Investment Management Association

4 July 2014

Dear Sir/Madam

The Bank of England/European Central Bank discussion paper on the case for a better functioning securitisation market in the European Union

The IMA represents the UK-based investment management industry. Our members include independent asset managers, the investment management arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. Our members manage investments worth more than £5 trillion for their clients, who are UCITS and other authorised funds, pension funds, insurers, sovereign wealth funds and individuals. Ultimately, much of what they manage belongs to the man in the street through their savings, insurance products and pensions. Their interest in this consultation is therefore in their role as the "buy side" of the market, accessing capital markets on behalf of their clients.

We welcome the opportunity to respond to the discussion paper on the case for a better functioning securitisation market in the European Union.

The IMA is supportive of the aims set out in the discussion paper and the principles based approach it proposes for differentiating the securitisation market. Our members agree that:

- the liquidity rules under Basel III do not act as a disincentive for banks to originate and invest in these instruments. Regulators should, **as a minimum**, consider extending the scope of securitisations that could potentially qualify as high quality liquid assets (HQLA) under Basel III and to align it with EIOPA's criteria of securitisations that qualify for lower capital requirements under Solvency II.
- a liquid market for qualifying securitisations would benefit from a qualifying certification.
- markets for less mainstream securitisations would benefit from improvements to the availability of data to investors and work should be done to standardise to the structure of disclosures made to investors.

The response outlined below, represents the general views of investment managers and their clients as institutional investors on the development of securitisation market in Europe. We do not respond to each question individually.

65 Kingsway London WC2B 6TD

Tel:+44(0)20 7831 0898 Fax:+44(0)20 7831 9975

www.investmentuk.org

The IMA looks forward to continued engagement with the Bank of England and the European Central Bank on how this market can be further developed and revived.

Yours sincerely,

Pamela Gachara
Policy Adviser, Markets

IMA Response to the Bank of England/ European Central Bank discussion paper on the case for a better functioning securitisation market.

The IMA welcomes the opportunity to respond to the discussion paper on the case for a better functioning securitisation market.

Securitisations are an important asset class for our members as the investment decision-makers on behalf of a range of investors, including insurance companies, pension schemes, UCITS, AIFs and other institutional investors. Securitisations provide:

- a mechanism through which (non-bank as well as bank) investors can provide funding to companies in the real economy,
- an additional means to diversify investors' exposures to debt securities, in terms of the underlying credits, and liquidity, and
- a mechanism for banks to transfer risk, reducing the likelihood of being capital constrained, therefore enabling them to make new loans and reallocate capital.

However, despite the wider benefits, the issuance of securitisations in Europe available to non-bank investors remains low. In 2013 total issuance was €181bn a fall of 28% from 2012. Of this only €76.4bn (less than half) was placed with third party investors. This is due to regulatory uncertainty and weak economic conditions. This in turn has limited the liquidity in this market.

For this market to be revived, it is imperative that the liquidity rules under Basel III do not act as a disincentive for banks to originate and invest in these instruments. Regulators should, **as a minimum**, consider extending the scope of securitisations that could potentially qualify as high quality liquid assets (HQLA) under Basel III and to align it with EIOPA's criteria of securitisations that qualify for lower capital requirements under Solvency II. These are securitisations with the following underlying assets:

- Loans to small and medium-sized enterprises (SME)
- Leasing
- Residential mortgages
- Auto loans
- Consumer finance
- Credit card receivables.

Banks should also be allowed to include commercial real estate securitisations as part of their HQLA. This is an asset class that is currently excluded from the definition of high quality "Type A" securitisation under draft Solvency II Delegated Acts making the definition unnecessarily restrictive. In addition, the list of assets that may be eligible for HQLA should not be a static nor definitive list. Rather it should allow for those asset classes or transaction structures that are not included currently to be considered in the future.

The IMA agrees with the paper’s assessment of the impediments to investors’ ability to invest in this asset class, including:

- the stigma attached to the asset class following the financial crisis. This has limited institutional investors’ willingness to allow their asset managers to invest in these instruments.
- the risk retention requirements under the CRDIV/CRR and AIFMD do not ease the identification of qualifying instruments and therefore investment in this asset class
- lack of market data for less developed asset classes e.g. ABS backed by SME loans.
- sovereign ratings caps applied to ABS from certain EU countries that mean that they are treated more harshly than their credit performance would imply. This would:
    - limit institutional investors’ - specifically insurers’ - ability to invest in these assets due to the higher capital charges under the standard model that would be applicable under the proposed Solvency II rules,
    - limit asset managers ability to allocate funds to these assets due to mandate and investment guideline restrictions, and
    - without further information, make it difficult for investors to distinguish between a true single-A rated securitisation and a rating-capped single-A securitisation.

The revisions to the draft Solvency II rules reducing the capital charges for high credit rated securitisations backed by certain categories of assets are welcome. However, these changes may not be sufficient to encourage insurance companies to invest in these products as the proposed capital charges remain very high relative to other fixed income products such as corporate and covered bonds. In addition, there remain severe cliff effects between the treatment of AAA rated and non-AAA rated securitisations. For insurers to invest in these products a graduated approach to risk is required; or better still, a removal of such hard-edged usages of credit ratings in regulatory definitions (in accordance with the wider EU policy of addressing over-reliance upon credit ratings).

Our members are supportive of the proposal to define qualifying securitisations as securities 'where risk and pay-offs can be consistently and predictably understood.' This definition, in addition to the principles that would identify such securities, offers enough flexibility to the market to create instruments that cater for the needs of market participants. It is important that in the long term these characteristics remain principles-based.

Our members agree that:

- A liquid market for qualifying securitisations would benefit from a qualifying certification. There may be merit in establishing an independent body to certify these instruments and, whilst more work may need to be done, focus should be to build up on the work of existing initiatives.
- Markets in riskier, less mainstream securitisations, such as SME-loan-backed ABS, would benefit from improvements to the availability of data to investors. This information should be made available to investors at a minimum cost to ensure accessibility and encourage investors to use of the data.

- The work should be done to standardize the structure of disclosures in prospectuses and investor reports across Europe to promote cross-border investment in these assets. This would be best accomplished through ESMA rather than through national initiatives.
- Whilst we are supportive of prospectuses and standardised investor reports being available in a single location, in practice, investors are likely to want to access any information depot through existing commercial information providers and the depot must provide wide access and licensing at low or no cost.
- Facilitating investor access to credit data would support the re-emergence of the securitisation market. Credit registers would be helpful in providing further information on an anonymised basis and to ensure that the borrower's data is protected. It is important that data protection laws across the EEA allow for this information to be provided on a unilateral basis.
- Additional information where sovereign and ancillary facilities ratings caps are applied should be provided. This would help reduce the mechanistic reliance on credit ratings and assist investors sense checks their internal ratings with a third party rating.
- There is a need to address the differing insolvency treatments of counterparties across the EEA and consistent recognition of bankruptcy-remote vehicles and arrangements. This would lower the costs and risks of securitisations and promote further investment in these assets.