

SECURITISATION

From a financial stability perspective

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ESM WITHIN THE EUROPEAN FINANCIAL ARCHITECTURE



- The ESM is part of the wide European institutional architecture to preserve financial stability
- It is an IFI; the world largest regional financial arrangement
- It is the successor of the temporary facility EFSF, established at the height of the euro crisis in 2010

* Ratification of the Amending Agreement to the ESM Treaty ongoing

SECURITISATION: TRADITIONAL VS CRISIS USES

1. Traditional Securitisations

UNDERLYING ASSET:

- Standardised Assets (e.g., mortgages, auto loans)

OBJECTIVE:

- Liquidity generation: enhances liquidity by converting illiquid assets into securities.
- Risk distribution and capital relief: allocates risk across a wider range of investors.

2. Publicly Supported Securitisations

UNDERLYING ASSET:

- Hard-to-Price Assets (e.g., Non-Performing Loans)
- Same objective as traditional, but with additional features

ADDITIONAL FEATURES:

- The structure is designed to extract value and mitigate losses from selling assets at deep discounts.
- Credit enhancement via government guarantees on senior tranches
- Banks may benefit from retaining senior tranches at zero risk weight.

HISTORICAL PERSPECTIVE – USA



Mortgage-backed Securities (MBS) Collapse: The crisis was ignited by subprime mortgage defaults, severely undermining confidence in the quality of Mortgage-backed Securities (MBS).



Regulatory Tightening: The enactment of the Dodd-Frank Act in 2010 ushered in a new era of stringent regulations to bolster transparency and elevate asset quality standards within the securitisation market.



Investor Caution: In the wake of heightened risk awareness, investors adopted a more cautious approach, resulting in a diminished appetite for complex financial instruments.

HISTORICAL PERSPECTIVE - EURO AREA



Sovereign Debt Concerns: The crisis spotlighted vulnerabilities in sovereign debt rather than MBS.



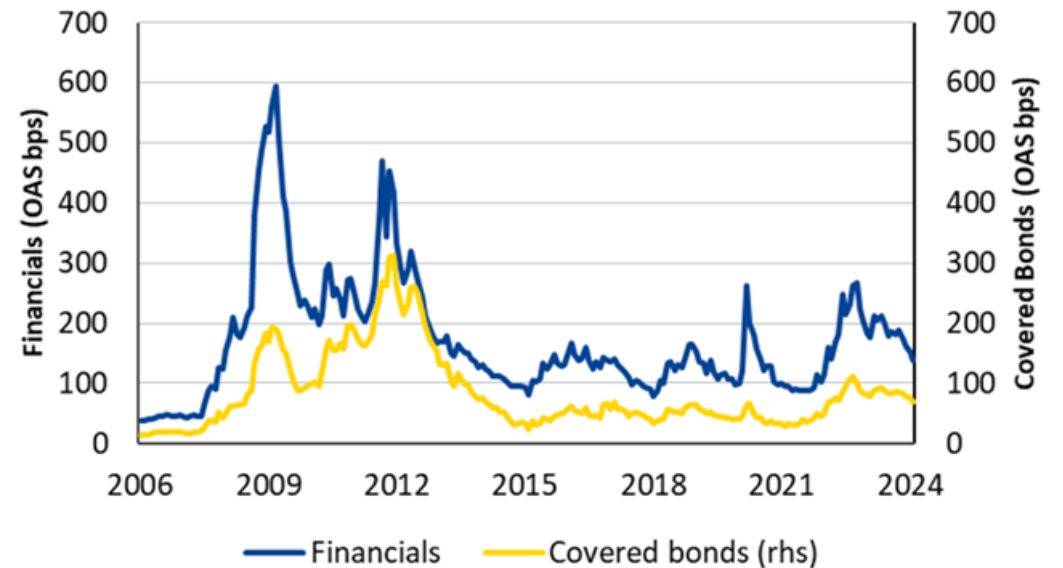
Market Fragmentation: Divergence emerged in financial markets across the EA due to sovereign risk apprehensions



EU Institutional and Regulatory Response: Including ESM, SSM, EMIR and CRR, were introduced to fortify oversight mechanisms and market stability. STS* framework from 2019

Use of Covered Bonds: Covered bonds proved resilient during the 2008 financial crisis and COVID times, but less so during the euro area crisis.

