EUROPEAN COMMISSION
Directorate-General for Financial Stability, Financial Services and Capital Markets Union

General affairs
Policy definition and coordination

RESPONSE OF CARDIF TO THE TARGETED CONSULTATION ON THE FUNCTIONING OF THE EU SECURITISATION FRAMEWORK

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This response is based on the information available at the time of consultation. Please note that questions to which Cardif did not provide a response are not included in this communication

CONSULTATION QUESTIONS

1. Effectiveness of the securitisation framework

1.1. Do you agree that the securitisation framework (including the Securitisation Regulation and relevant applicable provisions of the CRR, Solvency II and LCR) has been successful in, or has contributed to, achieving the following objectives:

	Fully agree	Somewhat agree	Neutral	Somewhat disagree	Fully disagree	No opinion
1. Revival of a safer securitisation market					✓	
2. Improving financing of the EU economy by creating a more balanced and stable funding structure of the EU economy					✓	
3. Weakening the link between banks' deleveraging needs and credit tightening						✓
4. Reducing investor stigma towards EU securitisations			✓			
5. Removing regulatory disadvantages for simple and transparent securitisation products					✓	
6. Reducing/eliminating unduly high operational costs for issuers and investors					✓	
7. Differentiating simple, transparent and standardised (STS) securitisation products from more opaque and complex ones					✓	
7.1 Increasing the price difference between STS vs non-STS products					✓	
7.2 Increasing the growth in issuance of STS vs non- STS products					✓	
8. Supporting the standardisation of processes and practices in securitisation markets			✓			
8.1 Increasing the degree of standardisation of marketing and reporting material			✓			
8.2 Reducing operational costs linked to standardised securitisation products					✓	
9. Tackling regulatory inconsistencies					✓	

4. Due diligence requirements

4.3. Please select your preferred option to ensure that investors are aware of what they are buying and appropriately assess the risks of their investments.

- **Option 1: The requirements should be made more principles-based, proportionate, and less complex**
- Option 2: The requirements should be made more detailed and prescriptive for legal certainty
- Option 3: There is no need to change the text of the due diligence requirements
- No opinion

Due diligence requirements prior to holding a securitisation position

4.4. Should the text of Article 5(3) be simplified to mandate investors to assess at minimum the risk characteristics and the structural features of the securitisation?

- **Yes**
- No
- No opinion

Please explain your answer.

The need for a deep revision of the due diligence rules is underlined by Mario Draghi in its report named The future of European competitiveness, p.57:
"[…] This report recommends that the Commission makes a proposal to adjust prudential requirements for
securitised assets […] In parallel, the EU should review transparency and due diligence rules for securitised assets, which are relatively high compared to other asset classes and reduce their attractiveness. […]"

We welcome that position defended by Mario Draghi since that aspect of securitisation can be forgotten. For example, The EIOPA Consultation Paper on the Advice on the Review of the Securitisation prudential framework in Solvency II, published on 7th June 2022, did not tackle the issue of the high burden of due diligence.

We understand the necessity of having due diligence requirements linked to investments in securitisation. A clear, proportionate and efficient approach can be useful for the supervisor as well as for the investor since it enables him, especially when it is an insurer, to go deeper into the securitisation market and to have an improved understanding of the risks associated to securitised products.
Nevertheless, the current framework is too prescriptive. The requirements remain burdensome, not taking enough into account the profile of the product and the profile of the investor.

That lack of proportionality blocks the activity of insurers. Under current requirements, the investment activity requires teams to understand securitisation markets and deal with compliance topics (such as the due diligence or the respect of the STS criteria already assessed by structurers, as mentioned in the paragraph 3. of the article 5 SECR). Associated with the capital costs generated by the Solvency 2 ("S2") calibration, the global burden of securitisation linked to regulation (SECR and S2) go against the potential gains made in securitised products by an insurance company.

