Prudential requirements for credit institutions and investment firms

2015/0225(COD) - 30/09/2015 - Legislative proposal

PURPOSE: to establish a revised regulatory framework on capital charges for exposures to securitisations within the objective of reviving EU securitisation markets.

PROPOSED ACT: Regulation of the European Parliament and of the Council.

ROLE OF THE EUROPEAN PARLIAMENT: the European Parliament decides in accordance with the ordinary legislative procedure on an equal footing with the Council.

CONTEXT: securitisations are an important constituent part of well-functioning financial markets. The Commission considers that **promoting the development of a securitisation market** based on sound practices will contribute to a return to sustainable growth and job creation. Furthermore, a **common, high quality EU securitisation framework** will promote further integration of financial markets in the Union, help diversify funding sources and unlock capital, making it easier for credit institutions to lend to households and businesses.

In order to attain this objective, **two steps** must be taken:

- 1) to develop a common substantive framework for securitisations for all participants in this market and identify a subset of transactions meeting certain eligibility criteria: simple, transparent and standardised (STS) securitisations or STS securitisations. This is the subject of the Commission Proposal for a Securitisation Regulation.
- 2) to make amendments to the regulatory framework of securitisations in EU law, including in the area of capital charges for credit institutions and investment firms originating, sponsoring or investing in these instruments, to provide for a more risk-sensitive regulatory treatment for STS securitisations.

The global financial crisis revealed a number of shortcomings in the current securitisation framework. In order to address these shortcomings and contribute to enhancing the resilience of institutions to market shocks, the Basel Committee on Banking Supervision (BCBS) adopted in December 2014 a recommendation for a revised securitisation framework ("the **Revised Basel Framework**"). The measure has been designed to reduce the complexity of the current regulatory capital requirements, reflect better the risks of positions in a securitisation and allow the use of the information available to institution to allocate capital requirements based on their own calculations, thus reducing reliance on external ratings.

At an European level, the European Banking Authority (EBA) issued a report on qualifying securitisations on 7 July 2015 which recommended lowering capital charges for STS securitisations to a prudent level relative to those set out in the Revised Basel Framework and to amend the regulatory capital requirements for securitisations set out in the Regulation (EU) No 575/2013 (CRR) in line with the Revised Basel Framework. For STS securitisations, the EBA re-calibrated downwards the 3 approaches developed by the BCBS for the Revised Basel Framework.

The Commission now proposes to amend the regulatory capital requirements for securitisations in the CRR in order to:

• implement the regulatory capital calculation approaches set out in the Revised Basel Framework;

• introduce a re-calibration for STS securitisations, consistent with the recommendation of the EBA.

IMPACT ASSESSMENT: the impact assessment accompanying the Securitisation Regulation clearly shows the benefits in terms of efficiency and effectiveness of:

- introducing a revised regulatory framework on capital charges for exposures to securitisations, and
- differentiating the treatment of STS securitisations having regard to the overall objectives of the Commission legislative package on securitisation, i) remove stigma attached to securitisations among investors; ii) remove regulatory disadvantages for STS products; and iii) reduce or eliminate unduly high operational costs for issuers and investors.

CONTENT: this Regulation forms a legislative package with the proposed Securitisation Regulation which aims to restart securitisation markets on a more sustainable basis and making this a safe and efficient instrument for funding and risk management.

The proposed Regulation aims to **review the regulatory capital requirements laid down in Regulation** (EU) No 575/2013 (CRR) for institutions originating, sponsoring or investing in securitisations should be amended to **reflect adequately the specific features of STS securitisations** and address the shortcomings of the framework which became apparent during the financial crisis, namely its mechanistic reliance on external ratings, excessively low risk weights for highly-rated securitisation tranches and, conversely, excessively high risk weights for low-rated tranches, and insufficient risk sensitivity.

The amendments to the existing regulatory framework should take account of the **regulatory capital** calculation approaches set out in the Revised Basel Framework. Under this framework:

- institutions may calculate capital requirements for their securitisation positions in accordance with a **single hierarchy of approaches**, which starts with the Internal Ratings Based Approach (IRB Approach) at the top;
- if an institution cannot use the approach based on internal ratings, it must use a **External Ratings-Based Approach** ("SEC-ERBA" Approach), provided the exposure has an external credit assessment which meets a series of operational requirements;
- in the case where the Institution cannot use the External Ratings Based Approach, either because is located in a jurisdiction that doesn't permit its use or because it lacks the information needed to use that approach, it shall use a **Standardised Approach** (the "SEC-SA" Approach) based on a supervisory-provided formula.

No later than 3-years from the entry into force of this Regulation, the Commission will review the proposed approach to capital requirements for securitisation exposures, including the hierarchy of approaches, taking into account its impact on securitisation markets developments and the need to preserve financial stability in the EU.