Comments on the European Commission’s consultation document “An EU framework for simple, transparent and standardised securitisations”

Proposals should adequately take into account financing needs of the real economy
General remarks

Bundesverband der Deutschen Industrie\(^1\), Deutscher Industrie- und Handelskammertag\(^2\) and Deutsches Aktieninstitut\(^3\) appreciate the opportunity to comment on the consultation on simple, transparent and standardised securitisations from the view of non-financial companies using capital markets for financing growth, innovation and employment. In this context, we focus on those issues that are of particular importance for the real economy.

Non-financial companies are interested in a financial market regulation that addresses systemic risks appropriately and thus ensures that they are provided with financial services in a reliable manner. Asset Backed Securities (ABS) and Asset-Backed Commercial Papers (ABCP) are an important source of funding for the German and European real economy.

Meanwhile, banks will again find it more relevant to use the securitisation market for their funding activities in order to extend credit exposures for SMEs. However, securitisation goes well beyond releasing banks’ regulatory capital to provide new scope for lending. For example, auto ABS support the sales of car manufacturers and thus stabilize large parts in the automotive value chain. Moreover, for larger SMEs it is increasingly important to use this kind of funding sources to better diversify their financial basis. More and more SMEs use the market for ABCP for the mobilization of trade receivables.

Securitisation of leasing receivables could support refinancing of leasing business that becomes increasingly important as a financing instrument in the real economy. In Germany, investment in machinery and equipment is financed to about one-fourth by lease. Moreover, securitisation could make an important contribution to the financing of infrastructure in Europe. With a view to close the striking investment gap in Europe, this financing option is of strategic importance. Through the

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\(^1\) Bundesverband der Deutschen Industrie (BDI) is the umbrella organisation of German Industry and industry-related service providers. It represents 38 industrial sector federations and has 15 regional offices in the German Laender. BDI speaks for more than 100,000 private enterprises – 98 % small and medium sized – employing around 8 million people.

\(^2\) The Association of German Chambers of Commerce and Industry (Deutscher Industrie- und Handelskammertag e.V. - DIHK) is the umbrella organization of the 80 German Chambers of Commerce and Industry and represents the collective interest of commercial and industrial businesses in Germany. Its legitimation rests on more than 3.6 million member companies from all sectors, regions and size classes that belong to the Chambers of Commerce and Industry.

\(^3\) Deutsches Aktieninstitut represents the entire German economy interested in the capital markets. Its about 200 members are listed corporations, banks, stock exchanges, investors and other important market participants. Deutsches Aktieninstitut keeps offices in Frankfurt am Main, Brussels and in Berlin.
use of securitisation small-ticket infrastructure projects could be aggregated thus making them an attractive investment option for institutional investors.

To revitalize the securitisation market in Europe, whose volume has shrunk significantly in the wake of the financial crisis, the European Commission is keen to ensure uniform quality standards and a consistent regulatory treatment. This is strongly welcomed. We have repeatedly called for a removal of the various regulatory impediments that contradict efficient and well-functioning European securitisation markets.

This approach is justified as securitisation products should not be lumped together. The quality of the securitised assets is impressive compared to the performance of corporate loans. The expected loss of ABCP transactions is even significantly lower than that of the selling company itself: While the risk of default of ABCP transactions is of a single-A rating the average creditworthiness of the respective selling companies is below investment grade. The verifiable high level of quality of securitisations linked to the real economy strongly demands for a differentiated regulatory approach.

Unfortunately, there are a number of impediments to an effectively functioning securitisation market:

- These include restrictive capital requirements for banks in their capacity as investors in securitisation products and as sponsors to maintain ABCP platforms for the securitisation of trade or lease receivables.

- The same is true for new and stringent liquidity rules that make it unattractive for banks to invest in securitised papers and maintain platforms for their corporate clients.

- Besides this, new capital requirement rules for insurance companies investing in securitisations are considerably diminishing the attractiveness of investments in ABS and ABCP by insurers.

- Furthermore, new investment guidelines for money market funds could make it more difficult to invest in auto ABS and ABCP programmes.

