SME securitisation[1] in Europe – a short summary

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This article summarises the situation and latest developments of the SME securitisation (SMESec) market in Europe and is based on Kraemer-Eis, Lang, Torfs, and Gvetadze (2017). Given that SMEs have almost no direct access to the capital markets and that, in particular, in Europe they heavily rely on bank lending (Exhibit 1 provides an indication), a functioning securitisation market can transform illiquid loans to SMEs into an asset class with adequate market liquidity and can as such provide an indirect access to capital markets for SMEs.

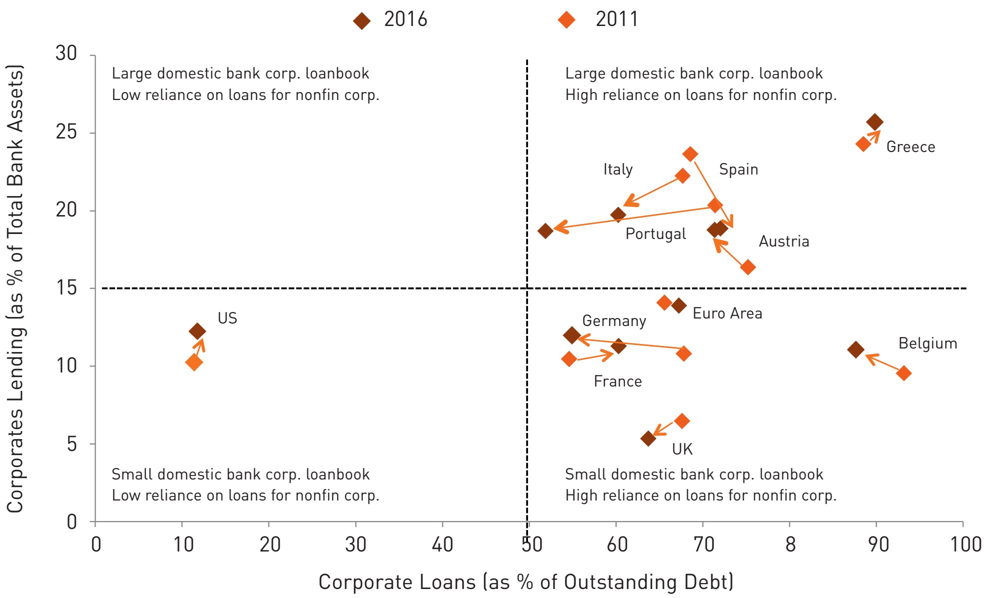
Empirical literature shows that securitisation can strengthen the capacity of banks to supply new loans (Altunbas et al., 2007). Since it can mitigate credit supply frictions, securitisation has the potential of having positive real effects on investment, sales and employment (Berg et al., 2015). It is sometimes stated that securitisation might lead to higher risk-taking by banks (or lower lending standards); however, this is neither confirmed by performance data, nor by research.

Kara et al. (2015) analysed data from the euro-denominated syndicated loan market. They found out that, in the run up to the financial crisis, banks, relying on securitisation, did not lower their lending standards more than other institutions. Albertazzi et al. (2017) used credit register data for loans to Italian SMEs and tested for the presence of asymmetric information in the securitisation market by looking at the correlation between securitisation and default probability. They found that, despite the presence of asymmetric information, credit risk transfer did not lead to lax credit standards.

Securitisation per se is not good or bad – it is a toolbox, an instrument, a technique. As such it is value-free; but its aggressive, opaque, and overly complex use by some market participants has negative consequences for both issuers as well as investors. Negative repercussions are however also created by an overly simplified discussion where everything related to structured finance is lumped together and sometimes dismissed or branded as “toxic”. The instrument is neither “toxic” nor is the underlying asset (in the case of SMESec: SME loans/leases) “toxic waste”.

