not just in Level 2B, but rather in every LCR Level (1, 2A, and 2B),[88] in recognition of their 'extremely high quality' from a liquidity perspective. Unlike securitisation tranches that need to be AAA/AA rated so as to be eligible for inclusion in the lowest level of the LCR, covered bonds with an AA- rating can qualify for inclusion in Level 1. A- rated covered bonds can be included in Level 2A, whereas for inclusion in Level 2B, covered bonds do not need to comply with any minimum rating limit.[89]

Regarding haircuts, Level 1 covered bonds are subject to a minimum 7% haircut.[90] In Level 2A the applicable minimum haircut is 15%,[91] and for Level 2B it is equal to a minimum 30%.[92] Evidently, compared to the minimum 35% haircut applicable to senior STS tranches,[93] covered bonds of all LCR Levels receive a more favourable treatment. Moreover, unlike securitisation, there is no 5-year maturity cap (or any other maturity cap for that matter) applicable to covered bonds.

Going beyond covered bonds, the adverse treatment of securitisation is evident when a comparison is drawn with corporate bonds.

Indicatively, corporate bonds are eligible for inclusion in both Level 2A and Level 2B of the LCR, provided they certain requirements, eg regarding their size and tenor.[94] Focussing on tenor requirements, the maturity cap for Level 2A and Level 2B corporate bonds is set at 10 years, that is, twice as long as the cap set for securitisation tranches. In addition, the minimum rating that a corporate bond needs to be eligible for Level 2A is AA, whereas for Level 2B, it drops to BBB.[95] Compared to the AAA/AA rating that a senior STS tranche needs for Level 2B eligibility, the difference is quite substantial.

Finally, Level 2A corporate bonds are subject to a minimum haircut of 15%, whereas for Level 2B, the minimum haircut is 50%. Although Level 2B securitisation tranches are treated better than Level 2B corporate bonds, in terms of minimum applicable haircut, the haircut of Level 2A corporate bonds is significantly lower (15%, compared to 25% or 35%).[96]

In view of the above, upgrading the treatment of securitisation under the LCR is considered crucial by the industry, in order to increase the attractiveness of securitisation amongst credit institutions, and facilitate a deeper and broader market for securitisation products. To achieve that, market participants are proposing that classifications, haircuts, and minimum ratings for

[86] William Perraudin and Yixin Qiu, 'Comparing ABS and Covered Bond Liquidity' (AFME and Risk Control, 25 February 2022) (hereinafter 'Perraudin Liquidity 2022'), at 8.
[87] ibid 7, Fig 3.
[88] Regulation 2015/61 art 10 para 1(f), art 11 para 1(c) and (d), and art 12 para 1(e).
[89] EBF Relaunching (n 27) 24.
[90] Regulation 2015/61 art 10 para 2.
[91] ibid art 11 para 2.
[92] ibid art 12 para 2(d).
[93] When backed by residential loans and auto loans and leases.
[94] Regulation 2015/61 art 11 para 1(e) and art 12 para 1(b).
[95] Regulation 2015/61 arts 11 and 12 refer to CRR art 122. For mapping see Commission Implementing Regulation (EU) 2016/1799 of 7 October 2016 laying down implementing technical standards with regard to the mapping of credit assessments of external credit assessment institutions for credit risk in accordance with Articles 136(1) and 136(3) of Regulation (EU) No 575/2013 of the European Parliament and of the Council [2016] OJ L275/3.
[96] cf Marke Raines, 'UK Regulation of Term Securitisation Following a Hard Brexit' (2018) 13(4) Capital Markets Law Journal 534, at 548.

securitisation tranches are reviewed, so as to align them more closely to the requirements set under the LCR for covered bonds with similar characteristics.[97]

More specifically, one suggestion put forward is to include senior STS tranches backed by residential loans and auto loans and leases in Level 1 of the LCR, subject to a minimum AA- rating, a minimum 7% haircut, and a minimum issue size of €500mn (similar to Level 1 covered bonds). Senior STS tranches backed by SME-heavy loans and consumer loans would then become eligible for Level 2A, subject to the same requirements as covered bonds eligible for the same level (minimum A- rating, minimum 15% haircut, a minimum issue size of €250mn). Senior STS tranches not meeting the issue size criteria for inclusion in either Level 1 or Level 2A, would be eligible for Level 2B, but the minimum rating would be BBB- (instead of AAA/AA, as it currently stands), and the minimum haircut would be 30%.[98]

In addition to the above, market participants are pushing for the reinstatement of non-STS senior tranches in the LCR. This could be achieved by making such tranches eligible for Level 2B, subject to minimum AA- rating, and a minimum 30% haircut.[99]

2.4. Regulatory Capital Requirements under Solvency II

A recalibration of capital requirements under the CRR, coupled with a review of the LCR treatment of securitisation, so as to align it more closely with the treatment of other 'neighbouring' financial instruments, could potentially make securitisation more attractive, and therefore more popular, amongst credit institutions looking to invest.

In and of itself however, an increased involvement on behalf of credit institutions in the securitisation market would be insufficient, if securitisation is to achieve the goals set by the European regulator in the context of the Capital Markets Union (the 'CMU'). In order for banks to be able to free capital via securitisation, the market for the latter needs to be sufficiently large and, most importantly, it cannot consist exclusively of credit institutions, both on the supply side and the demand side. It is in this context, that the involvement of (re)insurance undertakings in the European securitisation market becomes crucial.

Cognizant of the above, the securitisation industry has made it abundantly clear that the Solvency II framework for securitisation is in dire need of review, in order to reinvigorate interest in securitisation amongst insurers.[100] As market participants explain, it is imperative that (re)insurance undertakings become once again active investors in securitisation, not only for the sake of the insurance industry, but ever more importantly for the sake of the wider European economy.[101]

In theory, the European regulator has the same objective: By incorporating the STS regime in Solvency II,[102] the ultimate goal was to convince (re)insurance undertakings to return to the European securitisation market, where they once played a significant role.[103]

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[97] EBF Relaunching (n 27) 13; FBF (n 43) 33; Paris EUROPLACE (n 58) 10.

[98] EBF Relaunching (n 27) 47-48, Appendix 2.

[99] ibid.

[100] EBF Relaunching (n 27) 23.

[101] PCS (n 18) 39.

[102] This was achieved through the amendment of Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) [2015] OJ L12/1, via Commission Delegated Regulation (EU) 2018/1221 of 1 June 2018 amending Delegated Regulation (EU) 2015/35 as regards the calculation of regulatory capital requirements for securitisations and simple, transparent and standardised securitisations held by insurance and reinsurance undertakings [2018] OJ L227/1.

[103] cf ECB and BoE, 'The Case for a Better Functioning Securitisation Market in the European Union' (May 2014), at 14.

So far however, the results of this attempt by the regulator have been described as 'nothing short of catastrophic':[104] Indicatively, as revealed in the May 2021 Report of the ESAs' Joint Committee (the 'JC'), by end-2019, the share of securitisation positions in the investment portfolios of European (re)insurance undertakings was equal to 2.3%. 2% of that amount represented the investment of insurers in STS securitisation, making the total investment in STS securitisation by insurers equal to a mere 0.046%.[105]

In the industry's view, these truly disheartening data are inextricably linked to the prudential treatment of securitisation under Solvency II. Indeed, the consensus amongst market participants seems to be that the regulatory capital requirements imposed by Solvency II are the main factor hindering the increase of investment in securitisation by insurers.[106] To elaborate, the industry considers that capital requirements for STS tranches, senior and non-senior, as well as for non-STS tranches are not commensurate with the risks that investing in securitisation entails for (re)insurance undertakings.[107]

Beginning with non-STS securitisation, the introduction of the STS regime led to the effective downgrade of senior non-STS tranches, that are now 'bundled' together with non-senior (mezzanine) non-STS tranches, so far as their treatment under Solvency II is concerned.[108] In parallel, spread risks for all non-STS tranches are approx. 4.5 times the spread risks for equivalent non-senior STS tranches, and approx. 12 times the spread risks of equivalent senior STS tranches.[109]

These capital charges are considered excessive by the industry, who deems them as one of the main reasons why European (re)insurance undertakings are absent from the European CLO and commercial mortgage-backed security ('CMBS') market.[110]

Moving on to STS tranches, their treatment under the currently applicable provisions of Solvency II is admittedly better, compared to the treatment that an equivalent tranche would have received under the previous regime.