We are highly concerned that the cumulative effects of the various regulatory measures will be adverse to the European securitisation market and hence cause damage to the real economy. We therefore appreciate that the high economic potential of the securitisation market and the need for a more differentiated regulatory treatment are increasingly acknowledged. The delegated acts covering the prudential requirements for insurers (under the Solvency II directive) and the liquidity of banks (through the LCR) are important steps in the right direction.
However, we are concerned that the regulatory framework could fall short of what is necessary to deliver lasting impulses to the European securitisation market. Several challenges must be addressed to further develop high quality securitisation in Europe:

- The development of securitisation markets requires also and above all practical quality requirements for securitised assets to prevent that economically healthy SMEs are excluded from high-quality securitisation. The eligibility criteria for the underlying assets should be aligned with well-established market standards striking the right balance to ensure the evolution of a safe and stable securitisation market and the needs of SMEs to have access to funding means by securitisation.

- Apart from true sale securitisations also synthetic securitisations which have several advantages compared with the former should be included in the regulatory framework. In addition, in order to fully exploit the economic advantages of securitisations for the financing of the real economy a broader definition of “qualifying” securitisation is necessary. Therefore, securitisations of trade and lease receivables by ABCP should be incorporated as well.
Our answers to selected questions

**Question 1:**

*Do the identification criteria need further refinements to reflect developments taking place at EU and international levels? If so, what adjustments need to be made?*

We are concerned that the non-impairment requirements both in the delegated acts to the LCR and Solvency II and in the discussion of EBA could impede the political efforts to revive the securitisation market in the EU and to improve the conditions for medium and long-term financing of business.

According to these provisions, loans granted to credit-impaired borrowers shall be excluded from the definition of simple securitisations. However, the definition of impairment is unfortunately not based on accounting rules, unnecessarily too broad, partly unclear and might be difficult to implement. In particular, this relates to the requirement that loans to be securitised as qualifying shall be assessed by an ECAI (External Credit Assessment Institution) or a credit score where the assessment or credit score must not indicate a significant risk of default. Yet it is completely unclear, for the time being, what the indication of “significant risk of default” actually means.

It is important that the definition of “significant risk” is itself simple, objective and transparent and uniform in European countries. It should not be distorted by model risks or different default definitions in Europe and should not depend on the assessment of external rating agencies. The latter would contradict the political aim to reduce the dependency on external rating agencies.

Wrong credit decisions based on wrong scoring or rating models can have dramatic effects on SMEs. Thus, the stigmatisation of an SME as “significant risk” could induce a self-fulfilling prophecy due to shrinking willingness of banks to grant loans. This would notably cause problems if the „significance threshold“ is set restrictively. Banks could then be deterred to grant loans on their own acceptance policy but might follow the defined “significant threshold” to ensure that the loans with “significant risk” will not remain on the balance sheet of the credit institution and that the whole portfolio can be securitised. The intended effect to boost the financing opportunities could be turned to the contrary. If supervisory authorities referred to the term “significant risk” under IFRS 9 which means no “low risk” and that was published in July last year, then for example all companies would have to be excluded from qualifying securitization whose rating is a “non-investment” grade or an equivalent to it.
Especially, the creditworthiness of SMEs is often not “investment grade” due to the relatively low equity level although the company has a satisfactory creditworthiness. The problem might be heightened by EBA’s proposal in its discussion paper to simple, transparent standard ABS to allow only the securitisation of loans for qualifying securitisation that will have a certain risk weight based on the credit standardised approach.

According to the recent consultative paper by the Basel Committee on the revision of the credit standardised approach, this would mean, for instance, that all corporate SMEs with revenues up to 5 million Euro and an equity ratio of 33% would be excluded from qualifying securitisation irrespective whether there is a significant single risk or not. If only a third or a half of the loans of a bank portfolio can be securitised that are anyway linked with low risk weights then we believe that the intended effects to boost the financing opportunities for SMEs to create growth and jobs will not be achieved.