4.5. If you answered yes to question 4.4., please specify how this could be implemented.

The paragraph 3 of the Article 5 should mention explicitly that the approach followed is a proportionate approach, sufficient to fully grasp the risks linked to the investment. That would give some leeway to the investor and avoid the insurer from being overwhelmed by the requirements mentioned in the points a) to c), burdensome but considered as a minimum by the regulation.

4.7. Should due diligence requirements differ based on the different characteristics of a securitisation transaction?

- **Yes**
- No
- No opinion

4.8. If you answered yes to question 4.7., please select one or more of the following options to differentiate due diligence requirements:

- **Due diligence requirements should differ based on the risk of the position (e.g. senior vs non-senior)**
- **Due diligence requirements should differ based on the risk of the underlying assets**
- **Due diligence requirements should differ based on the STS status of the securitisation (STS vs non-STS)**
- Other

Please explain your answer.

These requirements could be part of the characteristics of the proportionate approach we propose in 4.4.

4.9. Taking into account your answers to 4.7 and 4.8, what would you estimate to be the impact (in percent or EUR) of differentiating due diligence requirements on your one-off and annual recurring costs for complying with the due diligence requirements under Article 5?

That impact remains difficult to assess since the first factor that prevents the insurers from investing in securitised products remains the current calibration of S2.

4.10. For EU investors investing in securitisations where the originator, sponsor or original lender is established in the Union and is the responsible entity for complying with those requirements, should certain due diligence verification requirements be removed as the compliance with these requirements is already subject to supervision elsewhere?

This could apply to the requirements for investors to check whether the originator, sponsor or original lender complied with:

- (i) risk retention requirements,
    - **Yes**
    - No
    - No opinion
- (ii) credit granting criteria requirements,
    - **Yes**
    - No
    - No opinion
- (iii) disclosure requirements,
    - **Yes**
    - No
    - No opinion
- (iv) STS requirements, where the transaction is notified as STS
    - **Yes**
    - No
    - No opinion

Please explain if you see any risks arising from the removal of these requirements, and if so, how they should be mitigated.

In order to avoid useless double burden, for EU investors investing in securitisations where the originator, sponsor or original lender is established in the Union and is the responsible entity for complying with those requirements, these four due diligence verification requirements should be removed as originators must already be compliant with these requirements.

7. STS standard

7.1. Do you think that the STS label in its current form has the potential to significantly scale up the EU securitisation market?

- Yes
- **No**
- No opinion

Please explain your answer.

The introduction of the STS label (change in the DR introduced with the Commission Delegated Regulation (EU) 2018/1221 of 1 June 2018) was a relevant step to improve the treatment of securitisation.
SECR indeed enabled the creation of the specific framework for STS securitisation:

- Simplicity refers to the structure of the vehicle and the homogeneity of the underlying assets.
- Transparency aims at providing static and dynamic data on past default and loss performance (delays, default…), and these data must cover a period of at least 5 years.
- Standardisation tries to facilitate comparison between different transactions with a standardisation of derivatives, risk retention, payment of interest, etc.

Nevertheless, as pointed out by Mario Draghi in its reports, the STS criteria are difficult to pass, are difficult to understand and remain burdensome to fulfill.

Numerous and burdensome STS requirements (100+) embed heavy due diligences for investors and may discourage insurers to invest in STS securitisations:

1/ Main requirements relating to simplicity (art. 20 SECR):

- "The title to the underlying exposures shall be acquired by the Securitisation special purpose entity (SSPE) by means of a true sale or assignment or transfer with the same legal effect in a manner that is enforceable against the seller or any other third party" […]
- "The underlying exposures transferred from, or assigned by, the seller to the SSPE shall meet predetermined, clear and documented eligibility criteria which do not allow for active portfolio management of those exposures on a discretionary basis" […]
- "The securitisation shall be backed by a pool of underlying exposures that are homogeneous in terms of asset type" […]
- "The underlying exposures shall not include any securitisation position" [No re securitisation]
- "The underlying exposures shall be originated in the ordinary course of the originator's or original lender's business" […]
- [No borrowers having had credit incidents]

2/ Main requirements relating to standardisation (art. 21 SECR):

- "The originator, sponsor or original lender shall satisfy the risk-retention

requirement (art. 6 SECR)".

