



## **Finance Watch response to the BCBS/IOSCO consultative document "criteria for identifying simple, transparent and comparable securitisations"**

Brussels, 13 February 2015

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

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

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

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

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Question 1:

Do respondents agree that the criteria achieve the goals they aim to achieve? In particular, do respondents believe that the criteria could help investors to identify “simple”, “transparent” and “comparable” securitisations?

We do believe that the criteria could help investors to identify simple, transparent and comparable securitisations. It is not clear however whether the criteria as they stand will be sufficient to achieve their goals.

Question 2:

Do respondents agree with the STC criteria set out in the annex of this paper? In particular, are they clear enough to allow for the development by the financial sector of simple, transparent and comparable securitisations? Or do respondents think they are too detailed as globally applicable criteria? The annex provides guidance on each criterion. Which additional criteria would respondents consider necessary, if any, and what additional provisions would be useful or necessary to support the use of the criteria? What are respondents’ views on the “additional considerations” set out under some criteria in the annex? Should they become part of the criteria? Are there particular criteria that could hinder the development of sustainable securitisation markets due, for example, to the costliness of their implementation?

We strongly support the STC criteria set out in the annex. We believe however that additional provisions are necessary as well as additional criteria:

Criterion 2 needs to be further defined in our view: we do agree that "substantially similar credit claims or receivables to those being securitised" requires a tight definition.

"Time period long enough to permit meaningful evaluation" also requires a tight and carefully thought through definition.

More generally it would be very useful to define what is meant by "new and potentially more exotic asset classes". We would be concerned to see new exotic asset classes become part of a qualifying securitisation framework. We also might want to question the consistency of allowing them in this definition versus the approach in the Solvency II delegated act, which limits underlying assets to specific asset classes.

While we understand that the potential impact of these criteria on regulation is out of the scope of this consultation, it is very likely that defining a qualifying securitisation framework will lead to a softer prudential treatment. This likely development cannot be ignored when defining the criteria.

We also note that with the exception of criterion 3, there are no criteria on the quality of the underlying assets, and it might be worth adding criteria aimed at ensuring sound creditworthiness assessments and minimum quality thresholds at loan level, as is the case in the definition recently put forward by the European Banking Authority. In a context where subprime car loans are currently being repackaged by US banks<sup>1</sup>, this is an important point in our view to avoid repeating the mistakes of the past.

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<sup>1</sup> <http://www.cbc.ca/m/touch/news/story/1.2938552>

On criterion 5 we strongly support the exclusion of synthetic securitisations from the qualifying framework. We are not convinced however that securitisations "*employing transfers of credit claims or receivables by other means*" should be allowed, even in the presence of material obstacles preventing true sale at issuance.

On criterion 7, we do not believe that there should be any exception to the rule that there should be no reliance on the sale or refinancing of the underlying credit claims or receivables in order to repay the liabilities.

On criterion 8, "genuine hedging purposes" needs to be defined. We believe that using IFRS 9 hedge effectiveness testing could be a good methodology to achieve the objective of genuine hedging purpose.

On criterion 12, the originator or sponsor of the credit claims or receivables should retain a material net economic exposure going beyond CRDIV requirements to be part of the qualifying framework. We believe that they should retain a net economic interest significantly higher than 5% and through a vertical slice of all tranches to ensure a full alignment of interests. It has indeed been demonstrated that retaining only the equity does not necessarily provide the necessary discipline if the equity tranche can be too quickly exhausted<sup>2</sup>.

Additionally, in order to ensure a meaningful risk transfer and limit interconnectedness, we believe that there would be benefits in clearly limiting credit and liquidity puts from the originator or sponsor of the credit claims or receivables to securitisations.

Lastly, we believe that one other criterion should be added: qualifying securitisations should not be allowed to use tranching. As discussed in our recent position paper<sup>3</sup> (cf. pages 35, 42, 43, 59) tranching creates model uncertainty and manufactures complex risks that are very hard to assess. It amplifies the impact of mistakes in the assessment of underlying asset default risk and correlation. It also creates additional procyclicality, enables more risk taking and reduces banks' ability to play a countercyclical role. It increases the length of credit intermediation chains and creates conflicts of interests. It attracts as well less informed investors who are more likely to neglect tail risks.

A recent BIS paper<sup>4</sup> called "Securitisations: tranching concentrates uncertainty" found that "*even when securitised assets are simple, transparent and of high quality, risk assessments will be uncertain. (...) Substantial uncertainty would remain and would concentrate in*

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<sup>2</sup> "When the probability of an unfavourable realisation of the systematic factor is high, and when the equity tranche would be exhausted if this unfavourable realisation were to occur, the originator holding the equity tranche may have less incentive to exert effort to screen borrowers than the originator holding a mezzanine tranche of equal "thickness" or a slice of the loan portfolio." BIS 2009

<sup>3</sup> Finance Watch "A missed opportunity to revive "boring" finance?", December 2014 <http://www.finance-watch.org/our-work/publications/998>

<sup>4</sup> BIS, Antoniadou, A. and Tarashev, N., *Securitisations: tranching concentrates uncertainty*, BIS Quarterly Review, December 2014f, pp. 37-53

*particular securitisation tranches. Despite the simplicity and transparency of the underlying assets, these tranches would not be simple.”*

On the argument that tranching enables the creation of securities that fit investors' preferences, non-tranched high quality securitisation would still be able to obtain investment grade ratings, and provided the risk-adjusted return is attractive, we believe that the market would develop a strong appetite for these securities. The current environment of very low interest rates and excess financial capital looking desperately for yield should also contribute positively.

Not including tranching in a future qualifying securitisation framework might also incentivise sounder underlying assets, as the potential for credit enhancement is reduced, which would be a positive development, especially given that the current criteria do not include any minimum quality threshold on underlying assets.

Question 3:

What are respondents' views on the state of short-term securitisation markets and the need for initiatives with involvement from public authorities?

Do respondents consider useful the development of differentiating criteria for ABCP, in a manner similar to that of term securitisations?

The BCBS and IOSCO would particularly welcome any data and descriptions illustrating the state of short-term securitisation markets by jurisdiction and the views of respondents on concrete comparable criteria that could be applied to short-term securitisations.

While short term securitisation markets have a role to play, we do not support the development of a qualifying framework with differentiating criteria for ABCP, in a manner similar to that of term securitisation.

We therefore strongly support BCBS/IOSCO's focus on term securitisation.