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The Swedish Government and the Swedish Authorities joint response to the Consultation Document of the European Commission: *"An EU framework for simple, transparent and standardised securitisation"*

Stockholm, 13 May 2015

Ministry of Finance **Finansinspektionen** **Sveriges Riksbank**

Introduction

The Swedish Ministry of Finance, Finansinspektionen (the Swedish Financial Supervisory Authority), and Sveriges Riksbank welcome the possibility to comment on and present a shared view on the European Commission's consultation on a EU framework for simple, transparent and standardised securitisation. Comments and answers to particular questions are provided with reference to the enumeration of the particular question in the consultation. If a question or topic has not been commented on or answered, that should not be taken to constitute our approval or dismissal and we would like to reserve the right to comment on these questions at a later point in time. The term 'we', when used herein should be considered as the common view of the Ministry of Finance, Finansinspektionen, and Sveriges Riksbank.

Executive Summary

We recognise that well-functioning, resilient and appropriately regulated capital markets, combined with appropriate and effective supervision, are important to maintain stability in the financial system and the economic well-being of the European economy. We also believe that securitisation, when used appropriately, can play an important role in funding the European economy and contribute to the objectives of the Capital Markets Union initiative. However, it is important not to overlook the pivotal role securitisation played in the run-up to the financial crisis and draw lessons from that experience. If the EU is truly dedicated to re-launching securitisation, a long term perspective must be taken to sustainably regain investors trust in this asset class.

Hence, we believe that to minimise any potential future negative impact on the financial system or financial stability arising from securitisation, any revitalisation initiative has to be combined with a well-capitalised banking system, transparent structures which make it clear as to who carries the risks of the securitized instruments, and the clear responsibility of investors to understand the risks related to the investment prospect as well as their responsibility to carry out adequate due-diligence. Given the problems already associated with an overreliance on external ratings it is important that institutional investors perform their own analyses of potential investments, also in the case when such prospects are defined as simple, transparent and comparable.

The combination of a strong capital market and a strong banking system could increase and sustain high levels of long-term investment in the real-economy over economic cycles insofar as the underlying assets of the securitized securities consist of long-term investments. However, if not properly monitored or implemented, new initiatives on securitization could lead to shifting risk outside of regulators' views into the area of the shadow banks, which would make it more difficult to identify and assess potential systemic risks related to these securities as well as to apply macroprudential mitigation tools.

Against this background we welcome the intention of the Commission to further strengthen the securitisation framework, in particular efforts aimed at facilitating investor due-diligence through standardisation and simplification. We believe that in order to be successful, it is imperative that the sustainable revitalisation of a securitisation market is preceded by a comprehensive impact analysis and thorough assessment so that new risks to financial stability do not emerge. The purpose and proposed content of such analysis will be further discussed in the section "Impact assessment" below.

Definition and certification

One component in this process is a common definition of simple, transparent and comparable securitisations. We believe that globally agreed terms can create commonality in understanding, which in turn could facilitate investments also by non-EU investors. Consideration should therefore be given to use simple, transparent and comparable (STC).

We advocate a two-step approach to STC-classification which concentrates on the structural risk of the securitisation issuance, a process that could be regulated through the prospectus directive and the due-diligence requirements in AIFMD, CRDIV/CRR and Solvency II. In the first step originators would need to disclose and demonstrate that a certain securitisation transaction adheres to the STC-criteria. This could for instance be added as a requirement in the issues' prospectus. In the second step investors would be required to perform due-diligence, in line with precise criteria set out in AIFMD, CRDIV/CRR or Solvency II, for a specific tranche to classify as STC. In particular, we object to any certification process that places the responsibility of demonstrating compliance with STC-criteria entirely on the originator and only is complemented by the current due-diligence requirements by investors. This would, in our view, lead to reduced incentives for investors to actually perform due diligence.

Tranching and regulatory treatment

Concerning potential adjustments to capital requirements we are not convinced of the empirical basis for adjusting the capital requirements in relation to the STC-criteria. The underlying regulatory treatment for bank capital, the internal ratings-based (IRB) approach, has in some cases been deemed to produce unwarranted variability in risk-weighted assets (RWA). This is further compounded by the securitisation process, through horizontal tranching, producing even greater unwarranted RWA variability. This is particularly true for non-senior tranches, where a sufficient capital buffer for model risk is needed. Therefore we advocate that the Commission performs a detailed analysis of capital requirements for securitisation exposures, followed by a thorough impact analysis. If any adjustments are to be made to the regulatory treatment it should be risk sensitive, and based on the sufficient and appropriate consideration of empirical evidence and model risk.