Due to limited capital resources of credit institution due to Basel III and increased capital requirements by EBA and ECB to augment the resilience of credit institutions, capital is becoming a scarcer resource in credit institutions in the meantime which limits the expansion of the lending business and which can be evidenced by the deleveraging of the balance sheet of credit institutions in the last years. Against this backdrop, banks are under pressure to focus their lending to customers who absorb lower levels of capital. However, these companies do not have problems in general to obtain financing means such as loans. Hence, it seems more important that also loans can be securitised as qualifying that are originated in the normal course of business based on transparent underwriting standards of the credit institution to enable the transfer of credit risk and the freeing up of capital for new credit business and thus growth and employment in the European Union.

Having said this, we expressively reject excluding SMEs with “significant risk” on the basis of internal or external scorings and ratings. In addition, we do not believe that it will be possible to fully harmonise the definition of significant risk based on internal or external scorings in Europe. But this would be necessary to build trust in the market and to avoid discrimination of SMEs in one European country against another European country.

A comparability of scorecard and rating model results would only be possible on the probability of default assigned to the scores. But it is not clear how to achieve comparable results if the probabilities of defaults differ in the various EU countries. For instance, Italian scorecards are based on a default definition with more than 180 days past due whereas in Germany an SME is considered to be in default after more than 90 days past due. A unique probability of default threshold for “significant risk” would discriminate German SMEs against Italian SMEs.
In addition, we would like to point out that it is not clear under which conditions a credit history is deemed adverse or not adverse and how long this shall go back after a company has recovered. Such a requirement would prevent the recovery of SMEs after an economic downturn due to increased financing costs even if the company is again in good shape and has good credit quality. This adverse impact especially on SMEs cannot be desirable for the economy in the EU.

Moreover, companies such as SMEs, that have recovered after an insolvency or debt rearrangement process should not be excluded if they are not impaired any longer according to the applicable accounting rules. Even according to the accounting rules, it has to be assessed after a recovery whether the borrower is still credit-impaired. If this is the case, then such loans would have to be exempted from the securitisation of high quality ABS. According to the current proposal such borrowers would be excluded for three years notwithstanding the current creditworthiness, which would be detrimental to the recovery of such companies.

Against this background, we plead to require the exclusion of loans and leasing receivables based on the delinquency status and not on an internal and external score. This procedure has in combination with the requirement that at least one payment and partly two payments have to be made before securitisation proved to be successful for high quality securitisations and is recognised by investors as reliable provided that the loans and receivables are selected randomly from a target portfolio originated in the normal course of business to ensure that the credit quality of the securitised loans is comparable and a little better, respectively than the non-securitised portfolio. Such an approach has the advantage that it is based on the underwriting standards of the credit institution to be the same for the securitised and non-securitised portfolio and do not have an adverse impact on the acceptance policy considering a potential strict PD-threshold of “significant risk” to avoid that such risks with their higher risk weights remain on the balance sheet of the credit institution.

In addition, it should be noted that securitisation refers to the securitisation of pools of receivables rather than to single risks. Diversification effects play an important role when assessing the quality of a portfolio if this is sufficiently granular. Provided that underwriting standards are stable in substance over time, such diversification effects increase the predictability of cash flows, reduce uncertainty of each assessment and thus the level of non-expected losses which is important for simple transactions. In other words, it is less a problem that the probability of defaults or the expected losses are a little bit elevated than rather the deviation and the level of deviation of such expectation on a pool level, because securitisations are typically structured to cover expected losses in a baseline scenario and unexpected losses in stressed scenario. First non-expected losses beyond the projection of a stress test scenario typically cause problems, but not the inclusion of “signifi-
COMMENTS ON THE SECURITISATION CONSULTATION LAUNCHED BY THE EU-COMMISSION

cant” single risks in a securitised portfolio provided that the selection occurs randomly from the target portfolio to warrant the comparability of the securitised and non-securitised loans and to avoid any bias in the assessment of such portfolio. Hence it would be worth considering to reward such diversification effects and to use this leeway to promote the financing of SMEs in Europe.