That said, the industry has also expressed a number of concerns in that regard: To begin with, the gap between mezzanine STS tranches and senior STS tranches, in terms of their treatment under Solvency II, is quite considerable. For instance, a 5-year AA rated senior STS tranche has a spread risk of 6%, whereas a mezzanine STS tranche of equivalent tenor and rating is assigned a spread risk of 17%.

As market participants argue however, the rating that a tranche attracts already encompasses the level of risk that investing in that tranche entails, therefore distinguishing between mezzanine and senior tranches, and applying a capital charge on the former that is almost 3 times higher than the charge on the latter, is considered unjustifiably excessive.[111]

In order to illustrate how adverse the treatment of securitisation is, under Solvency II, the industry refers to recent studies that analyse the relative risk of European securitisation structures during the Covid-19 pandemic and reach the conclusion that, whilst capital charges

[104] PCS (n 18) 7-8.

[105] ESMA, EBA, and EIOPA, 'Joint Committee Report on the Implementation and Functioning of the Securitisation Regulation (Article 44)' (17 May 2021), at 43-44.

[106] EC Targeted Consultation Summary (n 27) 57.

[107] ibid 57-59.

[108] Regulation 2015/35 art 178 para 8 (as amended via Regulation 2018/1221).

[109] A 1-year AAA rated non-STS tranche is assigned a spread risk of 12.5%, whereas a 1-year AAA rated non-senior STS tranche has a spread risk of 2.8%, as per Regulation 2015/35 art 178 para 4 (as amended via Regulation 2018/1221). A 1-year AAA rated senior STS tranche is assigned a spread risk of 1.0%, as per Regulation 2015/35 art 178 para 3 (as amended via Regulation 2018/1221).

[110] Deutsche Bank (n 42) 44. The STS regime in its current calibration excludes both CLOs and CMBS from its scope. As a result, CLO and CMBS tranches can only be assigned spread risks that correspond to non-STS tranches.

[111] Insurance Europe (n 58) 21.

for senior STS tranches imposed under Solvency II are more or less appropriate, the charges imposed to mezzanine STS tranches and non-STS tranches are effectively double of what the charges that should have been, in order to reflect the *actual* risk that those tranches entail for investing (re)insurance undertakings.[112]

The same conclusion is reached when spread risks assigned to other 'neighbouring' financial instruments are taken into consideration.

To elaborate, despite recent findings that the risk of senior and non-senior STS tranches is 5% and 3% lower respectively, compared to the risk that a (re)insurance undertaking assumes when investing in a covered bond,[113] the latter is treated in a clearly favourable fashion. The same holds true when securitisation is compared to corporate bonds.

By way of example, a 1-year AAA rated senior STS tranche has a spread risk of 1%, whereas an equivalent corporate bond is assigned a spread risk of 0.9%, and an equivalent covered bond has a spread risk of 0.7%.[114] As tenor increases, the gap becomes more visible: a 5-year AAA rated senior STS tranche has a spread risk of 5%, whereas the spread risk for an equivalent corporate bond and covered bond is 4.5% and 3.5% respectively.[115]

The biggest difference however lies between non-senior STS tranches and other financial instruments. Indicatively, a 5-year AAA rated non-senior STS tranche is assigned a spread risk of 14%. Compared to the 4.5% and 3.5% spread risk assigned to equivalent corporate bonds and covered bonds respectively, the difference is astonishing. In the same vein, a 5-year AA rated non-senior STS tranche is assigned a spread risk of 17%. Again, compared to the 5.5% and 4.5% spread risk assigned to equivalent corporate bonds and covered bonds respectively, the treatment that securitisation receives is without a doubt adverse.[116]

Furthermore, under Solvency II, securitisation tranches are also treated unfavourably vis-à-vis whole loan pools. This is the case not just for non-STS tranches, eg when the capital charge of investing in a CLO tranche is compared to investing in a pool of leveraged loans, but also for STS tranches, senior and non-senior.[117]

Remarkably, as one market participant explains, Solvency II effectively requires an (re)insurance undertaking to allocate more capital to the purchase of an AAA rated senior STS RMBS tranche, than to the purchase of a pool of the same residential mortgages that would collateralise that RMBS. This is despite the fact that such an RMBS tranche will have a credit enhancement equivalent to 20 times the worst credit loss that has been recorded historically for this asset class, and also notwithstanding the fact that such RMBS tranches suffered no credit losses during the GFC.[118]

Given the inability, so far, of the Solvency II framework to incentivise insurers to return to the European securitisation market, even after the amendments introduced via Regulation 2018/1221, the industry is pushing for a further fundamental review that will finally allow securitisation to compete with other 'neighbouring' financial instruments on an equal footing.

Thus, in addition to reducing the gap between STS and non-STS tranches,[119] market participants are arguing that capital charges for senior STS tranches (but also potentially for

[112] William Perraudin and Yixin Qiu, 'ABS and Covered Bond Risk and Solvency II Capital Charges' (AFME and Risk Control, 25 February 2022), at 3.
[113] ibid.
[114] See Regulation 2015/35 art 176 for corporate bonds, and art 180 for covered bonds.
[115] cf Raines (n 96) 547; Insurance Europe (n 58) 20.
[116] cf Deutsche Bank (n 42) 44.
[117] ibid 41, 42; Insurance Europe (n 58) 20.
[118] PCS (n 18) 40.
[119] Deutsche Bank (n 42) 44; High Level Forum (n 25) 53; Paris EUROPLACE (n 58) 14; Insurance Europe (n 58) 21.

senior non-STS tranches) should be more closely aligned to the charges applicable to covered bonds and corporate bonds of equivalent rating and maturity.[120]

This could be achieved by aligning capital charges for senior STS and non-STS tranches to equivalent covered bonds, when the securitisation is backed by granular mortgage loans or consumer loans. When the securitisation is backed by corporate loans, capital charges for senior STS and non-STS tranches could be aligned to charges applicable to corporate bonds.[121]

Finally, in order to close the gap between securitisation and whole loan pools, market participants are suggesting that the capital charge for senior securitisation tranches should in principle become lower than the charge applied to the respective whole loan pools on a standalone basis[122] or, at the very least, the capital charge for senior tranches should be capped at the capital charge of the underlying asset pool.[123]

3. THE EUROPEAN REGULATOR'S RESPONSE

Following the publication of the October 2022 EC Report on the functioning of the SECR, and the December 2022 Joint Advice of the ESAs on the prudential treatment of securitisation, the direction of travel for the regulatory treatment of European securitisation vis-à-vis other 'neighbouring' financial instruments has become clear. This direction however is hardly what the industry had been hoping for.

3.1. The Uneven Regulatory Playing Field is Justified

Before delving into an analysis of the specific points raised by the EC and the ESAs, concerning each area in which the securitisation industry is claiming there is an uneven regulatory playing field, it is pertinent to bear in mind that the European regulator does not agree with the very *idea* that the regulatory playing field surrounding securitisation and other 'neighbouring' financial instruments is uneven, or at least that the adverse treatment that securitisation receives should be a source of concern.

In all fairness, in their responses, the EC and the ESAs do acknowledge the industry's concerns regarding the regulatory treatment that securitisation structures receive in Europe, and how this treatment compares to the treatment reserved for other financial instruments.