Furthermore, it can be argued that the simplest, most transparent and comparable form of securitisation is vertical, i.e. a structure without tranches. Stratification of risks into horizontal tranches of different seniorities that absorb losses sequentially greatly increases complexity and reduces transparency as well as comparability - in ways that may be poorly understood by investors, thereby making their risk reward decision more difficult. Given the prudent disclosure requirements built into the proposed STC-criteria, investors will be given the ability to judge the risk in the un-tranched STC securitisation. Thus, in order to enhance liquidity of securitisations, limiting the degree to which STC securitisations may be tranched might be a way forward.

Impact assessment

Furthermore, we believe that to sustainably revitalise the securitisation market it is imperative that it be based on a comprehensive impact analysis and impact assessment so that new risks to financial stability do not emerge. Hence, we urge the Commission to perform a thorough impact analysis before introducing a new framework for securitisations. Such an impact analysis should take into account at least the following areas of potential prudential concern:

- The adverse effects of securitisation on the European banks. There is the possibility that securitisation could make banks more prone to retaining high-risk securities, since banks' incentives would drive them into securitising their high-quality assets, while keeping assets of lower quality on the balance sheet so that the inherent risk in the banks' portfolios increase. In combination with a possible move toward more standardised and thereby less risk sensitive capital requirements, as currently being discussed at the Basel Committee, this might result in banks significantly increasing the risk level (and correspondingly the expected return on equity) of their assets. The result would be a possibly smaller but clearly more risky banking sector.

- While there is a possibility that credit supply could increase in the short term, the long-term effects need to be understood in greater detail. Increasing market based dependency could increase volatility of credit supply over the economic cycle. Significantly decreased funding channelled through the banking system might make the system more vulnerable to liquidity shocks in the long-run. The social cost of recessions is likely to exceed the short-term benefits.

- Any re-shaped framework for European securitisations should be accompanied by an analysis of the new instruments for supervisors that would be required. This relates both to the collection and distribution of information relating to who in the non-banking credit intermediation sector owns securitisation products as well as to regulators' ability to act on credit bubbles by utilising macroprudential measures. In order to foster the development of a sustainable securitisation market it is therefore essential to ensure that regulators have both adequate information to analyse new risks as well as the proper set of tools to act upon those risks, if necessary. As an example, we are of the view that a variable retention requirement could be considered as a possible macroprudential tool.

- Any re-shaped framework should also include assessment of the need for guidelines for green securitisations and the development of standard contracts and agreements for low-carbon assets, in the view of the Swedish government. This could decrease barriers to investment in renewable sources and make Green investments more accessible to institutional investors. In this vein, the Swedish government also welcomes the EIB's proposed Renewable Energy Platform for Institutional Investors (REPIN).

1 a) *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 positive to aligning and calibrating requirements across different aspects of EU-regulations. These should be consistent with globally agreed upon standards and requirements to further increase transparency and comparability between different regulatory arenas. Furthermore, we note the absence of a discussion concerning the reduced comparability introduced through tranching. Hence, we would find it necessary to consider to further investigate the concept of securitisation without tranches, as suggested by several Member States in previous Council discussions. Securitisation without tranches could increase investor's ability to identify potential risks in order to better optimise their overall portfolio composition. Any impact analysis on this topic should include an evaluation of the pros and cons of un-tranched securitisations.

1 b) *What criteria should apply for all qualifying securitisations ('foundation criteria')?*

The appropriate evaluation and calibration of STC-criteria is important. We believe that it is imperative to avoid a system which automatically classifies and labels securitisations as for instance qualified or high quality. It is important to avoid an environment where investors purchase pre-labelled securitisations with the belief that they are safer and/or less risky than other securitisations as this could create a new "AAA" rating dilemma. We want to achieve this aim by ensuring that investor due-diligence requirements, as stipulated in Solvency II and CRR/CRDIV, are fulfilled.