Option adj. spreads (OAS) for EU financials and covered bonds

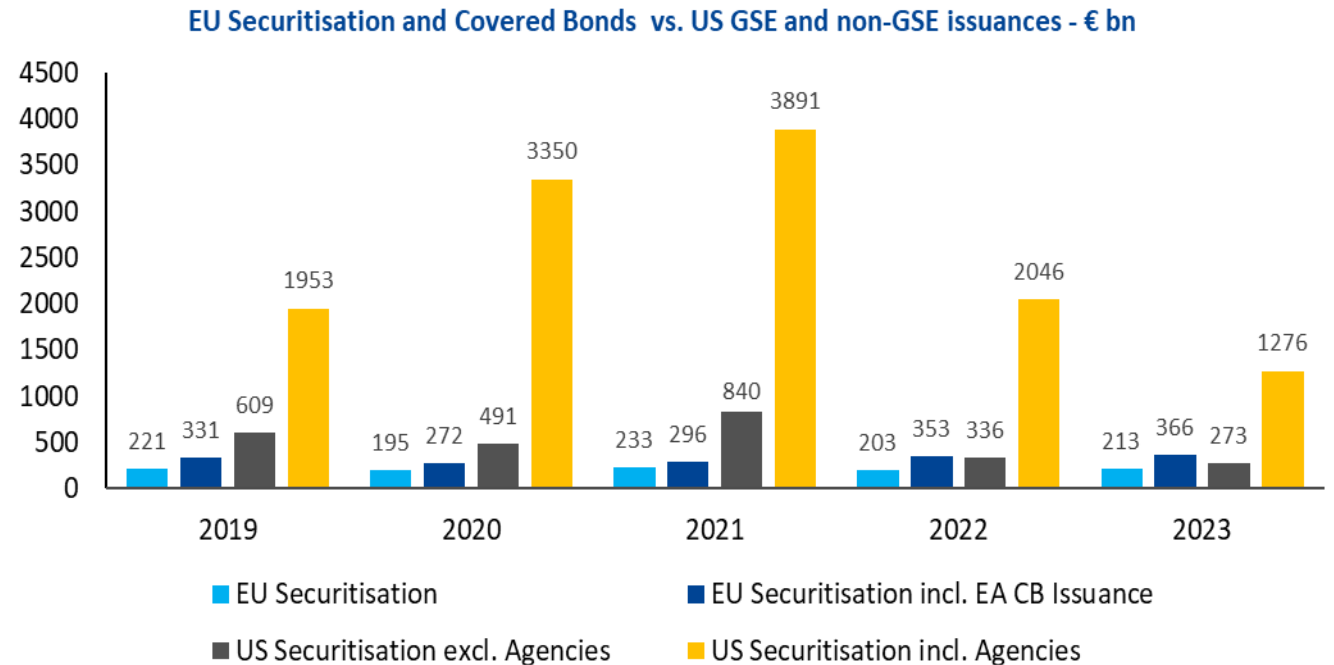


Source: Bloomberg

*Simple, Transparent and Standardised Securitisation (Regulation EU 2017/2402)

USE OF EA COVERED BONDS VS US GSE SECURITISATIONS

- EU utilises both securitisation and covered bonds, which provide additional investor protection.
- US largely relies on Government - sponsored enterprises (GSE), with volumes that far outpace those of the EU.
- Non-GSE US securitisation volumes however more aligned with EU securitisation and EA covered bond volumes since 2022.

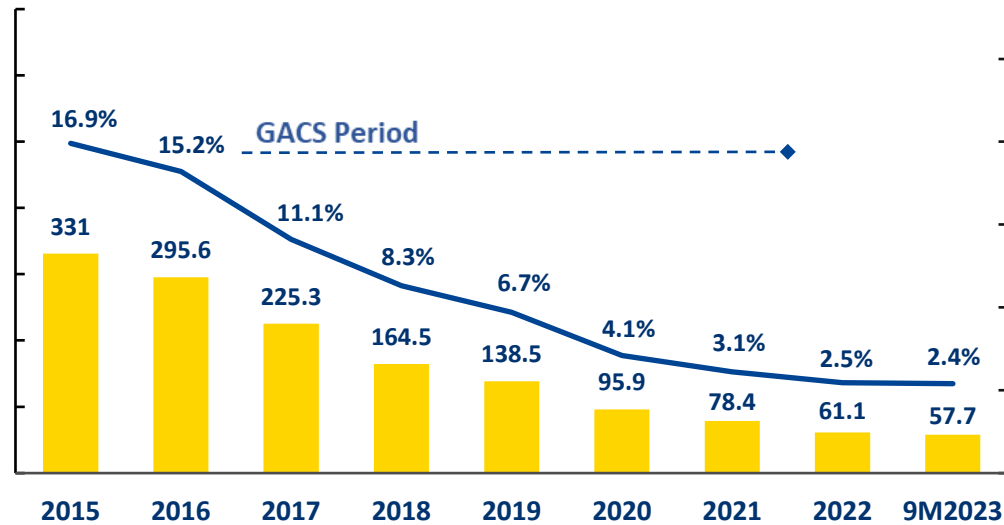


Source: AFME, Dealogic (EA Covered Bond data)