It is thus noted that the industry considers disclosure and due diligence obligations imposed under the SECR on sell-side and buy-side entities respectively as 'too prescriptive and strict', compared to the obligations imposed on institutions involved in covered bond transactions.[124] In a similar fashion, it is recognised that, according to market participants, STS securitisations (and asset-backed commercial paper ('ABCP') structures) should be treated in the same way as covered bonds under the LCR,[125] and that capital charges imposed on securitisation structures, particularly non-STS and non-senior STS, under Solvency II are too high, relative to capital charges for corporate bonds and covered bonds.[126]

This acknowledgement however, on behalf of the regulator, does not translate into an endorsement of the securitisation industry's concerns.

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[120] High Level Forum (n 25) 53.
[121] Insurance Europe (n 58) 20.
[122] High Level Forum (n 25) 53.
[123] Deutsche Bank (n 42) 43; EBF Relaunching (n 27) 23.
[124] EC Report (n 8) 9.
[125] ESA Joint Advice Banking (n 8) 90.
[126] Joint Committee of the ESAs, 'Joint Committee Advice on the Review of the Securitisation Prudential Framework (Insurance) JC-2022/67' (12 December 2022) (hereinafter the 'ESA Joint Advice Insurance'), at 36.

On the contrary, as the ESAs point out, the claim about an uneven regulatory playing field is probably an exaggeration, at least in the context of Solvency II. On the one hand, regulatory capital requirements imposed on senior STS securitisation tranches are 'approximately of the same magnitude' as those imposed on corporate bonds and covered bonds.[127] To the extent that there is any actual disparity in treatment, eg between non-STS and non-senior STS tranches and other 'neighbouring' financial instruments, such disparity is in fact justified.

This is due, not only to the 'nature of securitisation and its added risk', ie the fact that, in the ESAs' view, securitisation is inherently riskier, or that other instruments are inherently safer,[128] but also due to the limited interest that (re)insurance undertakings exhibit in investing in securitisation, compared to covered bonds and corporate bonds.[129] Focussing on the latter argument, the regulator interprets the fact that (re)insurance undertakings have been marginal investors in securitisation for a fairly long time—a phenomenon that even the STS amendment of Solvency II, via Regulation 2018/1221, failed to reverse—as an indication that such institutions do not consider prudential regulation as an important driver in their investment activity.[130]

After all, as the ESAs argue, capital requirements for senior STS tranches are 'broadly comparable' to those for covered bonds and corporate bonds. Nevertheless, the share of senior STS tranches in the portfolios of (re)insurance undertakings is only a fraction of the share that covered bonds and corporate bonds, but also—remarkably—non-STS tranches have, proving that incentives related to the prudential treatment of securitisation is not what keeps (re)insurance undertakings away from securitisation structures.[131]

Based on those findings, the ESAs conclude that a leveling of the regulatory playing field for senior STS tranches and other 'neighbouring' financial instruments (or for STS tranches vis-à-vis non-STS tranches) is unwarranted, because its effectiveness, as a means of incentivising (re)insurance undertakings to return to securitisation, is far from certain, whereas the cost of amending the existing framework is potentially too high.[132]

In a similar fashion, the evident disparity in treatment between securitisation and covered bonds in the context of the LCR[133] is justified because, contrary to the findings of research commissioned by the securitisation industry,[134] covered bonds are in fact much more liquid than securitisation, at least when the repo market is taken into consideration.[135]

In addition, the ESAs note that, ever since the introduction of the LCR, the share of securitisations (including STS tranches) in credit institutions' liquidity buffers has been practically negligible, unlike covered bonds that have been used extensively by banks as 'high quality liquid assets' ('HQLA').[136]

This 'indifference' towards securitisation, on behalf of credit institutions, is particularly noteworthy according to the ESAs, if one takes into account that, overall, the LCR levels of European banks are considerably above minimum regulatory standards.[137] On top of that, while

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[127] ibid 9, 24-25.
[128] ibid 63. See also id 31, where the ESAs point to the 'dual recourse' (to the issuer, as well as to underlying pool of assets) that covered bonds offer to investors, as a justification for the preferential regulatory treatment that covered bonds receive vis-à-vis securitisation.
[129] ibid 23, figs 17, 18.
[130] ibid 5.
[131] ibid 25-26.
[132] ibid 6.
[133] Where securitisation (STS) tranches are eligible only for inclusion in Level 2B, subject to a number of stringent requirements, regarding haircuts, maturity caps, ratings etc., whereas covered bonds are eligible for inclusion in all LCR Levels.
[134] Perraudin Liquidity 2022 (n 86).
[135] ESA Joint Advice Banking (n 8) 93.
[136] ibid 87-88, see especially fig 31.
[137] ibid 87.

developing the European liquidity framework, the European regulator deviated from Basel rules, and expanded the category of securitisation products that could qualify for the LCR, exactly so as to incentivise credit institutions to use securitisation as a means of improving their liquidity profile.[138] Not even that however was sufficient to convince banks to include more securitisation tranches in their buffers.

The conclusion reached by the ESAs is that credit institutions do not consider securitisation as an effective means of coping with liquidity stress periods, because they deem securitisation structures to be ineffectively marketable during periods of stress. An alternative explanation they provide is that banks do not find securitisation attractive enough to diversify into.[139]

In view of the above, leveling the regulatory playing field, by upgrading securitisation in the LCR, would make little sense, and is certainly not a priority, because banks already have considerable incentives to invest, yet they steer clear of securitisation. Further incentivising them would do very little to change that situation.

3.2. No Need for a Fundamental Recalibration of the Regulatory Framework

The European regulator's stance, regarding the regulatory playing field for securitisation vis-à-vis other 'neighbouring' financial instruments, is indicative of its wider perception of the European securitisation framework.

More precisely, the EC and the ESAs do not consider that the currently uneven playing field is a source of concern, because, more broadly, the regulatory framework of securitisation in Europe, ie the SECR and the prudential rules stemming from the CRR, LCR, and Solvency II, is overall fit for purpose.

As explained above, market participants have consistently expressed their frustration about the shortcomings of the existing framework, which has overall failed to achieve almost any of the objectives set by the regulator when it introduced it back in 2015.[140] Notwithstanding the extraordinary events of the period 2020-23, the securitisation industry puts a significant amount of blame on the disproportionate, burdensome, and often unnecessary provisions of the SECR and the prudential regime, for the fact that the European securitisation market remains effectively moribund. For all those reasons, the industry has been pushing hard for a fundamental reform of both the SECR and the prudential regime surrounding securitisation.

Based on the views expressed in the October 2022 EC Report and the December 2022 ESA Joint Advice however, the regulator seems to disagree with practically all of the points raised by the industry.

So far as the securitisation market is concerned, the regulator considers it to be fairing relatively well, and to have improved in terms of quality, having stabilised after years of decline.[141] That 'success' can partly be attributed to the new regulatory framework, since the latter has already contributed significantly to the achievement of the EU's core goal of establishing a safe and sound European securitisation market that works to the benefit of the wider economy.[142] Even more remarkably, and without providing any relevant evidence, the EC suggests that market participants are 'generally supportive' of the new securitisation framework.[143]

Bearing in mind those conclusions reached by the regulator, it should come as no real surprise that, unlike market participants, the EC and the ESAs consider any substantial reform

[138] ibid 87-88.
[139] ibid 8-9, 14, 87.
[140] See indicatively EC Report (n 8) 6, fig 1.
[141] ibid 4-5, 25.
[142] ibid 25.
[143] EC Report (n 8) 5.

to the SECR or the securitisation prudential framework as unwarranted for the time being.[144] Instead, they suggest that all that is needed is a targeted, technical, fine-tuning of the existing framework for consistency.

3.2.1. *Some Positive Developments*

To be fair, despite its explicit disagreement with the industry, some of the targeted amendments that the European regulator has proposed do have the potential indirectly to help level the regulatory playing field for securitisation vis-à-vis other 'neighbouring' financial instruments.

The plan put forth by the EC in its Report, to streamline disclosure obligations imposed on sell-side entities under the SECR, is a characteristic example of such potentially beneficial targeted amendments.