Because of the heterogeneity of assets across securitisations and the heterogeneous risks across tranches, it is important to employ criteria based on objective and observable securitisation characteristics. Such criteria should be employed in combination with the individual tranches' underlying credit risks and should include requirements on asset class homogeneity, risk retention compliance and loan-level data disclosure quality.

We believe that STC-qualification should be the outcome of a two-step process. First, the originator should be required to ensure that the securitisation as a whole fulfils the STC-criteria. This information should be disclosed in the accompanying prospect, which is approved by the competent authority. Secondly, the individual tranche should pass through the investor's due-diligence process, as regulated in CRDIV/CRR or Solvency II, to qualify for STC-recognition. In particular, we object to any certification process that would place the responsibility of demonstrating STC compliance entirely with the originator (complemented only by the normal due diligence requirements by investors) as this would, in our view, lead to reduced incentives for investors to actually perform due diligence. The design and impact of such an approach requires further analysis. For our views on regulatory treatment, please see our answer to questions 11 and 14.

2a. *To what extent should criteria identifying simple, transparent, and standardised short-term securitisation instruments be developed? What criteria would be relevant?*

Concerning Asset-Backed Commercial Papers (ABCP); we believe that, given the post-crisis stigma around securitisation, it is important to go about this gradually so as not to repeat previous mistakes. As action already has been taken in both Solvency II and LCR over a short period, we believe that this is a topic that can be discussed post potential adjustments to capital requirements and the implementation of common STC-criteria.

2b. *Are there any additional considerations that should be taken into account for short-term securitisations?*

If developing criteria for short-term securitisations, it is important to differentiate between arbitrage conduits (where the aim of the financial sponsor is to issue a ABCP as a way to receive funds to purchase term securities and earn a spread on the rate paid to purchasers of the ABCP and the return they receive on the term securities they purchased) and the securitisation of trade receivables. We believe that any potential future criteria for short term securitisations should only apply to the latter.

3a. *Are there elements of the current rules on risk retention that should be adjusted for qualifying instruments?*

There is not a strong case for any differential treatment of STC-transactions when applying retention rules. There is a need to keep incentives aligned which does not depend on whether the securitisation fulfils STC-requirements or not, since the originate-to-distribute moral hazard exists in both cases.

3b. *For qualifying securitisation instruments, should responsibility for verifying risk retention requirements remain with investors (i.e. taking an "indirect approach")? Should the onus only be on originators? If so, how can it be ensured that investors continue to exercise proper due diligence?*

We believe that the responsibility should remain with investors (i.e. an indirect approach), in order to ensure that bank investors only purchase securitisations where interests are aligned between investors and originators. However, the originator should make such information easily accessible both through the issues prospect and upon request from investors. This should be simplified and strengthened through the implementation of STC-requirements in for instance the prospect. Furthermore, a trustee or similar private institution could assist in asserting that the risk retention requirements are maintained on a continuous basis. Further central loan databases should also be considered to make loan-level data more accessible (see question 14d).

4a. *How can proper implementation and enforcement of EU criteria for qualifying instruments be ensured?*

By creating and maintaining a stable and long-term securitisation market which makes a positive contribution to the real-economy without jeopardising financial stability. As mentioned in question 1b) we believe that the distinction of STC securitisations should be the outcome of a two-step process that reflects structural risks. In the first step originators need to disclose and demonstrate that a certain securitisation transaction adheres to the STC-criteria. This could for instance be added as a requirement in the issues prospectus. In the second step investors in turn must also perform due-diligence, in line with precise criteria set out in, CRDIV/CRR or Solvency II, for a specific tranche to classify as STC.

Originators should be required to provide appropriate information in the prospectus and trustees could continuously monitor the originators' retention requirements. We believe that it is important to limit investors from automatically purchasing STC securitisations with the belief that they are safer and/or less risky than other securitisations. Such an internal process maintains investor accountability and minimises originators' moral hazard. It is important that competent authorities can continuously monitor both the originator and the investor through the prospectus directive, Solvency II and CRR. .

