BANK OF ENGLAND

# TSE/BdF Conference on Securitisation

## Removing regulatory barriers to healthy growth of securitisation markets

23 September 2015

# Basel 3 : Why a revised capital framework for securitisation ?

- The crisis revealed a number of weaknesses in the current framework, including
  - mechanistic reliance on external ratings,
  - excessively low risk weights (RW) for highly-rated securitisation exposures, and
  - cliff effects (in the rating based method – e.g. large increase in RW when ratings fell ; in the supervisory formula - e.g. a securitisation structure could require almost no capital on mezz and above).
- The revised framework (Dec 2014) attempts to correct them.

➢ Revisions follow 2 consultations and QIS exercises. To be implemented by January 2018.

# Basel 3 : What are the main policy changes ?

- Under the revised framework (Dec 2014), capital requirements are calculated using one of the following hierarchy of approaches:
  - **“Sec-IRBA”: a formula-based Approach** - using IRB (Kirb) on the underlying pool pre-securitisation as key input
  - **“Sec-ERBA”: an External Ratings Based Approach** - to be used when $K_{IRB}$ cannot be calculated and the securitisation position is externally-rated
  - **“Sec-SA”: a simplified less risk-sensitive formula-based Approach** - to be used when neither of the other two approaches can be used
- 15 % risk weight floor applies for all approaches

➢ Basel Committee is considering how to incorporate the STC concept in the capital framework

# BCBS-IOSCO: Criteria for “S TC” securitisation

- BCBS-IOSCO Task Force on Securitisation Markets (TFSM) co-chaired by David Rule (Executive Director, PRA) and Greg Medcraft (Chair, IOSCO Board) was established in early 2014 to :
  - review current functioning of securitisation markets ,
  - identify factors that may be hindering the development of sustainable securitisation markets, and
  - develop criteria to identify and assist in the development of more simple and transparent securitisation structures in view to help expand the current investor base.
- In July 2015, BCBS-IOSCO issued 14 criteria to identify securitisation transactions that are Simple Transparent and Comparable (term securitisation)

# BCBS-IOSCO: Why STC criteria on securitisation ?

- Securitisation declined since 2007 for various reasons, in partic. as demand from key elements of the leveraged investor base (including SIVs, conduits) vanished.
- Efforts to help revive as a complementary tool for financing of the "real" economy:
  - EU COM : Green Paper and Communication on Long Term Financing (March 2013 and April 2014)
  - BoE-ECB : 'The case for a better functioning securitisation market in the European Union' (May 2014)

# BoE-ECB Paper: what did we hear from investors ?

- Main impediments identified to securitisation
  - general stigma following the failing of certain asset classes (e.g. CDO and sub-prime RMBS)
  - difficulties for investors to assess risks in securitisation
  - practices related to credit rating
  - regulatory treatment and uncertainty.
- Other constraining factors due to current environment
  - the pricing and availability of alternative funding for bank originators (e.g. central bank facilities)
  - lack of credit demand
  - impaired market liquidity

# BCBS-IOSCO: What are the main policy proposals ?

- 14 STC criteria have been developed and classified under three categories as to whether they seek to mitigate risk related to:
  - The underlying asset profile
  - The securitisation structure
  - Governance and fiduciary duties
- But they deliberately do not address the fundamental credit risk of securitisations’ underlying assets.

➢ Purpose of these criteria **not to serve as a substitute for investors’ due diligence on the ultimate creditworthiness of a securitisation tranche.**

Rather to identify and assist in the development of STC securitisation transactions by the industry to facilitate these due diligence.

# EBA: What are the main policy proposals?

- Additional criteria related to the credit quality of underlying assets are also included.
- These are meant to ensure that Simple Standard and Transparent (SST) securitisation transaction are not put in place to finance high risk underlying exposures.

  They are based on:
  - qualitative conditions (e.g. underwriting standards)
  - quantitative conditions (e.g. granularity and maximum RW under CRR standardised approach) ensuring that the underlying assets of a securitisation transaction meet minimum levels of credit quality.

➢ These additional criteria will be given due consideration by banks when assessing whether the capital treatment for a SST securitisation is appropriate.