To elaborate, in an acknowledgement that, ever since it was introduced, article 7 of the SECR has been a source of considerable concern for market participants, the EC recognised that, in some areas, templated disclosure has been functioning inefficiently, forcing sell-side entities to produce and report information that is often useless to investors. This inefficiency has been the source of unnecessary compliance costs.[145] It also seriously took into account the industry feedback about ESMA templates being inappropriate in their current form, so far as private deals are concerned, acknowledging that 'because of the bespoke nature of private securitisation, investors in such transactions need more tailor-made information than the ESMA templates might be able to provide.'[146]

In response, the regulator suggested that templated disclosure should be further streamlined and simplified, and to that end, it mandated ESMA to review the existing templates for underlying assets in securitisation. More specifically, ESMA was invited to address certain technical difficulties faced by sell-side entities when completing the relevant templates; remove fields from the templates that are deemed unnecessary; and more closely align disclosure obligations to investors' needs. Furthermore, ESMA was asked to assess the extent to which disclosing loan-by-loan data is helpful to investors, regardless of the type of securitisation.[147]

Regarding private deals, despite not going so far as to suggest that templated disclosure should be scrapped altogether, as some market participants had urged it to do, the EC mandated ESMA to draw up dedicated templates for private deals. The goal is to considerably simplify disclosure obligations when sell-side entities engage in private securitisation, whilst facilitating supervisors in their effort to gain a holistic view of the private securitisation market and its features.[148]

To the extent that they are implemented, those suggestions by the EC have the potential significantly to ease the burden currently assumed by sell-side entities in securitisation deals, and align the SECR more closely to Directive 2019/2162, which imposes disclosure obligations on credit institutions that issue covered bonds. It is for such reasons that the EC's plan has been warmly received by market participants,[149] who have praised ESMA's proactive engagement

[144] See ibid 7 for the SECR; ESA Joint Advice Banking (n 8) 7 for the CRR and the LCR; and ESA Joint Advice Insurance (n 126) 4 for Solvency II.
[145] EC Report (n 8) 10.
[146] ibid 11-12.
[147] ibid 10.
[148] ibid 12.
[149] AFME and others, 'Securitisation can Provide Significant Support to Europe's Economy in the Testing Times Ahead – Targeted Measures are Needed to Unlock its Potential' (3 November 2022) (hereinafter 'AFME November 2022'), at 2, 8; AFME and others, 'Request for Guidance to National Competent Authorities to Use Enforcement Powers in a Proportionate and Risk-Based Manner' (9 December 2022) (hereinafter 'AFME December 2022'), at 1-2. cf Jennifer Aubry and others, 'EU Securitisation Review: Two Months on' (Clifford Chance, December 2022), at 2-3.

with the industry,[150] and have committed to work closely with the regulator in the context of the formal public consultation that ESMA is expected to launch later in 2023.[151]

Another example of a potentially beneficial proposal, from a regulatory playing field-perspective, is the ESAs' recommendation to recalibrate capital non-neutrality rules in the CRR.

Specifically, the ESAs have recommended that, subject to a number of requirements (concerning amortisation, granularity, and the thickness of the non-senior tranches that are sold to third parties),[152] the risk weight floor for retained senior STS tranches, risk weighted under the SEC-IRBA (as the most sophisticated approach), should be reduced from 10%, to 7%. For retained senior non-STS tranches risk weighted under all the approaches, the floor should be reduced from 15%, to 12%.[153]

If accepted by the EC, this recommendation will achieve a closer alignment between risk weights imposed on securitisation structures, and risk weights imposed on covered bonds.

At the same time however, by limiting the risk weight floor recalibration to retained tranches, the ESAs' recommendation aims exclusively at facilitating the SRT market, and those originating credit institutions involved in balance sheet synthetic securitisation (SRT) deals. On the contrary, risk weights for securitisation tranches sold to the market will remain unchanged. The ESAs justify this decision, by arguing that a recalibration of capital non-neutrality rules aimed at investors would not be particularly helpful in the effort to revitalise the European securitisation market, in view of other factors that keep investor demand subdued.[154]

Even regarding SRT deals, market participants point out that, unless this recommendation is coupled with a recalibration of the capital surcharge also known as a the 'p' factor, any potentially positive effect stemming from the recommendation risks being negated, as a result of the Basel III output floor, that will drastically increase regulatory capital requirements, particularly for retained securitisation tranches.[155]

In that context, it is pertinent to note that, in early 2023, the European Parliament's Committee on Economic and Monetary Affairs ('ECON') approved an amendment to 'CRR3' (the draft legislation, which along with 'CRD6' will implement the remaining Basel III reforms in the EU) that is expected to facilitate credit institutions that engage in synthetic SRT securitisation deals.[156]

More specifically, the amendment, tabled in August 2022 as 'Amendment 1388' to CRR3,[157] adopts an earlier proposal put forward by the HLF and the EBF to reduce the 'p'

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[150] ESMA quickly began working towards the implementation of its mandate, by launching an informal 'pre-consultation' in December 2022, through which the industry had the opportunity to provide feedback, see AFME, 'Securitisation Data Report Q4 2022' <https://www.afme.eu/Portals/0/DispatchFeaturedImages/AFME%20Securitisation%20Report%20Q4%202022%20and%202022%20Full%20Year-2.pdf> accessed 1 September 2023, at 6.

[151] ibid.

[152] ESA Joint Advice Banking (n 8) 70, table 4.

[153] ibid 69, table 3.

[154] ibid 7-8.

[155] AFME, 'AFME Disappointed by ESAs' Inaction on Securitisation – EU Legislators Should Provide Leadership to Address Regulatory Imbalances' (13 December 2022), at 1.

[156] European Parliament, 'Report on the Proposal for a Regulation of the European Parliament and of the Council Amending Regulation (EU) No 575/2013 as Regards Requirements for Credit Risk, Credit Valuation Adjustment Risk, Operational Risk, Market Risk and the Output Floor (COM(2021)0664 – C9-0397/2021 – 2021/0342(COD))' (9 February 2023).

[157] Committee on Economic and Monetary Affairs of the European Parliament, 'Amendment 1198-1561: Draft report Jonás Fernández (PE731.818v01-00): Amending Regulation (EU) No 575/2013 as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor: Proposal for a regulation (COM(2021)0664 – C9-0397/2021 – 2021/0342(COD))' (18 August 2022), at 109-110.

factor by half for the purpose of calculating the output floor, when risk weights for securitisation positions are calculated using the SEC-SA.[158] Thus, for STS securitisations, the 'p' factor should be reduced from 0.5 (the current calibration) to 0.25, whereas for non-STS securitisations, it should be reduced from 1 to 0.5.[159]

This amendment, which appears to have survived the trilogue negotiations between the EC, the European Council, and the Parliament,[160] is merely a temporary measure, pending a comprehensive review of the European securitisation framework in the context of the CMU. The industry's hope of course is that, by the time of that review, the European regulator will have reconsidered its stance, and will render the reduction in the 'p' factor permanent.

Nevertheless, the halving of the 'p' factor was welcomed by market participants, because it is expected to mitigate the adverse effects that the output floor, calibrated on the standardised approach, is expected to have, particularly on retained tranches in balance sheet synthetic SRT deals, due to the effectively double layer of conservatism that it would introduce, when coupled with capital non-neutrality rules.[161]

In that sense, the (temporary) reduction in half of the 'p' factor, coupled with the lowering of the risk weight floor, as proposed by the ESAs in their December 2022 Joint Advice, can have an (indirect) effect on the regulatory playing field, by substantially alleviating the burden of capital non-neutrality rules that apply to securitisation, and thus align more closely the regulatory capital requirements that the CRR imposes on securitisation structures and covered bonds respectively.

3.2.2. *Keeping Securitisation at Bay*

Notwithstanding the potentially beneficial effects of the proposed targeted amendments, the October 2022 EC Report and the December 2022 ESA Joint Advice offer very little in respect of the securitisation industry's push for a leveling of the regulatory playing field for securitisation vis-à-vis other 'neighbouring' financial instruments. On the contrary, through its proposals, the regulator risks creating additional hurdles that will further disincentivise market participants, so far as investing in securitisation structures is concerned.