CRISIS PREVENTION AND CRISIS MANAGEMENT

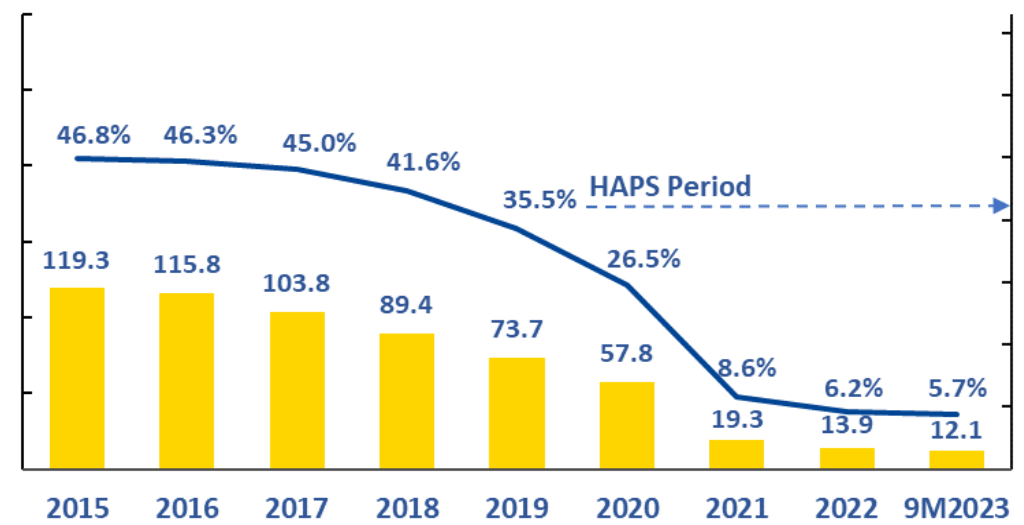
- **Two groundbreaking schemes were introduced:** GACS* in Italy (2016) and HAPS* in Greece (2019)
- **Pivotal in their role as industrial sized NPL management tools:**
 - ✓ Transformed troubled assets into marketable assets
 - ✓ Reduced information asymmetries and bid-ask spread
 - ✓ Showcased how structured financial tools can bolster investor confidence

Italy NPE Stock (€Bn) and NPE ratio (%)



Source: ECB

Greek NPE Stock (€Bn) and NPE ratio (%)