On the contrary – loans to SMEs are a key driver for the functioning of the economy and, properly applied, the securitisation technique is a replicable tool that can enhance access to finance for SMEs. A well-functioning securitisation market can be essential in helping financial intermediaries broaden their funding base, achieve capital relief and ultimately, increase their SME financing. In this context, the recovery of the (SME-) securitiation market is also one of the focus areas of the Capital Markets Union (CMU) and the European Commission intends to revive securitisation with the objective “to ensure that it can act

Reliance on bank financing by non-financial corporations (in %) **Exhibit 1**



Source: Kraemer-Eis et al., 2017 (as per YE/2016)

as an effective funding channel to the wider economy and mechanism to diversify risk" (see European Commission 2015a, b).

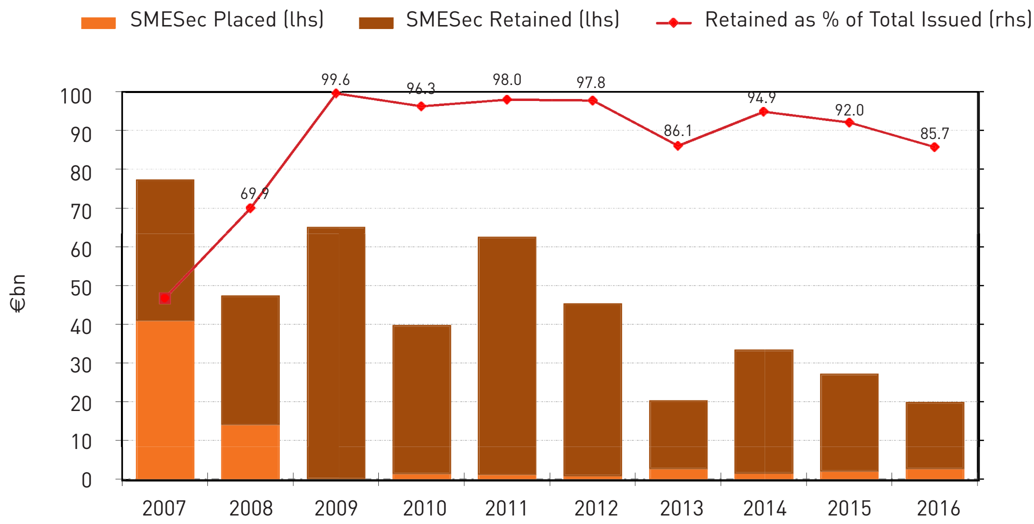
A recovery and development of the primary securitisation markets could play a role in unlocking credit supply and economic recovery. Moreover, in addition to the direct effects of the SMESec markets, there are indirect benefits to SMEs from the development of other securitisation segments that free up space on bank balance sheets in order to allow for further SME lending (AFME et al., 2016). However, this will only be to the benefit of SMEs if the freed-up capital/fresh liquidity is going to be used to finance the real economy (i.e. for new SME lending).

Using this instrument in developed capital markets, public-sector support for SMEs (e.g. guaranteeing mezzanine tranches) can create multiplier effects – and hence it is an efficient use of public resources, which is especially important against the background of a high public debt burden in many countries. "Taken together, strengthening SME securitisation may be one of the most effective ways to facilitate the flow of funds to the real economy, while not creating too much distortion" (Kaya, 2014). It can also help to develop new market segments: e.g. in 2016 EIF supported the first European SMESec transaction, based on loans originated via a peer-to-peer platform (Funding Circle).

The European securitisation market had grown steadily from the beginning of the previous decade until the outbreak of the crisis. During the crisis, issuance remained initially at high levels (compared to pre-crisis values) in Europe, but these volumes were almost exclusively driven by the eligibility of ABS as collateral for ECB liquidity operations;[3] then the overall market activity decreased to the 2003/04 levels.[4]

Over the past years, public issuance was indeed hindered by regulatory uncertainties (potential introduction of

European SMESec issuance by retention (€bn and %)	Exhibit 2



Source: Kraemer-Eis et al. (2017), based on data from AFME

regulations that make transactions less attractive for originators and investors), by the availability of cheap funding for banks driven by the ultra-loose monetary policy, as well as by ECB eligibility rules under the repo-collateral framework that favour alternative instruments, such as sovereign bonds or secured or unsecured bank debt. Furthermore, spread levels required by investors are often unattractive for originators – both compared to funding alternatives as well as for capital release purposes.