- "The originator [...] of a securitisation shall retain on an ongoing basis a material net economic interest in the securitisation of not less than 5 %. That interest shall be measured at the origination and shall be determined by the notional value for off-balance-sheet items".
- [adequate coverage of interest rate risk and currency risk]
- [no amount of cash trapped in the SSPE]
- "The transaction documentation shall include appropriate early amortisation provisions or triggers for termination of the revolving period where the securitisation is a revolving securitisation" [...]
- [description of asset performance monitoring (and consequences of deterioration)]

3/ Main requirements relating to transparency (art. 22 SECR)

- "The originator and the sponsor shall make available data on static and dynamic historical default and loss performance [...] Those data shall cover a period of at least five years".
- [audit of a sample of the underlying exposures]
- "The originator or the sponsor shall, before the pricing of the securitisation, make available to potential investors a liability cash flow model" [...]
- [environmental performance, if available, for cars and housing loans]

The controls made by the French Financial Market Authority (AMF) showed (August of 2022: Summary of SPOT controls on simple, transparent and standardized securitisation (STS), in French Synthèse des contrôles SPOT sur la titrisation, simple, transparente et standardisée (STS)) that even investment structurers do not really understand the current STS criteria. Our interpretation of these results is that the current regulation is far too difficult to be fully understood, even for specialized institutions (3 out of 5 institutions of the panel are sponsors).

That's why we believe that, even if some STS criteria should be clarified or simplified, it is key that regulators should also design appropriate prudential calibration for non-STS in S2.

7.2. Which of the below factors, if any, do you consider as holding back the expansion of the STS standard in the EU? You may select more than one option.

- **Overly restrictive and costly STS criteria**
- Low returns
- High capital charges
- LCR treatment
- Other

Please explain your answer.

The quantity of criteria makes difficult a clear and short assessment of which criteria are the most difficult to comply with.
Nonetheless, we can quote several criteria that illustrate well the difficulties that stem from SECR. Most of them are related to the article 22 which concerns the transparency:

- "The originator and the sponsor shall make available data on static and dynamic historical default and loss performance […] Those data shall cover a period of at least five years".
  "That statement makes the regulation SECR non applicable for small firms with a few years of existence which would like to find financing sources via securitisation".
- [audit ("external verification) of a sample of the underlying exposures] That audit requirement could be costly for an insurer. It also requires time to be fulfilled, thus making the transaction too slow to be interesting should an opportunity occur.
- "The originator or the sponsor shall, before the pricing of the securitisation, make available to potential investors a liability cash flow model" […]
  A liability cash flow model may be useful, but remains at the discretion of the institution that produces it in terms of quality. Producing it requires also time and may slow down the transaction.
- [environmental performance, if available, for residential and car loans]
  That requirement could be heavy, since an environmental performance is not that easy to establish for example in the case of car loans for the motor sector.
- [making available to potential investors before pricing asset information and documentation in its quasi-definitive form]
  That could overwhelm the investor with a huge amount of documentation. The treatment of a significative number of documents may be useful but once again slow down considerably the transaction.

7.3. How can the attractiveness of the EU STS standard be increased, for EU and non-EU investors?

As explained in our answer to the question 4.10, we propose not to duplicate the verification of these STS criteria within the framework of Investor Due Diligence. As a matter of fact, originators/sponsors are already responsible for this complex work, and it is also common to obtain verification by a third company (e.g. PCS, TSI).

10. Prudential treatment of securitisation for insurers

10.1. Do you think that the STS label in its current form has the potential to significantly scale up the EU securitisation market?