4b. *How could the procedures be defined in terms of scope and process?*

Please see question 4a)

4c. *To what extent should risk features be part of this compliance monitoring?*

Originators should assure that the originated assets continuously fulfil the STC-criteria that are relevant also after issuance. Any self-attestation and compliance with criteria should be clearly and fairly communicated to investors. A trustee could monitor that the originators fulfil the retention requirements. Supervisory oversight over the compliance procedures could help to ensure their effectiveness.

5a. *What impact would further standardisation in the structuring process have on the development of EU securitisation markets?*

Harmonisation and standardisation that strengthens the single market is seen as positive but this should not affect national competences, especially concerning taxation and insolvency law, having regard to the principle of subsidiarity and any reforms should not extend beyond what is necessary and proportionate to achieve the goals of the initiative. A careful analysis of what could be standardised is needed in the light of differences in legal systems across the EU.

5b. *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?*

Recognising the difficulties to achieve this goal given the regulatory and tax issues mentioned above, it could be preferred to develop industry standards and best practices concerning the origination documentation and structure of SPVs. Such a harmonisation could be coordinated with the industry by the ESAs.

5c. *If pursued, what aspects should be covered by this initiative (e.g. the legal form of securitisation vehicles; the modalities to transfer assets; the rights and subordination rules for noteholders)?*

NA

5d. *If created, should this structure act as a necessary condition within the eligibility criteria for qualifying securitisations?*

NA

6a. *For qualifying securitisations, what is the right balance between investors receiving the optimal amount and quality of information (in terms of comparability, reliability, and timeliness), and streamlining disclosure obligations for issuers/originators?*

Except for the prospectus, two key sources of further information are investor reports and loan level data. Given the current information environment, information in a standardised format concerning the loan-pool should be possible to provide to both investors and potential investors to ensure that they can understand the underlying risks on a sufficiently granular level. This could be included as a requirement in the STC-criteria. Such information should be standardised and be comparable across countries. We believe that this would not result in unduly increased cost for originators. On the other hand, it could be a cost-efficient way of reducing both the information asymmetry and the stigma around securitisation. We encourage industry initiatives in this area.

6b. *What areas would benefit from further standardisation and transparency, and how can the existing disclosure obligations be improved?*

Please see question 6a)

6c. *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?*

Please see question 6a)

7a. *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?*

It is important not to forget that security specific risks also encompass country specific risk. Risks such as political and regulatory risks are important features to take into consideration when investing in a securitisation. Increasing the amount and quality of available information to the investor is important when moving towards a lower reliance on country specific rating. The STC-criteria should provide investors with additional information to that which is available to rating agencies as stated in question 6a).

7b. *Would the publication by credit rating agencies of uncapped ratings (for securitisation instruments subject to sovereign ceilings) improve clarity for investors?*

Please see question 7a)

8a. *For qualifying securitisations, is there a need to further develop market infrastructure?*

Market infrastructure that centralises documentation and data for STC securitisations should assist investors in taking investment decisions and reducing investment barriers. We believe that such infrastructure should be provided and maintained by the industry.

8b. *What should be done to support ancillary services? Should the swaps collateralisation requirements be adjusted for securitisation vehicles issuing qualifying securitisation instruments?*

NA

8c. *What else could be done to support the functioning of the secondary market?*

As suggested in the answer to question 1, making more quality information available, introducing STC-requirements and minimising tranching could be the first steps to increasing understanding, lowering the stigma and increasing demand on the secondary market.

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 risks attached to securitised instruments?*

We believe that the current legislation, largely based on Basel II standards, has certain weaknesses. These are addressed by the Basel securitisation framework published in December 2014.

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

Please see question 9.

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

Concerning potential adjustments to capital requirements, we are not convinced of the empirical basis for adjusting capital requirements in relation to the STC-criteria. The underlying regulatory treatment for bank capital, the internal ratings-based (IRB) approach, has in some cases been deemed to produce unwarranted variability in risk-weighted assets. This is further compounded by the securitisation process, through horizontal tranching, producing even greater unwarranted RWA variability.

This is particularly true for non-senior tranches, where a sufficient capital buffer for model risk is needed. Therefore we advocate that the Commission performs a detailed analysis of capital requirements for securitisation exposures, followed by a thorough impact analysis. If any adjustments are to be made to the regulatory treatment they should be risk sensitive, and based on sufficient and appropriate consideration of empirical evidence and model risk.