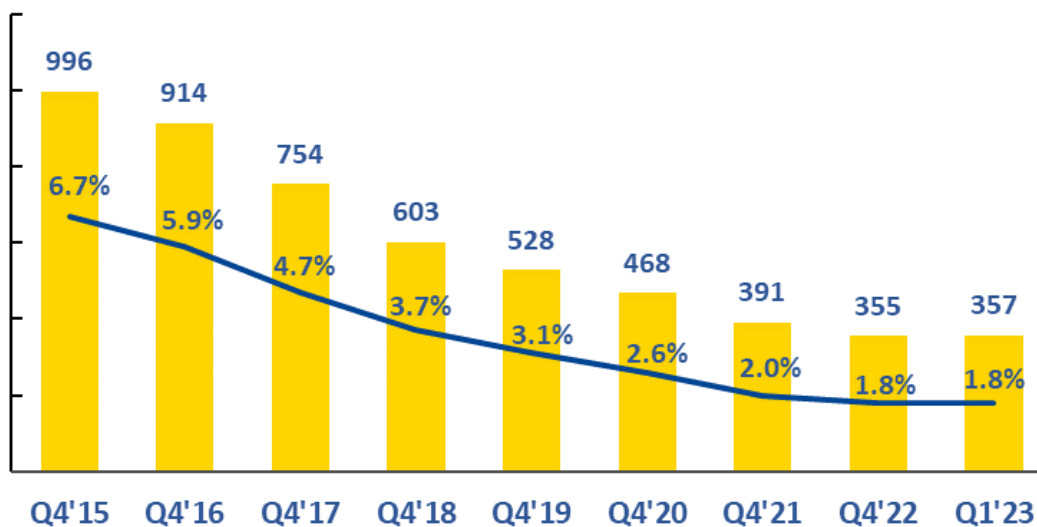
Source: ECB

* Garanzia Cartolarizzazione Sofferenze
 * Hellenic Asset Protection Scheme

PROGRESS AND CHALLENGES IN THE EURO AREA

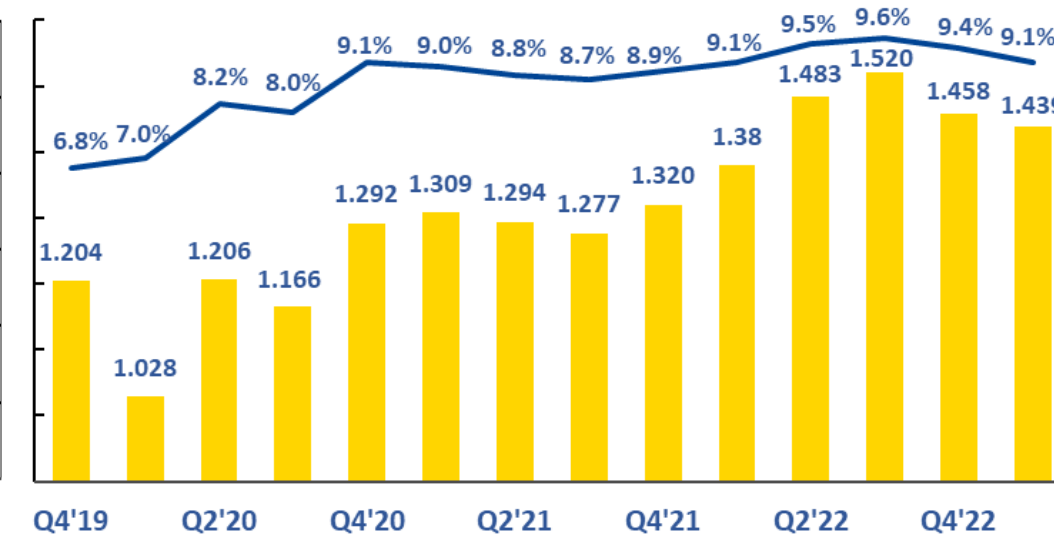
- **Significant strides made to date:**
 - ✓ EA NPE ratio down from 6.7% to just under 2% at end-2022
- **Now is not the time for complacency:**
 - EA Stock of Stage 2 loans at 1.5 trillion, equal to 9% of total EA loans

EA Gross NPE Stock (€Bn) and NPE ratio (%)



Source: EBA

EA Stage 2 Stock (€Bn) & as percent of total loans



Source: EBA

SHORTCOMINGS OF NATIONAL SECURITISATION SCHEMES

Complexity and Performance Challenges

- National schemes like HAPS and GACS involve intricate structures and coordination among various stakeholders, including banks, government, investors and EU authorities.
- Performance of securitised portfolios is still to be seen.

Limited Scope and Scale

- National schemes are confined to specific countries, limiting their effectiveness in addressing broader EU challenges.
- They may not fully address cross-border exposures.

Exposed to Country-Specific Risks

- National schemes are susceptible to country-specific conditions whereby economic conditions and/or political instability can derail the effectiveness of these schemes.
- Reinforces sovereign-bank nexus.

POTENTIAL BENEFITS OF PAN-EUROPEAN SECURITISATION



Market Depth and Liquidity:

Pooling loans from multiple countries
Increasing depth and liquidity
Improve pricing and market efficiency



Harmonisation and Transparency:

Standardising securitisation processes, enhancing transparency
Simplifying cross-border transactions
Reducing legal complexities and costs



Diversification and Risk Mitigation:

Wider diversification across different asset types and geographies
Reduced concentration risk associated to national schemes



Expand Investment Opportunities

New investment opportunity for pension schemes
Additional option for citizens to save for retirement

CMU INITIATIVES TO UNLEASH PAN-EUROPEAN SECURITISATION



Framework enhancement

Objective: Developing EU securitisation to allow for efficient and transparent transfer of risks

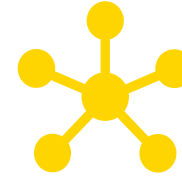
Initiative: EC to assess supply and demand factors holding back the development of the securitisation market in the EU, covering the **prudential treatment** of securitisation for banks and insurance companies and the **reporting** and **due diligence** requirements.



Insolvency Law Harmonisation

Objective: Targeted convergence of national corporate insolvency frameworks

Initiative: EC to facilitate further convergence in specific features of insolvency frameworks that could deter cross-border capital investments, notably in the areas of **ranking of claims** and **insolvency triggers** and rules for financial collateral and settlement.



Supervisory Alignment

Objective: Further supervisory convergence of capital markets across the EU

Initiative: EC to assess ways to improve supervision and enhance supervisory **convergence** through a more efficient and effective use of the **existing powers** of the European Supervisory Authorities and a possible targeted strengthening of their role and **governance** arrangements.



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