It is important to note that only a very small fraction of the issuance has been placed with investors (see Exhibit 2): the nature of the SMESec market changed from a developing market (pre-crisis, with most transactions placed in the primary market) to a purely retained/ECB repo-driven market during the crisis (with almost no placement in the primary market). This shift led to liquidity drying up and originators accepting higher all-in costs as, in addition to the credit enhancement, the repos envisage considerable haircuts to the face value of the notes.

SMESec issuance is still suffering from the crisis and remains at low levels. The overall issued volume of SME deals in 2016 (€19.8bn) was well below the 2015 values (€27.1bn), see Exhibit 3. In the first quarter of 2017 SME issuance was only around €2bn – significantly lower than during the same period last year (€4.6bn). The market share

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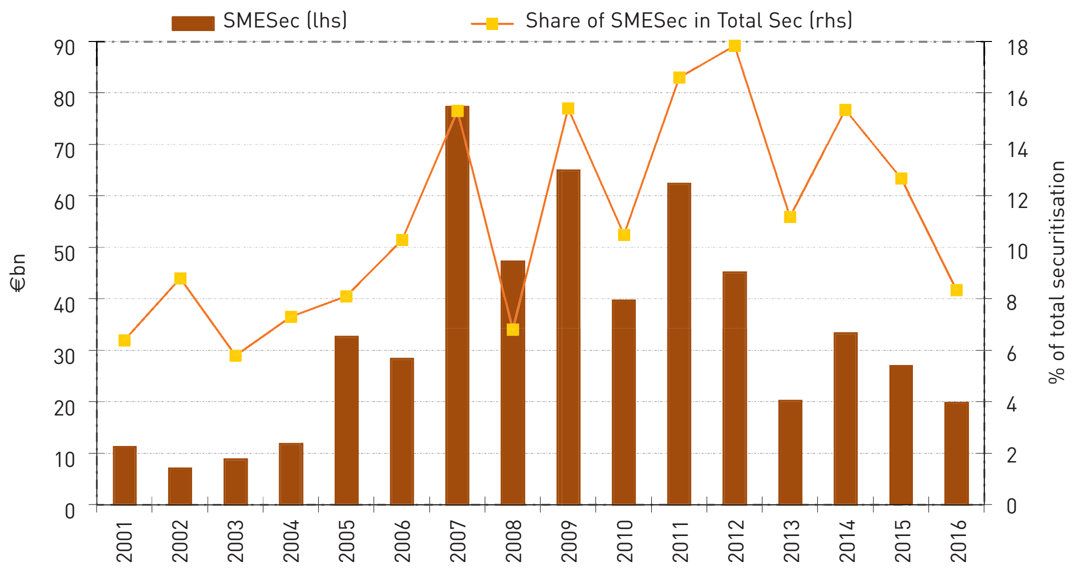
SMESec issuance in Europe (volume and share of total securitisation, €bn and %)	**Exhibit 3**



Source: Kraemer-Eis et al. (2017), based on data from AFME and own calculation

of SMESec in overall securitisation issuance rose (with some volatility) from 6% in 2001 to 18% (of total yearly issuance) in 2012, the highest value ever registered in Europe. This, however, came about due to the base effect, as the overall activity went down (while SMESec activity decreased slightly less). In 2016, the share of SMESec was 8.3%, significantly lower than the year before (12.7%).

Typical originators are large banks or banking groups – some of them are active as originators in several countries (e.g. UniCredit, Raiffeisen, ING Group), but also mid-sized banks. Moreover, in particular in the field of leasing, non-bank asset finance providers are active as originators.

