Box 11

REVIVAL OF "QUALIFYING" SECURITISATION, MAIN HURDLES AND REGULATORY FRAMEWORK

The securitisation market seized up with the onset of the financial crisis and has remained severely impaired since then. Many factors are deemed to be causing this stagnation, including poor investor sentiment, unfavourable transaction economics, a poor macroeconomic environment and regulatory concerns.

Risks and losses associated with securitisation products have, however, been substantially different across asset types and jurisdictions. While certain securitisation market segments were key contributors to the widespread stress, this was not the case for all segments. Indeed, only 0.1% of European residential mortgage-backed securities (RMBSs), accounting for more than half of total European securitisation issuance, defaulted between 2007 and the third quarter of 2013, by one estimate[1]. This is in stark contrast to the performance of collateralised debt obligations (CDOs) of asset-backed securities (ABSs), where the default rate was around 40% over the same period. The chart below provides additional evidence of heterogeneity in securitisation performance across both jurisdictions and asset classes. The performance of securitised instruments throughout the crisis has at times been extremely heterogeneous, which in many ways contrasts with the stigma that has affected the overall demand for securitised instruments across the board.

On the regulatory side, the treatment of securitisation is profoundly under review, both at the European and international level. This is however a complex task: the beneficial features of securitisation (such as risk diversification and the creation of marketable securities out of illiquid assets) should be fostered, while mitigating potential risks (such as the lack of risk retention by originators and the complexity and opaqueness of certain products). At the same time, consistency needs to be ensured relative to other instruments (such as covered bonds) and across various market participants (e.g. banks, insurers, money market funds) which are subject to different regulatory frameworks; failure to achieve this balance could lead to unintended consequences. The regulatory treatment of securitisation requires close scrutiny: recent proposals appear to have been calibrated on the worst-performing transactions, whereas structural differences across jurisdictions could have been taken into consideration more prominently.

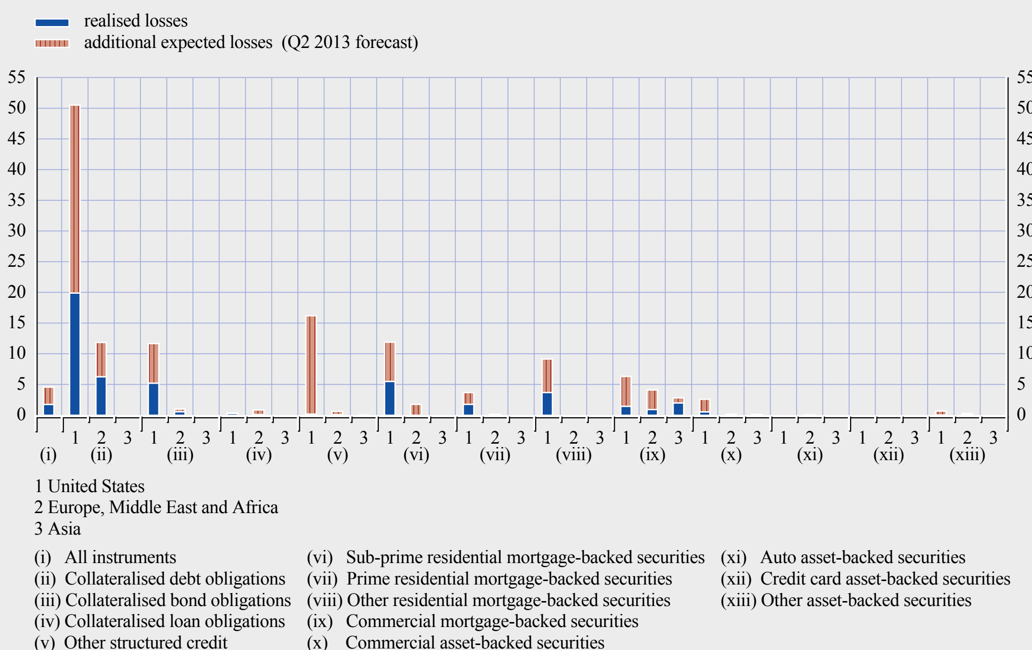
1 Source: Standard and Poor's.

In this context, some recent initiatives aim to identify qualifying securitisations, which through their simplicity, structural robustness and transparency, would enable investors to model risk with confidence and would provide originators with incentives to behave responsibly. Qualifying securitisations could benefit from improved market liquidity and may also warrant a more favourable regulatory treatment. The European Commission is currently undertaking work on high-quality securitisation products in order to assess if a preferential regulatory treatment compatible with prudential principles is warranted for such securitisations. The ECB has a keen interest in a well-functioning ABS market and is therefore closely following the developments in initiatives regarding securitisations, also in the light of the role of ABSs as collateral in the Eurosystem's monetary policy operations. The ECB has introduced loan-level information requirements for ABSs if used as collateral in the Eurosystem's credit operations. Through the launch of the Prime Collateralised Securities (PCS) label initiative in November 2012, market participants have also attempted to identify high-quality ABSs. Moreover, the ECB is actively contributing to efforts to revive the ABS market by expressing its views on the matter, including in two joint publications with the Bank of England on the revival of the securitisation market in April and May 2014.

The topic is of wider importance owing to the desire among EU policy-makers to explore the role of SME loan securitisation in funding the real economy and to ensure that such issuance is not unduly constrained by its regulatory treatment. With the European deleveraging cycle not yet completed, enhancing the access to financing is a crucial policy objective. Owing to the ability of securitisation instruments to diversify credit risks, lower funding costs and mitigate asset encumbrance, this topic is also key from a financial stability perspective.

Structured finance: realised and additional expected losses across regions

(2000 – 2012; percentages)



Source: Fitch Ratings.

Many challenges remain in terms of making any definition of "qualifying securitisations" operational, reaching an EU and international agreement, and the possible "rewards" for qualifying ABSs. In this context, the Eurosystem's (and, more generally, central banks') ABS collateral eligibility criteria may offer an appropriate starting point to define qualified securitisation criteria, while prudential considerations should also be taken into account when defining a qualifying instrument for regulatory purposes.

The potential revival of a qualifying securitisation market will certainly require concerted and coordinated efforts; thus, the active involvement of all key EU and international policy bodies involved in structured finance and long-term financing is crucial. A healthy securitisation market based on high-quality underlying assets, robust and standardised structures, and increased disclosure could contribute to providing smooth funding channels for real economy assets, distributing risks across different asset classes, regions and financial sectors, and increasing banks' flexibility to tap additional sources of liquidity. All in all, it could support both the financial system and the broader economy.