For instance, despite admitting that due diligence obligations imposed on buy-side entities under the SECR are complex and disproportionate, creating an assessment premium in the form of high due diligence costs that does not exist when investing in covered bonds,[162] the regulator does not purport to ease that burden. Far from it, the interpretative guidance that the EC provided in its Report, concerning the jurisdictional scope of SECR's article 5(1)(e), has created a *de facto* ban for European investors, regarding third-country securitisations in which sell-side entities are not willing (or able) to engage in a 'full article 7-style disclosure'.[163]

This is due to the position adopted by the EC, that the scope of due diligence obligations imposed on European investors cannot depend on whether the relevant sell-side entities are located inside or outside the Union. Accordingly, interpreting article 5(1)(e) as leaving it to the discretion of investors to decide, when investing in third-country securitisations, whether they

[158] High Level Forum (n 25) 61-62; EBF Relaunching (n 27) 15.
[159] European Parliament (n 156) art 465 para 5a.
[160] cf AFME , 'AFME Welcomes EU Political Agreement on the Implementation of the Basel 3 Standards, but Cautions Against Expendable Capital Increases' (27 June 2023).
[161] DLA Piper, 'The European Parliament Offers the Prospect of Relief Regarding the Upcoming Output Floor' (27 January 2023).
[162] ESA Joint Advice Banking (n 8) 7-8, 12. See also Precious Ivongbe, Kevin Ingram, 'A False Dawn for the European Securitisation Prudential Framework?' in Clifford Chance, 'Securitisation Markets and Regulation: Choosing Different Paths?' (June 2023), at 6.
[163] EC Report (n 8) 21.

have received all the information needed to properly conduct their due diligence,[164] is not in line with the legislative intent behind this provision.[165]

Instead, the regulator interprets article 5(1)(e) as requiring that investors receive a 'full article 7-style disclosure' from sell-side entities, even when the latter are located outside the EU. Investors have no discretion to decide whether the information they have received is sufficient, eg because it is materially comparable to the information that European sell-side entities have to disclose under SECR article 7.[166]

It is evident that this interpretation on behalf of the EC drastically increases the burden that securitisation investors assume, regarding their due diligence obligations, and makes the disparity vis-à-vis covered bondholders (who assume no due diligence obligations under Directive 2019/2162) even greater. For that reason, it has been heavily criticised by the securitisation industry.[167]

So far as the LCR and Solvency II frameworks are concerned, it was explained above that the regulator considers the current calibration of the regulatory playing field for securitisation vis-à-vis financial instruments like covered bonds and corporate bonds as appropriate and justified.

Therefore, the October 2022 EC Report and the December 2022 ESA Joint Advice contain no substantive proposals for amending either framework in the foreseeable future.[168]

The only relevant recommendation by the ESAs refers to a 'technical' fix to the LCR, and specifically Regulation 2015/61, in order to resolve the issue that arose by the regulator's failure to carry over the reference to article 251 of the CRR, when Regulation 2015/61 was amended via Regulation 2018/1620.

Specifically, it has been recommended that, instead of referring solely to securitisation tranches that have been assigned a credit quality step ('CQS') 1 in accordance with article 264 of the CRR, Article 13(2)(a) of Regulation 2015/61 should refer to tranches assigned a CQS 1 to 4. This change in reference, coupled with the amendment to Regulation 2016/1801 (which provides for the mapping of credit assessments)[169] via Regulation 2022/2365,[170] will allow securitisation tranches rated AA to become once again eligible for inclusion in Level 2B of the LCR.[171]

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[164] That was the practice followed by a significant number of European investors, prior to the EC's interpretative guidance, see Andrew Bryan and James Watkins, 'The Future of the Securitisation Regulations in the EU and the UK: Brexit and Beyond' (Clifford Chance, March 2022); Sushila Nayak, 'European Commission Publishes Report with Important Implications for EU Institutional Investors Investing in Third Country Securitisations' (Orrick, 17 October 2022).
[165] EC Report (n 8) 21.
[166] ibid.
[167] cf Dominic Griffiths and others, 'European Commission Report on the Functioning of the EU Securitisation Regulation' (Mayer Brown, 28 October 2022); and especially AFME December 2022 (n 149) 3-5, where a number of theoretical scenarios are explored, to illustrate the potentially catastrophic effects of the EC's interpretation of SECR art 5 para 1(e).
[168] That said, according to Ivongbe (n 162) 8-9, the EC is understood to be sympathetic to the need for recalibrating the Solvency II rules that apply to securitisation. However, the opposing view of the ESAs in that regard is expected to make any such attempt for recalibration more difficult, because the EC will have to carry out any relevant technical analysis on its own.
[169] Commission Implementing Regulation (EU) 2016/1801 of 11 October 2016 on laying down implementing technical standards with regard to the mapping of credit assessments of external credit assessment institutions for securitisation in accordance with Regulation (EU) No 575/2013 of the European Parliament and of the Council [2016] OJ L275/27.
[170] Commission Implementing Regulation (EU) 2022/2365 of 2 December 2022 amending the implementing technical standards laid down in Implementing Regulation (EU) 2016/1801 as regards the mapping tables correspondence of credit assessments of external credit assessment institutions for securitisation in accordance with Regulation (EU) No 575/2013 of the European Parliament and of the Council [2022] OJ L312/101.
[171] ESA Joint Advice Banking (n 8) 93-94.

This is, without a doubt, a positive development, but it hardly constitutes a step forward. After all, AA rated securitisation tranches were eligible for Level 2B even before the STS regime was embedded in the LCR framework via Regulation 2018/1620. Meanwhile, covered bonds with an AA rating can qualify for inclusion in Level 1 of the LCR. A- rated covered bonds can be included in Level 2A, whereas for Level 2B, covered bonds do not have to comply with any minimum rating limit.[172] AA rated corporate bonds on the other hand, are eligible for Level 2A, and BBB rated corporate bonds are eligible for Level 2B.[173]

It is therefore clear that, even if the ESAs' 'technical' fix is accepted, the disparity vis-à-vis other 'neighbouring' financial instruments will remain vast.

Overall, the way that the regulator perceives securitisation and its role in Europe, as reflected on its October 2022 EC Report, and the December 2022 Joint Advice of the ESAs, has provided fodder to the accusation on behalf of market participants that the regulator's true (albeit unconfessed) aim is to keep securitisation at bay, that is, make sure that the European securitisation market remains niche, and does not grow to an extent that the regulator is no longer able effectively to control it.[174]

4. EFFECTS OF AN UNEVEN REGULATORY PLAYING FIELD: THE QUESTION OF COMPETITION

Based on the analysis conducted in the previous sections, it is suggested that the European securitisation industry's claim about the uneven regulatory playing field for securitisation vis-à-vis other 'neighbouring' financial instruments is valid.

Indeed, in a number of regulatory areas, European securitisation structures are treated in a distinctly adverse fashion, compared to whole loan pools, corporate bonds, and especially covered bonds.

Despite the validity of its claim however and the forcefulness with which the industry has expressed its concerns and frustration, and notwithstanding any potentially beneficial effect that the proposed targeted amendments of the regulatory framework might have, the European regulator appears unwilling to engage in any fundamental recalibration of the existing framework that would lead to a leveling of the regulatory playing field.

Deciding which of the two sides is correct presupposes a clear understanding as to *why*, in the industry's view, it is crucial that securitisation stops being treated in such an adverse fashion. After all, demonstrating that the regulatory playing field is uneven (as the industry has successfully done) does not, in and of itself, provide a sufficient reason as to why a leveling of the playing field is warranted.

Instead, in order to be able properly to answer the question 'should the regulatory playing field be leveled?', it is necessary to examine the effects of the currently uneven playing field on the European securitisation market.