- **Yes**
- No
- Don't know / No opinion / Not applicable

10.2. If you answered yes to question 10.1., please specify the segments of securitisations in which (re)insurers would be willing to invest more (in terms of seniority, true sale or synthetic nature, type of underlying assets, etc.) and describe the potential for increase in the share of securitisation investments in (re)insurers' balance sheet.

We do have an interest. Indeed, securitised products can be used to meet the following objectives:

- to diversify or increase the decorrelation between strategic asset classes. The securitised product supplements the whole asset allocation capabilities.
- to tailor risk-return characteristics of assets to the business model/asset liability management, through the tranching of underlying assets

As an insurer, the part of these products in our investments would be dependent on our LT Assets & Liabilities and liquidity management policies constrained in particular by Solvency 2, risk appetite and customer behavior, risk /return on LT duration and value for money expectations.
In a first approach, should appropriate prudential, reporting, market conditions and frameworks be met, insurers under standard formula could target one percentage point of their investments dedicated to some securitised products, under a necessarily controlled trajectory and framework compatible with the specific constraints of insurers as mentioned above.
In a medium-term perspective, should these markets become deeper with notably higher liquidity characteristics, insurers could then envisage to reach a few percentage points of their investments dedicated to some securitised products, under the constraint of a necessarily controlled trajectory and framework compatible with the specific constraints of insurers as mentioned above.

10.3. Is there anything which in your view prevents an increase in investments in securitisation by (re)insurance undertakings?

- **Yes**
- No
- Don't know / no opinion / not applicable

Please explain your answer to question 10.3. If you mention prudential rules as part of your answer, please provide an estimate of the impact on the level of investments in securitisation, of the reduction of capital requirements for securitisation investments by a given percentage, e.g. 5% or 10%:

Securitisation's calibration proposed by S2 embeds several major issues in its design:

- there is an unjustified gap between STS senior and bonds & loans.
- there is an unjustified gap between STS and non-STS tranches.
- the non-STS category does not enable to distinguish between senior and non-senior tranches, then leading to very huge shocks especially for products with a low-risk rating (AAA).
- shocks for certain securitised products are sometimes higher than the one foreseen by S2 for equity, even if they present a lower risk:
  - a tranche that is non-STS, rated AAA, with a duration of 5 years has a 62,5% shock, much more than type 2 equity shock (49%).
  - a tranche that is STS, non-senior, rated BBB with a duration of 5 years has a 39,5% shock, as much as standard equity shock (39%). With a downgrade to BB, the shock becomes 79%.

Meanwhile, many reports have lately underlined how the current calibration in Solvency 2 is irrelevant. We already mentioned the Draghi Report (see 4.3), but we can also mention the Report of the FSB published in July (Evaluation of the Effects of the G20 Financial Regulatory Reforms on Securitisation: Consultation report)

- This report explains in its box 8 that "EU stakeholders argue that Solvency II is not sufficiently risk sensitive or reflective of the actual risk in securitisation investments, which has allegedly reduced insurers' interest in this product." That comment made by the industry is consistent with the one already observed, but not taken into account by EIOPA, in the Joint Committee Report on securitisation (December 2022)
- This report also quotes the Becker et al (2022) analysis which concludes that capital requirements are a key element in insurers' behaviour about their investment policy (see p.74 of the Report: "[it] corroborates the interpretation that capital requirements are a key driver for insurers' differential trading behaviour across asset classes").

Lately, Paris Europlace (How can securitisation contribute to the financing of the EU agenda?) released a complete report on securitisation. We are aligned with the proposal made on a new calibration of S2 shocks:

- New Senior STS could be aligned to Bonds & Loans
- New Senior Non-STS shocks could be set at 1.3 times the New Senior STS shocks
- The New Non-Senior shocks could set at 1.5 times the New Senior shocks, to be applied to both STS and Non-STS

Finally, from an academical perspective, we have to mention the article of Perraudin and Qiu (2022) named ABS and covered bond risk and Solvency II capital charges that lays the emphasis on the calibration and demonstrates how irrelevant it is currently.

