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SRT market prepares to grapple with upcoming regulation

By Tom Brown

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The European Banking Authority (EBA) is set to produce a report for the European Commission by 2021, which will lay the groundwork for the regulation of the significant risk transfer securitization market. However, participants say they are are still coming to terms with potential new requirements.

Jakub Kaczmarczyk, principal supervisor at the European Central Bank (ECB), said that the rising risk of a recession meant that SRT technology needed to be treated with greater caution.
Kaczmarczyk emphasised that the purpose of the regulatory consultancy was to "make SRT waterproof under stressed conditions." He said that he "realise[d] it can be cumbersome" but that the process will make SRT "sounder and safer."

The EBA released a discussion paper in 2017 which was set to produce guidelines for the market ahead of the 2021 finalisation, but panellists speaking at the True Sale International Congress 2019 in Berlin expressed concern that current guidelines were not sufficient.
Jonathan Walsh, partner at Ashurst, said that the discussion paper had not "necessarily led to sensible or harmonised treatment" of SRT, and suggested that further review was necessary.
"We are in a little bit of an interregnum limbo," said Walsh.

Market participants argued that SRT technology is one of the few tools banks have in their arsenal to effectively transfer risk and create space on their balance sheet. Increased capital requirements of post-crisis regulatory reforms have further restrained banks from raising capital.
"So, I own a house and I have no insurance; the risk of the house burning down is my risk. I go and buy insurance; it's a full insurance, so I shift the risk of the house burning down to the insurance company," said Ian Bell, head of the PCS secretariat. "Why does the fact that the house is more or less likely to have burned, because of someone's wire, or because it is dried or wetter, in any way impact the fact that the risk has been transferred?"

“It changes perception of the risk,” said Kaczmarczyk in response. “So, it’s easy to argue when we are in the good-weather conditions with some selective data that the risk [to the economy] is remote.”
Other panellists said the focus should be on assessing whether the house has been insured correctly, instead of limiting the use of the technology itself.

“You really don’t want to have to review to find suddenly that your house is uninsured for no good reason,” said Walsh. “So the whole point [is] about getting this right and getting it done correctly.”

The panel agreed that the technology has evolved since the crisis. The majority of public SRT deals in Europe are cash risk transfer deals, such as ones brought by BNP Paribas through its Autonoria programme, or the recent Spanish consumer ABS brought by Banco Sabadell.
“You have to make sure that the person who is honouring the risk can afford it as well,” said an audience member, extending Bell’s house-insurance metaphor. “Otherwise you risk two crises because you have to save that company, too.”

The removal of uncertainty around the SRT market would be a boost for the sector, which has seen over 150 deals issued in 2019 as of August 29.
This is down from the record-breaking figures of 230 in 2018, but uncertainty around new securitization regulation in the first quarter slowed issuance significantly.
“We still have time to get this right,” said Walsh.