4.1. The Industry's Main Argument for a Leveling of the Playing Field

The securitisation industry's main argument for a leveling of the regulatory playing field has been that the preferential treatment reserved for other 'neighbouring' financial instruments is negatively affecting the European securitisation market, because it is discouraging potential issuers and investors from engaging in securitisation transactions. In parallel, market participants claim that the uneven regulatory playing field is causing a migration, both from a

[172] Regulation 2015/61 art 10 para 1(f), art 11 para 1(c) and (d), and art 12 para 1(e).
[173] Regulation 2015/61 arts 11 and 12 refer to CRR art 122. For mapping see Regulation 2016/1799.
[174] Tom Lemmon, 'The EUSR Joke isn't Funny Any More' *Global Capital* (18 October 2022).

sell-side and a buy-side perspective, away from securitisation and towards other financial instruments that the regulator is treating more favourably.[175]

Therefore, the hope is that a leveling of the regulatory playing field for securitisation vis-à-vis other 'neighbouring' financial instruments would help reverse that trend, by incentivising potential issuers and investors to engage with securitisation, whilst alleviating the effects of the aforementioned migration. Ultimately, a level playing field would help the European securitisation market to flourish.

4.2. Assessing the Industry's Argument

In order to assess whether a leveling of the regulatory playing field could have the beneficial effects suggested by the securitisation industry, it is necessary, first, to examine if the adverse treatment that securitisation receives is actually pushing market participants towards other financial instruments.

This brings us to the question of competition. Indeed, the industry's argument presupposes that a competitive dynamic exists between securitisation and other 'neighbouring' financial instruments, which allows supply-side entities and/or buy-side entities to use those financial instruments interchangeably.

Otherwise, absent such a competitive dynamic, the preferential treatment that the European regulator offers to other financial instruments would not affect the European securitisation market, since it would not be in a position to attract sell-side and buy-side entities that would otherwise engage in securitisation transactions.

Consequently, a more favourable treatment of securitisation that would align it more closely to the treatment of whole loan pools, corporate bonds, or covered bonds would not be successful in incentivising potential issuers and investors to engage with securitisation *instead* of a 'neighbouring' financial instrument, nor would it reverse the trend away from securitisation.

That is not to say of course that, if no competitive dynamic exists, a regulatory easing vis-à-vis securitisation would be totally worthless, from a market revival perspective. Without this dynamic however, the securitisation industry's argument that the regulatory playing field should be leveled would be stripped of a significant part of its power. Perhaps, it would still be useful to draw a comparison between securitisation and covered bonds and/or other financial instruments, just to illustrate how adverse the regulatory treatment of securitisation is. In all other respects however, such an exercise would be akin to comparing apples to oranges.

4.3. Identifying Competitive Structures

At the outset, it is pertinent to note that comparing any financial instrument to 'securitisation' *per se* makes very little sense. That is because securitisation is not a single financial instrument. Rather, the term 'securitisation' is used to describe a technique via which a multitude of different financial instruments can be created, each of which is unique in its structure, and the objectives its serves.[176] In other words, securitisation is a spectrum.

Therefore, it is important to identify those specific securitisation structures that *can* be compared to other 'neighbouring' financial instruments. Having identified those structures, it then becomes possible to examine if a competitive dynamic exists between them, in other words whether those securitisation structures and their 'neighbouring' financial instruments can be perceived as substitutes of one another.

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[175] cf PCS (n 18) 11; AFME November 2022 (n 149) 2.
[176] Penn (n 30) 225-226.

The three 'neighbouring' financial instruments usually put forward by the securitisation industry in this context are corporate bonds, whole loan pools, and covered bonds.

Notwithstanding the potentially valuable results it could yield, any comparison between specific securitisation structures and corporate bonds and/or whole loan pools is not touched upon in the present article, due to a scarcity of relevant data and previous research in that regard. Absent such data and research, any comparison with corporate bonds and/or whole loan pools would inevitably be speculative.

That leaves us with covered bonds. And in their case, a comparison with specific securitisation structures is both meaningful and feasible.

4.4. Comparing RMBS to Covered Bonds

4.4.1 Theoretical and Empirical Findings

From a sell-side perspective, covered bonds are used by credit institutions as a cost-efficient funding tool, ie as a means for banks to finance their low-profit businesses.[177] Although, historically, covered bond issuance financed both mortgage lending and public sector lending, hence the distinction between 'mortgage covered bonds' and 'public sector covered bonds', the latter's importance has declined significantly during the last 20 years,[178] to the extent that it would be accurate to suggest that covered bonds today are, first and foremost, a tool for funding mortgage loans, and particularly 'high-quality' residential mortgage loans.[179] From an investor perspective, credit institutions and assets managers/funds are the biggest investors in covered bonds today,[180] and have been so since the early 2000s.[181]

Regarding securitisation, it is important to distinguish at the outset between 'true sale' structures, used primarily for funding purposes, and 'synthetic' structures, that are mostly used for risk management purposes (transfer of credit risk), and for achieving regulatory capital relief.[182] Based on that distinction, it is much more appropriate, at least from a sell-side perspective, to compare covered bonds to 'true sale' securitisation structures.

Specifically, it is meaningful to compare covered bonds to RMBS, a financial instrument that is typically structured as a 'true sale',[183] and is used as a means of financing residential mortgage loans, just like 'mortgage covered bonds'. Indeed, historically, both covered bonds

[177] Giuseppina Chesini, Monica Tamisari, 'The Regulatory and Market Developments of Covered Bonds in Europe' in Luisa Anderloni, David T. Llewellyn, and Reinhard H. Schmidt (eds) *Financial Innovation in Retail and Corporate Banking* (New Horizons in Money and Finance 2009) 199.

[178] EBA, 'Report on EU Covered Bond Frameworks and Capital Treatment: Response to the Commission's Call for Advice of December 2013 Related to Article 503 of the Regulation (EU) No 575/2013 and to the ESRB Recommendation E on the Funding of Credit Institutions of December 2012 (ESRB/12/2)' (July 2014), at 14-15, figs 1, 2.

[179] cf issuance and outstanding amounts of 'mortgage covered bonds' vis-à-vis 'public sector covered bonds' in 2021, in ECBC, 'Statistics' in *ECBC Covered Bond Fact Book* (2022), at 561.

[180] Leaving central banks aside, see Florian Eichert, Frederik Kunze, and Niek Allon, 'Covered Bond Investor View: Private Buyers Return as the ECB Steps Back' in *ECBC Covered Bond Fact Book* (2022), at 97, fig 2.

[181] European Commission, 'Report of the Mortgage Funding Expert Group' (22 December 2006) (hereinafter the 'EC Expert Group'), at 51, graph 6.

[182] This refers primarily to 'balance sheet' synthetic securitisation structures, to be distinguished from 'arbitrage' synthetic structures, that seek to capture the arbitrage opportunity or profit by capturing the spread between the yields paid to securitisation investors and the yield realised on the underlying assets, see European Commission, 'Report from the Commission to the European Parliament and the Council on the Creation of a Specific Framework for Simple, Transparent and Standardised Synthetic Securitisation, Limited to Balance-sheet Synthetic Securitisation' (24 July 2020) (hereinafter 'EC SynthSec July 2020'), at 1; Penn (n 30) 226.

[183] EC SynthSec July 2020 (n 182) 4.

and RMBS have been used extensively by European credit institutions as a source of mortgage funding.[184]

It is also important to note that there is considerable overlap in terms of the assets used to collateralise both covered bonds and European RMBS, that is, 'prime', highly-rated, residential mortgage loans with a loan-to-value ('LTV') ratio between 60% and 80%.[185]

From an investor perspective, credit institutions and funds form the bulk of the investor base, so far as European RMBS is concerned.[186]

In view of this significant overlap between covered bonds and RMBS, in terms of sell-side entity objectives, underlying assets, and investor bases, it is suggested that the two financial instruments can—in theory—function as competitors, or substitutes of one another.