Any potential changes to the current regulation should be prudent and originate from globally agreed standards as well as on a sound and well-documented empirical and theoretical basis. An equal treatment with regard to capital requirement of covered bonds and other asset classes like ABS/RMBSR may not be justified. The European Banking Authority's own empirical studies show that covered bonds rank at the same level as government bonds and even outperform them in a few criteria like price volatility. The empirical studies also show that covered bonds clearly outperform non-financial corporate bonds, ABS/RMBS and equities. It is also important that any changes are implemented as minimum requirements, such as in the form of a directive that would allow individual member states to impose stricter requirements.

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

As expressed in previous questions, we believe that initiatives in this area, be it as a framework or in legislative form, should, in the interest of long term credibility and comparability for third country investors, be aligned with global standards.

13. *Are there wider structural barriers preventing long-term institutional investors from participating in this market? If so, how should these be tackled?*

NA

14a. *For insurers investing in qualifying securitised products, how could the regulatory treatment of securitisation be refined to improve risk sensitivity? For example, should capital requirements increase less sharply with duration?*

It is important that any potential changes to the capital requirements of insurers are preceded by a thorough impact analysis. If capital differentiation is introduced for STC securitisations through a more risk sensitive regulatory framework for insurers, consideration should be given to the capital requirements on non-STC securitisations and they should possibly be adjusted to a commensurable extent.

14b. *Should there be specific treatment for investments in non-senior tranches of qualifying securitisation transactions versus non-qualifying transactions?*

We believe that is a question that could be revisited at a future date.

15a. *How could the institutional investor base for EU securitisation be expanded?*

We see merit in stimulating a wider, both EU and non-EU, institutional investor base. Initially the STC-criteria should make securitisation more investable and increase investors' comfort in investing in such instruments. It is also important to maintain high STC-standards so that more complex securitisations are not classified as STC securitisations.

Furthermore, the Swedish government believes that a framework for green securitisations through the development of standard contracts and agreements for low-carbon investments should be evaluated. This could contribute to catalyse green investment by decreasing barriers to invest in renewable sources and to making Green investments more accessible to institutional investors.

15b. *To support qualifying securitisations, are adjustments needed to other EU regulatory frameworks (e.g. UCITS, AIFMD)? If yes, please specify.*

It is important to align the treatment of securitisation across all EU regulatory frameworks, where appropriate. As a first step, a common terminology should be developed and adopted across the different frameworks. The regulatory treatment of securitisations may, however, differ across frameworks as different frameworks may have different purposes (eg liquidity risk, credit risk, consumer protection), but terminology and methods should be aligned and consistent. At this point we do not believe that there is a need to adjust the UCITS or AIFMD frameworks.

16a. *What additional steps could be taken to specifically develop SME securitisation?*

We believe that because of the heterogeneous and resource intensive nature of individual SME loans they are not the most optimal assets to securitise. Since the crisis several issuances have been attempted, but few have had a successful market uptake. Also, the US has no such market except for very particular government guaranteed and standardised SME loans. Further work on standardisation and evaluation should be completed before action is taken in this area.

16b. *Have there been unaddressed market failures surrounding SME securitisation, and how best could these be tackled?*

Please see previous question.

16c. *How can further standardisation of underlying assets/loans and securitisation structures be achieved, in order to reduce the costs of issuance and investment?*

NA

16d. *Would more standardisation of loan level information, collection and dissemination of comparable credit information on SMEs promote further investment in these instruments?*

Please see our joint response to the Green paper consultation.

17. *To what extent would a single EU securitisation instrument applicable to all financial sectors (insurance, asset management, banks) contribute to the development of the EU's securitisation markets? Which issues should be covered in such an instrument?*

In our view it is important to begin with sound principles for STC classification. As the market develops and we can identify best practices, the creation of a single EU instrument for securitisation should be given further consideration. Given the general stigma attached to securitisations, it is important to proceed with caution and maintain a long-term perspective.

18a. *For qualifying securitisation, what else could be done to encourage the further development of sustainable EU securitisation markets?*

Please see question 1.

18b. *In relation to the table in Annex 2 are there any other changes to securitisation requirements across the various aspects of EU legislation that would increase their effectiveness or consistency?*

NA