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EBA Discussion Paper on simple standard and transparent securitisations

Bundesverband der Deutschen Industrie (BDI)[1] and Deutsches Aktieninstitut (DAI)[2] appreciate the opportunity to comment on the EBA Discussion Paper on simple standard and transparent securitisations from the view of non-financial companies using capital markets for financing growth, innovation and employment.

Non-Financial companies are interested in a financial market regulation that addresses systemic risks appropriately and thus ensures that non-financial companies 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. In particular, for larger SMEs it will be increasingly important to use this kind of funding sources to better diversify their financial basis. Meanwhile, also banks will again find it more relevant to use the securitisation market for their funding activities in order to extend credit exposures for SMEs.

BDI and DAI have repeatedly called for a removal of the various regulatory impediments that contradict efficient and well-functioning European securitisation markets. We therefore appreciate that the high economic potential of the securitisation market and the need for a more differentiated regulatory treatment are increasingly acknowledged. We explicitly welcome

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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] 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.

the efforts of EBA to create the regulatory requirement for simple, standard and transparent securitisations.

However, we are concerned that the regulatory framework could fall short of what is necessary to deliver lasting impulses to the European securitisation market. We are not convinced, that the right balance between the regulatory treatment of securitisations and the political aim and the economic need to promote growth and employment by a smooth financing of companies has been found already. Against this background we would like to make the following comments from the perspective of the real economy discussed in more detail below:

- 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 save and stable securitisation market and the needs of SMEs to have access to funding means by securitisation (see Criterion 5 on p. 41).

- Apart from true sale securitisations also synthetic securitisations which have several advantages compared with the former should be included in the regulatory framework (see Criterion 3 on p. 40). 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.

Non-impairment requirements for simple securitisations

Question 8: Do you agree with the proposed criteria defining simple standard and transparent securitisations? Do you agree with the proposed credit risk criteria? Should any other criteria be considered?

We are concerned that the proposed recommendations on criteria defining simple standard and transparent securitisations could impede the political efforts to revive the securitisation market in the EU and to improve the conditions for long-term financing of business.

According to Criterion 5 iii), loans granted to credit-impaired borrowers shall be excluded from the definition of simple securitisations. The term "impaired" refers to borrowers with adverse credit history or with a credit assessment by an ECAI or a credit score indicating significant risk of default. So far it is not clarified what is exactly meant by "significant risk of default".

It is important that the definition of "significant risk" is itself simple, objective and transparent and unique 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. A reference of "significant risk” on such internal or external score would aggravate the effect, because SMEs identified as “significant risk” would not obtain any or not favourable funding any longer. Thus, the stigmatisation of an SME as “significant risk” could induce a self-fulfilling prophecy due to rising interests and shrinking willingness of banks to grant loans.

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 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 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 to ensure that the credit quality is comparable but a little better than the non-securitised portfolio.

Risks to SMEs are reduced by diversification effects that offset a certain portion of higher single risks. Even if an SME portfolio contains a number of significant single entity risks, the quality of the portfolio might be good due to diversification effects. It would worth considering to reward such diversification effects and to use the 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:

1. Receivables qualify for default according to Basel II to be excluded,
2. Receivables that show evidence of impairment requiring specific allowances according to the applicable accounting framework i.e. IFRS to be excluded
3. Receivables with significant risk based on the delinquency status that are past due more than 30 days to be excluded.

Thus, a sufficient high quality of underlying assets could be ensured with simple, objective and well established criteria 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 long-term financing opportunities to the real economy.

Regulatory treatment of “qualifying” securitisations (synthetic securitisations, trade and lease based ABCP)

Question 2: Should synthetic securitisations be excluded from the framework for simple standard and transparent securitisations? If not, under which conditions/criteria could they be considered simple standard and transparent?

We disagree with EBA’s view to focus only on true sale securitisation and, hence, to exclude synthetic securitisations from the definition of simple securitisations as these instruments play a key role in transferring risks to free up capital that in turn can be used to promote the financing of the real economy. To serve the financing needs of SMEs properly, banks primarily need regulatory capital relief, for granting loans to SMEs and to avoid concentration risks. 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.

In particular, smaller credit institutions like savings banks and cooperative banks in Germany made 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. In addition, synthetic securitizations of SMEs are generally easier to handle than true sale securitizations which are technically and legally much more complex.

Synthetic securitizations 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. In this respect, synthetic securitization 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.

Securitisations of trade and lease receivables by ABCP should also be acknowledged as “qualifying” securitisations according to the standards developed by EBA. These instruments are well established 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. Extreme 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. To ensure a sustainable and diversified access of companies to finance, existing potentials of ABCP should be further developed and used on a broader basis.

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