The adaptation of the calibration of securitized products could be done through a Delegated Act, as stated in the S2 version expected to be published at the OJEU in December, as per recital (105).

10.5. Is the current calculation for standard formula capital requirements for spread risk on securitisation positions in Solvency II for the senior tranches of STS securitisations proportionate and commensurate with their risk?

- Yes
- **No**
- Don't know / no opinion / not applicable

Please explain your answer to question 10.5, being specific in your reply, and, where relevant, provide a comparison, including, where appropriate, with internal models and their relative impact on the share of securitisation investments.

If you consider calibrations inappropriate, please indicate what you would consider as 'appropriate' calibrations, as well as any data/evidence of historical spread behaviours that would justify your proposal:.

See 10.3. We propose to align the shocks designed for STS senior tranches on the shocks designed for bonds & loans.

10.6. Is the current calculation for standard formula capital requirements for spread risk on securitisation positions in Solvency II for the non-senior tranches of STS securitisations proportionate and commensurate with their risk?

- Yes
- **No**
- Don't know / no opinion / not applicable

Please explain your answer to question 10.6, being specific in your reply, and, here relevant, provide a comparison, including, where appropriate, internal models and their relative impact on the share of securitisation investments.

If you consider calibrations inappropriate, please indicate what you would consider as 'appropriate' calibrations, as well as any data/evidence of historical spread behaviours that would justify your proposal:

See 10.3. We propose to reduce the gap between STS non-senior tranches and STS senior tranches based on the recommendations made by Paris Europlace.

10.7. Is the current calculation for standard formula capital requirements for spread risk on securitisation positions in Solvency II for the non-senior tranches of STS securitisations proportionate and commensurate with their risk?

- Yes
- No
- **Don't know / no opinion / not applicable**

Please explain your answer.

To have a sound revision of the S2 calibration, we would rather focus on the points mentioned in the answer to the question 10.3.

10.9. Is the current calculation for standard formula capital requirements for spread risk on securitisation positions in Solvency II for non-STS securitisations proportionate and commensurate with their risk, taking into account?

- Yes
- **No**
- Don't know / no opinion / not applicable

Please explain your answer to question 10.9, being specific in your reply, and, where relevant, provide a comparison, including where appropriate with internal models and their relative impact on the share of securitisation investments:

See 10.3. The calibration for the non-STS is an issue. We understand the will to foster the investments in the STS label, but the current calibration of the non-STS products is clearly here to prevent these kinds of investments. Based on the works made by Paris Europlace, we have in mind that the market lies predominantly in non-STS transactions. That calibration thus narrows drastically the range of opportunities.

10.10. Is there a specific sub-segment of non-STS securitisation for which evidence would justify lower capital requirements than what is currently applicable?

- **Yes**
- No
- Don't know / no opinion / not applicable

10.11. If you answered yes to question 10.10., please specify the sub-segment of non-STS securitisations that you have in mind as well as its related capital requirement, including any evidence/data of historical spreads supporting your proposal:

See 10.3. Works mentioned in the answer to the question 10.3 demonstrate how relevant it is to distinguish senior and non-senior tranches for non-STS products.

10.12. Is it desirable that Solvency II standard formula capital requirements for spread risk differentiate between senior and non-senior tranches of non-STS securitisations?

- **Yes**
- No
- Don't know / no opinion / not applicable

Please explain your answer.

See 10.3. and 10.10.

10.13. If you answered yes to question 10.12., please provide suggestions for calibrations of capital requirements for such senior and non-senior tranches, including the data/evidence backing such suggestions. Please also indicate whether you target a specific segment of non-STS securitisation.

See 10.3. and 10.10.