This proposition is also supported by existing market analysis and academic literature, which suggest that, notwithstanding certain differences, covered bonds and RMBS structures can be considered 'close substitutes' or 'workable alternatives', and confirm that some sort of competition can be expected between the two financial instruments, both from a supply, and from a demand perspective.[187]

It is very pertinent to note that this competition/substitutability between covered bonds and RMBS is not a mere theoretical possibility, but is in fact corroborated by empirical findings.

Indeed, by analysing data from the period of the GFC, ie between 2007 and 2012, existing academic literature has observed a substitution effect in the relationship between covered bonds and RMBS.

More precisely, during the GFC, credit institutions that had a covered bond programme were observed to securitise less of their assets, they became in other words more dependent on covered bonds, whilst reducing their engagement with RMBS, as a means of financing their mortgage loans.[188] As a result of this 'crowding out', the European covered market experienced significant growth, in terms of issuance, seemingly at the expense of the European RMBS market: The latter contracted considerably during the crisis.[189]

Indicatively, European RMBS issuance in 2007 was equal to €259bn.[190] Although volume increased sharply in 2008 (€585bn),[191] the market then experienced a dramatic contraction, and

[184] EC Expert Group (n 181) 3.

[185] cf Phillip Moore, 'Covered bonds: Picking up Tacks in Front of the Steamroller' *Euromoney* (5 November 2009); ECB and BoE (n 103) 11. For LTV ratios of assets collateralising RMBS see ESRB (n 17) 49, chart 13 for RMBS. For covered bonds in Europe see Directive 2019/2162 art 6 para 1(a), referring to CRR art 129 para 1. According to those provisions, residential mortgage loans collateralising covered bonds can have a maximum LTV of 80%, in order to fall under the scope of Directive 2019/2162.

[186] ECB, 'Recent Developments in Securitisation' (February 2011), at 16. For more recent data see ESRB (n 17) 22, chart 2a (referring to all types of securitisation structures).

[187] ECB and BoE (n 103) 16, 26; Global Capital, 'When RMBS are Safer than Covered Bonds' *Global Capital* (27.3.2015); Mafalda C. Correia and João M. Pinto, 'Are Covered Bonds Different from Securitization Bonds? A Comparative Analysis of Credit Spreads' (2023) 29(3) European Financial Management 841, at 843; Santiago Carbó-Valverde, Richard J. Rosen, and Francisco Rodríguez-Fernández, 'Are Covered Bonds a Substitute for Mortgage-backed Securities?' (2017) 20(3) Journal of Economic Policy Reform 238, at 251. See also Nils Boesel, Clemens Kool, and Stefano Lugo, 'Do European Banks with a Covered Bond Program Issue Asset-backed Securities for Funding?' (2018) 81 Journal of International Money and Finance 76, at 77, who argue that covered bonds and 'asset-backed securities' ('ABS') can be considered substitutes of one another, without however drawing any further distinction between the various securitisation structures.

[188] Boesel (n 187) 77. See also Correia (n 187) 879, who use data from 2000 to 2020, and reach the same conclusion as Boesel, Kool, and Lugo. It is important to note that the aforementioned authors refer to mortgage-backed securities ('MBS') more generally. Nevertheless, their findings are equally relevant for RMBS.

[189] ECB and BoE (n 103) 26.

[190] AFME/ESF, 'Securitisation Data Report, 2008 Q4' <https://www.sifma.org/resources/research/afme-esf-securitisation-data-report-2008-q4/> accessed 1 September 2023, at 3.

[191] ibid.

by 2012 issuance was equal to €119bn.[192] On the contrary, European mortgage covered bond issuance in 2007 was equal to €283.[193] In the following years issuance increased considerably and in 2012 European mortgage covered bond issuance had a value of €612bn.[194]

From the perspective of buy-side entities, a migration of buy-to-hold investors away from RMBS and towards other financial instruments, including covered bonds, was observed from 2009 onwards.[195]

Various suggestions have been put forward, to explain this substitution effect, including an (alleged) superiority of covered bonds vis-à-vis RMBS from an agency cost perspective, which became obvious to market participants during the crisis, and rendered covered bonds cheaper, as a funding tool for credit institutions, because of the lower risk premia required by investors.[196] A similar, yet distinct, explanation points to the 'higher protection level' that covered bonds offer, ie the structural features that covered bonds deploy to protect investors from issuer-related and cover pool-related risks. Those features are thought to have created, in the context of the crisis, an additional incentive for investors to invest in covered bonds, and, conversely, to have reduced the demand for RMBS.[197]

4.4.2. The Role of Regulation in Crowding Out RMBS During the GFC

A third, very interesting, suggestion put forward by market commentators is that the growth that the covered bond market experienced during the GFC, by crowding out securitisation structures, may be attributed to the preferential regulatory treatment that covered bonds received at the time vis-à-vis securitisation (including RMBS).[198]

According to this argument, it was the incentives that the regulator created for issuing and investing in covered bonds, combined with its 'punitive' treatment of securitisation, that allowed the covered bond market to flourish, whilst preventing the European RMBS market from bouncing back from the standstill it had been ever since 2007.[199]

Focussing on this final suggestion, it is important to bear in mind that the uneven regulatory playing field surrounding securitisation and covered bonds is not a recent phenomenon. Far from it, even before the GFC, investing in covered bonds implied lower regulatory requirements than securitisation, including RMBS.[200] Indicatively, under the

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[192] AFME, 'Securitisation Data Report, Q4 2012' <https://www.sifma.org/resources/research/afme-securitisation-data-report-q4-2012/> accessed 1 September 2023, at 3.
[193] ECBC, 'Statistics' in *ECBC Covered Bond Fact Book* (2011), at 456.
[194] ECBC, 'Statistics' in *ECBC Covered Bond Fact Book* (2013), at 545.
[195] EBA, 'Report on Qualifying Securitisation: Response to the Commission's Call for Advice of January 2014 on Long-Term Financing' (July 2015) (hereinafter 'EBA Qualifying'), at 26.
[196] Boesel (n 187) 79, 86. For a comprehensive critique of the supposed 'agency problems' that plagued European securitisation (including RMBS) during the GFC see Penn (n 30) 231-233.
[197] ECB and BoE (n 103) 8. See Thomas Papadogiannis Varouchakis, 'Risks for investors at the Post-Insolvency Stage of the Covered Bond Issuer' (2023) 38(4) Journal of International Banking and Financial Law 227, at 228, for an analysis of covered bonds' structural features, in comparison with 'true sale' securitisation structures.
[198] cf Jaime Caruana, Adrian Van Rixtel, 'International Financial Markets and Bank Funding in the Euro Area: Dynamics and Participants' (2011) Bank for International Settlements, at 11; International Organization of Securities Commissions, 'Global Developments in Securitisation Regulation: Final Report' (November 2012), at 47. See also Lawton M. Camp and others, 'Covered Bonds Regulatory Update: The Good, the Bad, and the United States' (2013) 19(2) Journal of Structured Finance 16, at 21; EBA Qualifying (n 195) 21. Finally, see European Commission, 'Consultation Document: Covered Bonds in the European Union' (2015), at 10-11, where the argument is presented, without being endorsed by the author.
[199] Louise Bowman, 'Can ABS Rescue Europe's Bank-Funding Market?' *Euromoney* (6 March 2012); Euromoney, 'Schizophrenic Regulators Killing Securitization' *Euromoney* (12 April 2013).
[200] Rebeca Anguren Martín, José Manuel Marqués Sevillano, and Luna Romo González, 'Covered bonds: The Renaissance of an Old Acquaintance' (2014) 9(1) Banks and Bank Systems 46, at 55.

original CRD, the risk weight floor for top-rated RMBS positions was 20% when the SA was applied, compared to 10% for covered bonds.[201]

As the crisis unfolded, the divergence in regulatory treatment between RMBS and covered bonds intensified, as securitisation was stigmatised for the ongoing debacle, prompting the regulator to introduce, via CRD II and III,[202] a set of punitive rules that aimed at curbing securitisation's supposedly 'perverse' incentives and complexity.[203] Covered bonds on the other hand, were able to maintain, and even extend, their regulatory privileges.