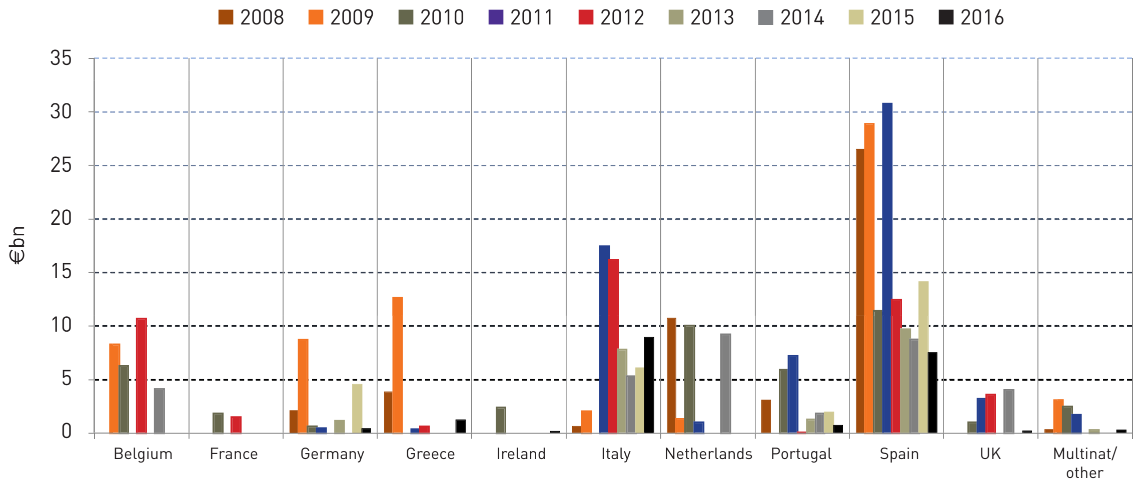
In terms of countries, the market activity is concentrated: The SME related issuance in 2016 occurred mainly in Italy (€9bn, 46% of SME issuance) and Spain (€8bn, 39%). Minor activity happened in Greece (6%), Portugal (4%), Germany (2%), Ireland and UK (1% each), see Exhibit 4.

Due to low new activity levels, the volume of total outstanding securitisation transactions (see Exhibit 5) is on a downward trend (negative net supply), however at reduced speed. Compared to the end of 2015, until end of 2016, the total outstanding decreased further by around 2%. Since the end of 2009, the volume of total outstanding securitisation transactions decreased by 44%. During the same period, the volume of outstanding SMESec transactions decreased by 47%, from €168bn to €89.6bn (end of 2016). By the end of Q1/2017 the volume of outstanding SMESec transactions reduced further to €86.6bn.

Breaking down SMESec volumes per end of 2016 by country shows that the main three countries together represent more than 62% in terms of outstanding: Spain (€20.1bn/22.4%), Italy (€18.6bn, 20.8%), and Belgium (€17bn, 19%). These countries are followed by Greece (8.5%), UK (7.9%), Germany (7.7%), and Portugal (7%).

