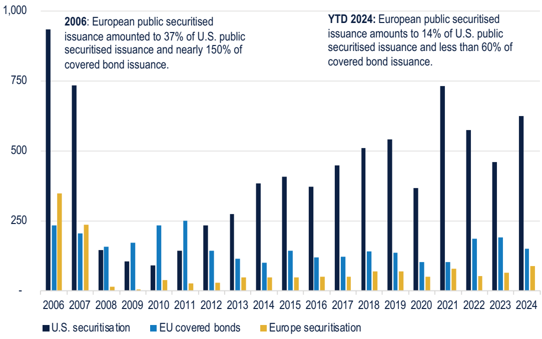
Reviving European Securitisation

Securitisation is critical for expanding access to funding and diversifying Europe's financial system. Currently, Europe relies heavily on bank financing (90% vs. 25% in the U.S.[1]), which increases risk during market or sector disruptions. Securitisation transfers risk from banks to global investors, fostering financial stability and boosting funding across the real economy.

Challenges

- Europe's securitisation market has shrunk to 17% of the size of the U.S. market (from 85% pre-GFC[2]).
- Transparency and due diligence requirements in the EU are overly complex and costly, discouraging European issuance and investor demand.
- EU regulations limit investors to only 25% of the global securitisation market, restricting competitiveness.

EU securitisations have languished in the context of those in the U.S. and EU covered bond issuance (€bn)



Source: PGIM Fixed Income, J.P.Morgan, and Bank of Amercia.
Note: Excludes government guaranteed securities. EU Covered Bonds and Securitisation only covers Eurozone and excludes UK and Australia. EU Securitisation only include placed securities. As of October 2024

Benefits

- **For Borrowers:** Increased access to credit for mortgages, consumer loans, businesses, infrastructure, and renewable energy projects.
- **For Investors:** Broader portfolio diversification by accessing non-corporate credit and resilient returns.
- **For Financial Stability:** Improved transparency, risk transfers away from banks, and dynamic price discovery in credit markets.

Here is what is needed to address these challenges:

1. Simplify Due Diligence Requirements

Duplicative due diligence obligations under the EU Securitisation Regulation (EU SR) add unnecessary operational burdens for investors, particularly smaller institutions. Isolating securitisation as a "special" asset class with its own extra layer of due diligence requirements makes Europe an outlier among peers.

- **Action:** Adopt a principles-based approach, streamlining overly prescriptive requirements, similar to recent UK reforms.
- **Impact:** Encourages participation, especially from smaller investors, while maintaining high fiduciary standards.

2. Reform Transparency and Reporting Standards

Granular EU SR reporting requirements create excessive issuance hurdles without adding meaningful value for investors.

- **Action:** Reduce the scope of required data fields, focusing only on key performance and risk indicators.
- **Impact:** Lowers issuer compliance costs, which can surpass €10,000–€31,000 per deal annually for CLOs, facilitating higher issuance and lowering borrowing costs for enterprises.

3. Recalibrate Insurance Capital Requirements

Current Solvency II capital charges for securitised products are disproportionately high compared to their risk profiles, deterring insurance investments. Insurance capital requirements in Europe are higher than in jurisdictions with more developed markets; this severely dampens demand.

- **Action:** Lower capital charges for highly rated securitised products (e.g., AAA CLOs), reflecting their lower risk profile.
- **Impact:** Unlocks insurance sector participation and promotes liquidity while reducing spreads and borrowing costs for European corporations.

4. Revise UCITS Investment Limits

The 10% issuer limit under the UCITS framework restricts fund investment in securitisations. Furthermore, EU regulators treat securitisation investments with extreme caution in the context of UCITS supervision, only allowing limited investment in some securitisations. Supervisors should take comfort in the nearly two decades of sound performance in the most senior securitisation tranches (AAA and AA rated).

- **Action:** Exempt securitised products from this rule, recognising their inherently diversified nature. Take a risk-based approach to supervision of UCITS investment in securitisation.
- **Impact:** Expand UCITS fund allocations to securitisations, broadening the investor base and supporting market depth and liquidity This underpins innovation of the European investment fund market.

5. Expand EU Investors' Access to Global Markets

EU regulations restrict investors to securitised assets that adhere to EU standards, leaving them locked out of 75% of the global securitisation market.

- **Action:** Align EU standards with global frameworks to enable access to non-EU assets, especially U.S.-originated securities, without additional compliance costs.
- **Impact:** Broader investment opportunities for European institutions should boost returns and liquidity while strengthening global competitiveness.

Revitalising the securitisation market will:

- Diversify funding sources to promote economic growth across the European economy.
- Empower global investor participation.
- Mobilise capital towards critical sectors like housing, small businesses, and renewables.
- Enhance regional and global competitiveness for European institutions.
- Support innovation enhancing the attractiveness of EU financial markets.

Now is the time for bold reforms to unlock Europe's securitisation potential and ensure its place at the forefront of global capital markets.

PGIM FIXED INCOME

[1]SIFMA, 2024 Capital Markets Factbook.

[2]AFME Securitisation: Q4 2023 and 2023 Full Year. & Op. Cit., "Developing European capital markets to finance the future."