Having said this, we propose to exclude loans with higher risks based on well-established criteria as follows:

- Receivables qualify for default according to Basel II;
- Receivables that show evidence of impairment requiring specific allowances according to the applicable accounting framework (whether IFRS or national accounting rules);
- Receivables with significant risk based on the delinquency status that are past due more than 30 days.

As a result, a sufficient high quality of underlying assets could be ensured with simple, objective and well established criteria already existing in the market. Otherwise, originators might not be able to securitise loans for a while, which would be detrimental to the funding opportunities of European SMEs and that would not be acceptable given the declared priority of the EU Commission to improve the financing opportunities to the real economy.

**Question 2:**

*To what extent should criteria identifying simple, transparent and standardised short-term securitisation instruments be developed? What criteria would be relevant? Are there additional considerations that should be taken into account for short-term securitisations?*

Short-term securitisations of trade and lease receivables by asset-backed commercial paper (ABCP) are well established financing instruments in many European countries. In Germany, ABCP programmes contribute to working capital financing of business with a volume of 13-14 Billion Euro. ABCP securitisations are a solid mainstay in the financing mix of German corporates. By this means, financing sources are diversified. Dependencies from bank lending and the company’s own rating are reduced. Existing credit lines are spared and can be used for other financing activities. More positive balance sheet ratios have an effect on the general creditworthiness, thus leading to more favourable financing costs of firms.

Empirical studies reveal that ABCP transactions showed remarkable resilience during the recent crisis. Extremely low default rates and the increasing relevance of
ABCP transactions as a financing option of the real economy should be taken into account in the current debate on the regulatory treatment of qualifying securitisations.

The typical structure for such ABCP programs for the real economy are so-called “multi-seller-programs”. Investors are exposed to various different pools from different sellers and industries which distinguish fully supported multi-seller ABCP programs from traditional securitisations. Moreover, the sponsoring bank provides liquidity facilities to the program. We therefore advocate criteria identifying simple, transparent and standardised short-term securitisation instruments that take specifically into account the double layer of protection of the investment position (liquidity bank coverage plus pool structure).

**Question 4:**

*How can proper implementation and enforcement of EU criteria for qualifying instruments be ensured?*

*How could the procedures be defined in terms of scope and process?*

The implementation and enforcement of EU criteria for qualifying ABS instruments should be done by means of a well-defined certification process by a private institution which has relevant market experience and market proximity, a clear track record in the development of market standards and close contact with the market, the regulatory authorities and the legislator. There is a need for an institution which, while safeguarding the overall interests of all participating market players – banks, investors and supervisors – transparently monitors, organises and steers the process of developing and implementing quality standards for the securitisation market.

In Germany TSI pursues that concept, which has long proved its value in German industry. TSI’s task is, among other things, to develop quality standards for German securitisations and to implement them by means of a certification process. For the past three years Prime Collateralised Securities (PCS) has had a similar function at the European level.

Although simpler at face value, we are sceptical that a self-certification by originators could restore the level of trust necessary to create new dynamics in the European securitisation market.
Question 5:

What impact would further standardisation in the structuring process have on the development of EU securitisation markets?

Further standardisation in the structuring process could help to expand the market for securitisations. It would enhance comparability for investors and by thus creating a level playing field with similar credit products such as covered bonds, it would also make securitisations more attractive.

In the European capital market there are only a few very large investors. The market is dominated by medium-sized insurance companies and banks, whose investment lot sizes are naturally smaller than that of pension funds and large asset managers. In such conditions, standardisation helps to reduce the fixed costs associated with investment decisions and makes the capital market more efficient. In particular with a view to the envisaged European Capital Markets Union, it is essential to standardise the legal framework for securitisations.

Would a harmonised and/or optional EU-wide initiative provide more legal clarity and comparability for investors? What would be the benefits of such an initiative for originators?

A more harmonised environment would of course be beneficial for both investors and originators. Each one would benefit from different areas of such a harmonisation. Investors being active in different European markets would clearly benefit from one legal form with the corresponding rights and mechanism to e.g. the bankruptcy proceedings for such an entity. The complexity of the investment process should be reduced significantly. For originators the main benefit would be in reducing complexity within the structuring process as well as within the recurring transaction processes.