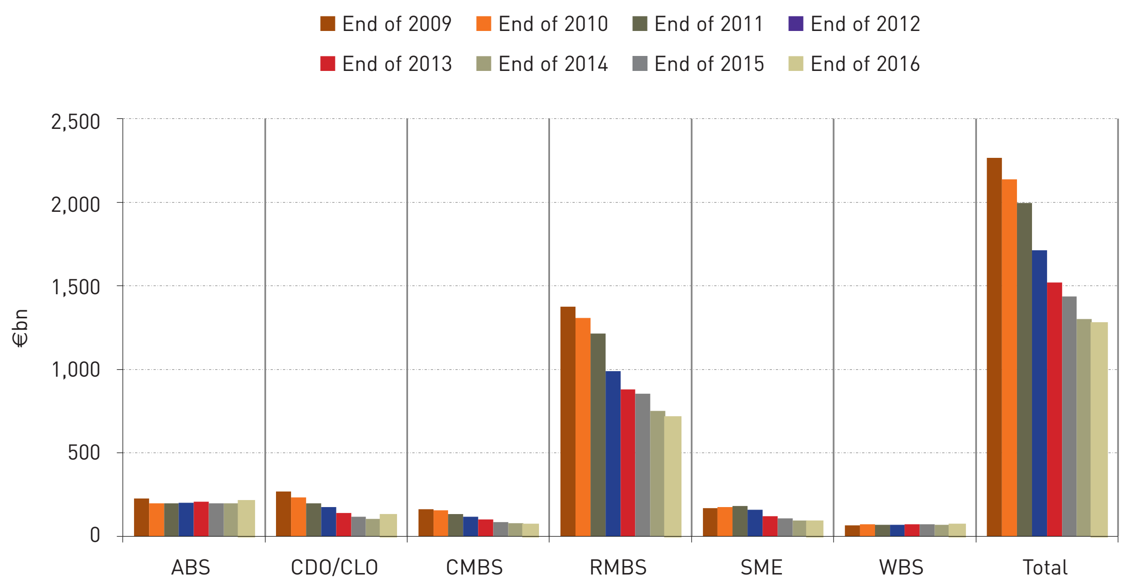
Despite the financial and sovereign crisis and the prolonged negative economic cycle, the European securitisation market in general has performed relatively

European SMESec issuance during the crisis (by country, in €bn) **Exhibit 4**



Source: Kraemer-Eis et al. (2017), based on data from AFME

European outstanding securitisation transactions by collateral (€bn) **Exhibit 5**



Source: Kraemer-Eis et al. (2017), based on data from AFME

well with comparatively low default rates. The low losses are not only based on the typically high granularity, diversification and seasoning of these transactions, but also on the structural features (such as large credit enhancement) that helped counterbalance the negative effects of the deteriorating European economy (i.e. increased SME default rates).

As described above, many years after the start of the financial crisis, European SMESec has still not recovered. Originators and investors need to have certainty and clarity. Reasonably defined criteria for simple, transparent, and standardised (STS) securitisations (incl. SMESec) – which should receive preferential regulatory treatment – could help on the way out of this dilemma.[5] In this context, the European Commission (EC) proposed a framework and started a legislative process in 2016.[6] The "Trilogue negotiations" between the EC, the European Council and the European Parliament lead to an agreement (30.05.2017) on the "securitisation package", comprising STS and a revised capital charges framework for credit institutions and investment firms originating, sponsoring or investing in securitisation products (CRR amendments).

Following the agreement, the related regulations are expected to be formally endorsed by the Council and the Parliament (Council of the EU, 2017; European Commission, 2017). According to the European Commission (2017), "the swift implementation of the securitisation package could unlock up to EUR 150bn of additional funding to the real economy".

The agreement covers two (draft) regulations: The first one brings together rules that apply to all securitisations, including STS, which are currently scattered amongst different legal acts. It aims at ensuring "consistency and convergence across sectors (such as banking, asset management and insurance), and streamlines and simplifies existing rules" (Council of the EU, 2017). In addition, it establishes a general and cross-sector regime to define and set rules related to STS securitisation. It is important to highlight that the STS concept does not refer to the quality of the underlying assets involved, but to the process by which the securitisation is structured (Council of the EU, 2017).

The other part of the agreement amends regulation 575/2013 (Capital Requirements Regulation, "CRR") on bank capital requirements. It sets out capital requirements for positions in securitisation, which aims at providing for "a more risk-sensitive regulatory treatment for STS securitisations" (Council of the EU, 2017). One of the main political issues resolved relates to the risk retention requirement.[7]

All in all, the agreement brings out important features of the future STS securitisation market segment. The fog around the future regulation design has lifted[8] – which is good in order to reduce uncertainty. We note that the requirements of the STS regulation consist of a "light" set of high quality criteria, which in turn translates in a marginal (rather than substantial) reduction in the risk-weights. Interpreting the effects of the new legislation, it has to be borne in mind that the proposed risk weights for STS will still result in increased capital requirements for IRB banks compared to today.