In parallel, it is worth noting that the crowding out of RMBS by covered bonds during the GFC might also have been fueled by the covered bond purchase programmes ('CBPPs') that the ECB introduced at the time.

More specifically, CBPP1, which ran from July 2009 until June 2010, is thought to have been very successful in supporting the covered bond market, by lowering covered bond spreads; easing funding conditions for banks and corporates; supporting credit institutions in their lending capacity; and improving liquidity in the private debt securities market.[204]

At the same time however, spread analysis has shown that the covered bond purchases by the Eurosystem in the context of CBPP1 fed into RMBS prices, causing RMBS spreads to widen.[205] Although the effects of CBPP2 (which run from November 2011 until roughly mid-2012) on the covered bond market are less straightforward,[206] it, too, has been observed to have had a negative effect on the European RMBS market, by leading to a credit spread increase.[207]

4.4.3. Parallels Between the GFC Period and Today

To recapitulate, there is sufficient evidence to suggest that, during the GFC, the uneven regulatory playing field, coupled with the monetary policies implemented by the ECB, negatively affected the European securitisation market, by contributing to the substitution of RMBS with covered bonds.

To assess whether the adverse regulatory treatment of securitisation continues negatively to affect the securitisation market, it is worth having a look at the post-GFC state of that market, vis-à-vis the market for covered bonds.

From an issuance perspective, average annual RMBS issuance for the period 2013-2021 was equal to €100bn, which signifies a 65% decrease, compared to annual RMBS issuance during the GFC period (€283bn).[208] On the other hand, average annual mortgage covered bond

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[201] See Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) [2006] OJ L177/1, Annex IX, Part 4, Point 6, table 1 for securitisation, and Annex VI, Point 71 for covered bonds. When the IRBA was applied, covered bonds could attract a risk weight as low as 2.1%, see EC Expert Group (n 181) 68.

[202] Directive 2010/76/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies [2010] OJ L329/3.

[203] See Penn (n 30) 236-238.

[204] Holger Markmann and Joachim Zietz, 'Medium-term Impact on the Secondary Market' in Holger Markmann (author) *Covered Bonds Under Unconventional Monetary Policy* (Nico B. Rottke and Jan Mutl (eds), Essays in Real Estate Research: Band 14, Springer Gabler 2017), at 49-50; Maureen Schuller, 'ECB Policy Toolkit and Covered Bond Supply' in *ECBC European Covered Bond Fact Book* (2013), at 52-53, figs 2, 3; John Beirne and others, 'The Impact of the Eurosystem's Covered Bond Purchase Programme on the Primary and Secondary Markets' (January 2011) 122 ECB Occasional Paper Series, at 5.

[205] Correia (n 187) 877.

[206] cf Schuller (n 204) 53.

[207] Correia (n 187) 877.

[208] For RMBS issuance and outstanding amounts, data was collected from the sections titled 'European Issuance by Collateral' and 'European Outstandings by Collateral' respectively, included in the 'Securitisation Report' issued quarterly by the Association for Financial Markets in Europe ('AFME').

issuance was equal to €412bn in the post-GFC period, compared to an average of €485 in the GFC period (this translates into a 15% decrease).[209]

It is also worth observing that average annual RMBS issuance in the post-GFC period was roughly 25% of the average annual mortgage covered bond issuance. During the GFC period, average annual RMBS issuance was equal to 58% of the average annual mortgage covered bond issuance. This signifies that, since 2007, the gap between the RMBS market and the mortgage covered bond market has increased sharply, at least in terms of annual average issuance.

The same conclusion is reached when outstanding amounts in the two markets are compared: In the period 2013-2021, the European mortgage covered bond market exhibited remarkable growth, from €1.97tn to €2.36tn. On the contrary, the European RMBS market contracted from €879bn in 2013 to €589bn in 2021. It is therefore evident that the covered bond market has been continuously expanding during the last decade, whereas the European RMBS market has sharply shrunk.

This analysis illustrates a clear parallel between the GFC period and today, regarding the regulatory treatment that covered bonds and RMBS receive, as well as the state (and interrelationship) of the market for each of the two financial instruments. Put simply, fueled by preferential regulatory treatment, covered bonds appear to have continued to crowd out RMBS in Europe.

In light of that analysis, it is submitted that the claim put forward by market participants about the effects of the uneven regulatory playing field on the European securitisation market is hard to ignore, and indeed seems to be vindicated, at least so far as RMBS is concerned.

By treating covered bonds in a clearly preferential fashion, the European regulator appears consistently to be discouraging potential issuers and investors from engaging in RMBS transactions, and could even be fueling a migration away from RMBS and towards covered bonds. The continuous contraction of the RMBS market could very well be a reflection of the negative effects that the uneven regulatory playing field has had on securitisation.

In that sense, it is submitted that the securitisation industry has good reasons to be pushing for a leveling of the regulatory playing field, since there is enough evidence to suggest that, by aligning the treatment that RMBS receives vis-à-vis covered bonds, the regulator can incentivise issuers and investors to migrate back to RMBS, resulting in a slowdown (or even a reversal) of the European RMBS market's continuous contraction.

Even more importantly, the significance of the RMBS segment for the wider European securitisation market (indicatively, in 2022, more than half of total European issuance was RMBS),[210] means that by boosting RMBS, through a leveling of the playing field, the regulator could also provide critical assistance to other securitisation segments that remain subdued or underdeveloped.

5. CONCLUDING REMARKS

The analysis conducted in this article confirms the existence of an uneven regulatory playing field for securitisation structures vis-à-vis whole loan pools, corporate bonds, and covered bonds. It also confirms that, at least so far as RMBS vis-à-vis mortgage covered bonds is concerned, the adverse treatment of securitisation is negatively affecting the European securitisation market, by incentivising issuers and investors to migrate to other financial instruments.

[209] Data on covered bond issuance and outstanding amounts were collected from the 'Statistics' section included in the 'European Covered bond Fact Book' published annually by the ECBC.
[210] AFME Q4 2022 (n 150) 17.

It follows that, by treating RMBS more favourably, the European regulator can assist the RMBS market and, consequently, the entire securitisation market, to escape from the subdued state it has been ever since the GFC.

Whether the regulator will (and should) pursue this course of action is a different question. After all, favouring securitisation at the expense of covered bonds would signify going against a political economy in Europe which seems almost inescapable.[211]

Indeed, covered bonds have a track record of 250 years in Europe, without any defaults in their modern history. They are deeply ingrained in the financial system of multiple European countries like France, Denmark, and especially Germany, where no strong tradition of using RMBS exists as of yet. Because of their long history and importance, and their 'pristine creditworthiness', covered bonds have been treated as the European regulator's 'darling' ever since the 1980s.[212]

For all those reasons, if helping the European securitisation market to flourish would risk unsettling the market for covered bonds, the regulator would, in all probability, consider this simply too high a price to pay.

This does not mean that the European securitisation industry should cease trying to level the regulatory playing field. It does mean however that this is not a purely 'technocratic' or legal question, but rather a political one. Any technical analysis that illustrates how securitisation structures are not inherently riskier than other financial instruments and should therefore be allowed to compete with them on an equal footing, can only take the securitisation industry so far. Convincing officials that securitisation is a powerful tool that can be leveraged for the benefit of the wider European economy is equally important, if the European securitisation market is to experience its long-awaited revival any time soon.

[211] The author wishes to thank Professor Niamh Moloney for making this insightful remark.

[212] cf the preferential treatment of covered bonds when undertakings for the collective Investment in transferable securities ('UCITS') invest in them, introduced in 1988, via Council Directive 88/220/EEC of 22 March 1988 amending, as regards the investment policies of certain UCITS, Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investments in transferable securities (UCITS) [1988] OJ L100/31.