Question 6:

To what extent should disclosure requirements be adjusted – especially for loan-level data – to reflect differences and specificities across asset classes, while still preserving adequate transparency for investors to be able to make their own credit assessments?

We believe that disclosure requirements should be specifically tailored to each type of securitisation. As our answer to question 16 presents in more detail, in general we do not think that disclosure requirements beyond those already enacted would be useful.
Moreover, since we strongly support the inclusion of Asset-Backed Commercial Papers (ABCP) as high-quality securitisations, specific criteria must be developed to reflect the specificities of this asset class. Since investors are protected by the underlying assets and the liquidity guarantees, information about the ABCP structure and sponsor are particularly important, while granular information about individual underlying claims are not. Moreover, granular information from ABCP programs could reveal important business secrets (i.e. terms of trade). Thus, disclosure obligations on this level would seriously harm the acceptance of these programs among corporates.

**Question 7:**

*What alternatives to credit ratings could be used, in order to mitigate the impact of the country ceilings employed in rating methodologies and to allow investors to make their own assessments of creditworthiness?*

Even having in mind the problems caused by credit insurances and especially monoliners during the crisis we think it is still worth considering credit insurance for credit enhancement issues in cases related to country ceilings or, as referred to in question 16, the evaluation and rating of SME’s credit risks. Credit insurers in general have a very good understanding of country specific risks in European market players and are helpful for SME securitisations.

*Would the publication by credit rating agencies of uncapped ratings (for securitisation instruments subject to sovereign ceilings) improve clarity for investors?*

The European Union rightly follows a strategy to emphasize each investors’ own risk assessment and due diligence, which reduces systemic risk. In this respect, additional publication of uncapped rating ceilings would be beneficial as investors could then choose to apply their own assessment of relevant sovereign risk where divergent from a rating agency’s view. Moreover, it might also improve incentives to structure transactions to a high level rating even in a country where rating caps apply.
Question 9:

With regard to the capital requirements for banks and investment firms, do you think that the existing provisions in the Capital Requirements regulation adequately reflect the risk attached to securitised instruments?

We regard the existing calibration of risk weights as appropriate. A tightening of the capital requirements as it is currently discussed would impede the further development of the markets for high quality ABS and ABCP.

Question 10:

If changes in EU bank capital requirements were made, do you think that the BCBS recommendations on the review of the securitisation framework constitute a good baseline? What would be the potential impacts on EU securitisation markets?

The recent BCBS recommendations would be inappropriate to adequately reflect risk attached to securitised instruments. We also refer to question 9. A sharp increase of the risk weights as it is envisaged by BCBS would severely worsen financing conditions for EU corporates. Especially SMEs would be prevented from accessing capital markets via a securitisation of trade receivables and/or loans and lease. This would also stand in contradiction to the efforts to create a Capital Markets Union.

Question 11:

How should rules on capital requirements for securitisation exposures differentiate between qualifying securitisations and other securitisation instruments?

Capital requirements should primarily be based on historical data for qualifying and non-qualifying exposures. Empirical findings suggest that historical losses of qualifying securitisations and non-qualifying securitisation differ significantly. This should be adequately reflected in the respective capital requirements which should not be higher than today. With regard to liquidity facilities to ABCP transactions we advocate for risk weights which properly reflect the low risk profile of securitised instruments and are comparable to similar risk positions for corporate lendings.
Question 12:

*Given the particular circumstances of the EU markets, could there be merit in advancing work at the EU level alongside international work?*

During and after the crisis, very important differences between securitisation markets – e.g. in the US and the EU – became visible. Some problems which have plagued other markets have little or no relevance for European issuances, nor do we have (or support) large-scale public guarantees for certain types of securitisations. As a result, concerning this specific topic, we do not believe that European action should be organized so as to follow the international discussion. On the contrary, we believe that action on the European level is required without further delay. A system of mutual recognition for high-quality securitisations could then be set up to prevent new friction from international divergences.