Moreover, another perspective regarding STS – mentioned by some market participants – is, that it can even circumvent a proper securitisation market recovery if "everything but STS" is seen as being toxic.

Implementation of the new rules will still take time. There are even concerns in the market that an implementation by mid-2018 might be too fast as this would not leave sufficient time for regulators to develop and consult on the large number of technical standards required to flesh out key details of the new rules. Hence many market participants expect implementation only in 2019. The approach of the CMU Action Plan to change the rules of the game to a certain extent can help mitigating some of the current obstacles to securitisation. However, it will most likely not be sufficient in order to produce a strong effect on market activity as long as the current monetary policy environment remains unchanged.

As said above, a well-functioning securitisation market can be essential in helping financial intermediaries broaden their funding base, achieve capital relief and ultimately, increase their financing to the real economy, including to SMEs. From the perspective of direct public support – including by the EIB Group and in particular by the EIF[9] – strengthening the SME securitisation market can be an effective way to facilitate the flow of funds to the real economy, while not creating distortion.[10]

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Notes:

1 The term SME Securitisation (SMESec) comprises transactions backed by SME loans, leases, etc. It is important not only to look at banks/lending when analysing SMESec, but equally at leasing companies, which form part of the securitisation market. For more information on the importance of leasing for SMEs finance, see Kraemer-Eis and Lang (2012, 2014).

2 Dr. Helmut Kraemer-Eis is Head of Research & Market Analysis, and Chief Economist of the European Investment Fund, EIF (part of the European Investment Bank Group). See: http://www.eif.org/news_centre/research/index.htm. EIF facilitates the execution of SMESec transactions via credit enhancement/guarantees. For more information see Kraemer-Eis, Passaris, Tappi, and Inglisa (2015) and www.eif.org.
Any views expressed herein, including interpretation(s) of regulations, reflect the current views of the author(s), which do not necessarily correspond to the views of EIF or of the EIB Group. Contents of this article, including views expressed, are current at the date of drafting, and may change without notice.
This article benefited from comments by my colleagues Salome Gvetadze, Giovanni Inglisa, Frank Lang, George Passaris and Wouter Torfs for which I am grateful.

3 The ECB's asset repurchase or "repo" facility allows (among other

assets) Asset Backed Securities to be used as collateral for funding.

4 The source for market activity data in this article is AFME (2017a, b). SMESec data only shows lending-based transactions. Moreover, the data does not cover "invisible transactions"(e.g. bilateral synthetic deals).

5 We use here STS as term – in the current discussion, also other terminologies are used in the same context, e.g. HQS (high quality securitisation) or STC (simple, transparent and comparable) securitisation, used by BCBS-IOSCO, or SST (simple, standard and transparent) securitisation, used by the European Banking Authority. In can be expected that the STS acronym will prevail in European regulation.

6 The important milestones are summarised in Kraemer-Eis et al., 2017.

7 Risk retention will remain set at 5%, even though EBA/ESMA will need to provide an RTS (regulatory technical standard) addressing further details of the technical implementation. The requirement will ensure that securitised products are not created solely for the purpose of distribution to investors.

8 This is valid for STS/CRR – another area that will have to be calibrated is the Solvency II capital rules. High charges on securitisations are preventing insurance companies from providing long-term investment capital to the securitisation markets.

9 Integrated EU capital markets (and their need for transparency and standardisation) and the relative complexity of securitisation techniques require considerable know-how and show the necessity for specialised institutions. As an established and respected player in the European market, EIF can play a role via market presence, reputation building, and signalling.

10 See for more information on this topic as well Kraemer-Eis, Schaber, and Tappi (2010), Kraemer-Eis, Passaris, and Tappi (2013), and Kraemer-Eis, Passaris, Tappi, and Inglisa (2015).

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