Question 16:

*What additional steps could be taken to specifically develop SME securitisation?*

We consider synthetic securitisation transactions as an important capital management tool for banks (not only with respect to SME portfolios) as they help banks to release regulatory capital and therefore provide them the opportunity to grant new loans to bank customers.

From our perspective the equal treatment of synthetic securitisations and true sale securitisations would support the development of a market for SME securitisations. This applies in particular against the background that banks in Germany employ almost predominantly synthetic securitisations to securitise SME loans.

In particular, smaller credit institutions like savings banks and cooperative banks in Germany make use to a large extent of synthetic securitisations. There are two motivations involved here: First, the credit institutes have no great interest to reduce their balance sheet. Second, their contracts with borrowers often contain clauses that explicitly exclude the sale of loans, and borrowers value that their bank remains their single point of contact concerning the loan contract. In addition, synthetic securitisations of SMEs are generally easier to handle than true sale securitisations which are technically and legally much more complex. Synthetic securitisations allow a wider range of SME financing instruments and address a central current problem of corporate financing by banks: the creation of new scope for lending through capital relief, which becomes increasingly important in view of the more stringent regulatory requirements (CRD IV). In this respect, synthetic securiti-
zation is clearly superior. As loans are neither sold nor assigned in the case of synthetic securitization, this class of financing instruments clearly meets the needs and interests of SMEs and should be included as qualifying securitisations.

Synthetic securitisations are an essential tool for banks to transfer expected and/or unexpected loss risk to the capital markets where adjustments to the banks risk profile is desired. It frees up regulatory capital as a limiting factor to extend new credits.

As German experience since 2003 with securitisations via the platform PROMISE of the Kreditanstalt für Wiederaufbau (KfW) shows, this can be attained easier and more cost-effective by the broad use of synthetic securitisation than by true sale transactions. Evidence with the KfW platform suggests that standardisation of synthetic securitisations should be rather easy to fix.

Unfortunately, the ongoing discussions about “qualifying securitisations” exclude synthetic securitisations. It is often argued that synthetic securitisations are more complex than true sale securitisations and include significant amount of counterparty risk. However, synthetic securitisations of plain vanilla (real economy) balance sheet assets such as SME loans (as opposed to synthetic CDOs) are generally structured in a simple and transparent way. Often the transaction and associated documentation actually are less complex than a true sale transaction for both issuer and investor as it does not involve the sale of assets.

Would more standardisation of loan level information, collection and dissemination of comparable credit information on SMEs promote further investment in these instruments?

Investors need reliable information on the reference portfolio and the transaction structure to profoundly evaluate the credit risk of the transaction. However, detailed data and information necessary for a substantial evaluation of risk are already provided in advance of new issuances and as part of the current transaction reporting system to interested investors. In addition, the requirements for publication of data and information on SME securitisations for issuers, originators and sponsors have been significantly expanded by the delegated regulation CRA3. Transparency requirements on the underlying exposures that go beyond what already exist would be counterproductive. The publication of detailed customer-related information could harm the relationship between banks and their SME clients. The use of securitisations for risk and capital management of banks would become more difficult, the potential for new lending would shrink. An alternative, as already mentioned answering to question 7, could be to re-consider the utilisation of credit insurances. These institutions typically have a deep knowledge of SMEs and could wrap-up the credit risk of the portfolio by providing specific policies.
Concluding remarks

The overall aim should be to safeguard a proper financing of business to overcome the economic crisis in Europe. To ensure this, bank financing and capital market financing must be intelligently interlinked. Securitisation in its full range of instruments should play a vital role in this respect.

Ensuring a regulatory level playing field vis-à-vis alternative financing forms is a necessary precondition for originators and investors alike to give new impulses to the securitisation market in Europe.

Obviously, the right balance between the regulatory treatment of securitisations and the economic need to promote growth and employment by a smooth financing of companies has not yet been found until now. Ongoing reforms should be optimized with the aim to fully exploit the huge potential of a sustainable high-quality securitisation market to the benefit of the real economy.
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