Keynote on Enhancing the EU Securitisation Framework

Non-verbatim version (featuring additional details not included owing to time restrictions) intended for reading with the supporting slides.

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Warning: Speech may contain light-hearted humour

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[SLIDE 1 | TITLE]

Good afternoon.
Thank you for the invitation.
It's a privilege to speak about enhancing the EU securitisation framework at the Belgian Financial Forum in this auditorium of the National Bank of Belgium.

[SLIDE 2 | DISCLAIMER]

For context, I'm a Senior Credit Portfolio Manager at Great Lakes Insurance SE, part of Munich Re.
But the views today are strictly my own.

[SLIDE 3 | SLS ↔ STS HOOK]

When a topic hits the headlines, everyone becomes an expert overnight.
Lately, it's space, with the successful launch of the Artemis II mission, and suddenly we're all rocket scientists.
In Belgium, we've always been rocket scientists. Here is the proof! [see passport picture].
But here is an insider tip: the pros don't say 'rocket', they say SLS – *the Space Launch System*.

In our world, we have STS – *Simple, Transparent, and Standardised*.
SLS aims for the Moon; STS aims to get financing to the real economy, safely and efficiently.

Securitisation is the hot topic in Brussels, and after this presentation we'll all be securitisation experts.
But the people that really need to become experts, are the Brussels policymakers as their decisions matter.
This is what I'll show later.

[SLIDE 4 | 2024 QUESTION & 3 RULES]

Let's rewind to 2024 and the question that still matters: how do we finance the EU's transformation – about 1 trillion euros per year?
Three rules guide the answer.

Rule #1: Because we have a market structure – Europe is bank-centric; households and firms access credit via banks. Therefore, regardless of whether one likes banks or not, the EU needs policies that work for EU banks.

Hence, we have two paths.
Option 1 – raise equity and fund with covered bonds.
But Rule #2: We have a market economy, and when price-to-book is below 1, raising equity can destroy shareholder value. In 2024, the situation looked like this graph. You can see Europe's case with the red curve below 1 and the US above. Thus, it's not really a path one can take.

Option 2 – be more efficient with existing capital. Here comes Rule #3: as we are in a regulated economy, more risk needs more capital; less risk needs less capital. That is where securitisation shines. It makes that rule operational by moving risk to those willing to bear it, so banks can lend again.

This is the virtuous cycle: transfer risk, free up capital, lend more, or use the capital savings to become more profitable, opening the path to option 1. That's what securitisation does: it gives capital velocity.

[SLIDE 5 | WHAT SECURITISATION DOES]

What does securitisation actually do?
Four simple steps – it's just a little engineering.

First – slice the risk. Pool the loans and issue tranches: the senior one is very low risk, the junior is the riskiest, and the mezzanine is in between. But altogether, it is the same risk as the pool – no more, no less.

Second – go to markets. That means choosing the route. Traditional: blue arrow, top-down cashflows; Synthetic: red arrow, bottom-up losses. Both have the same risk. Blue cashflows will stop where red losses will stop.

Third – who takes the risk? Junior and mezzanine investors and credit underwriters do – they are financing the economy.

Fourth – who provides funding? The senior tranche of traditional securitisations does. Because it is risk-remote, it only provides funding.

Important: funding is not the same as financing. This is why I'm happy making this presentation in Brussels in English and not in French, because it's the same word in French. Imagine if I had to explain that "*le financement n'est pas pareil que le financement!*"

- Covered bonds only fund.
- Traditional securitisation with risk transfer does both funding and financing.
- Synthetic significant risk transfer (SRT) is pure financing – it moves risk, not cash.

Europe has plenty of savings for funding, but too few risk-bearing channels for financing.

Let's go back to 2024. The Commission could see the trajectory shown in the top right corner, which is the downward importance of traditional securitisation compared to the EU GDP, even though reforms took place. In fact, the EU has lost a whole decade compared to other regions. So, the Commission wrote a consultation that basically said: "What shall we do?"

[SLIDE 6 | 'RESILIENT SENIOR' IDEA]

While waiting for the responses from stakeholders, the Commission used its crystal ball and decided that the future depends on whether the senior tranche is resilient or not. Here is Copilot's AI interpretation of what happened in Berlaymont! Joke aside, they may have a point.

Five criteria were sketched; three are clearly good: granularity, sequential amortisation, and a minimum attachment point. Two are problematic, and we'll talk about those later.

But the three good ones keep the senior risk-remote, not pool-like. By the way, pool-like tranches exist. You blend all the colours and you get a green vertical tranche.

Easy fix to insert the concept of a "Resilient position" in the legislation? Not quite. Securitisation sits across SECR, CRR, Solvency II, and LCR, plus three ESAs. It's a system that decides whether funding and financing flow – or get stuck. More like…

[SLIDE 7 | THE EIGHT IMPEDIMENTS]

At the time of the consultation, Paris Europlace Securitisation Experts Group, under the leadership of Véronique Ormezzano, flagged eight issues that block Europe from unlocking this market.

Four prudential at the top, Four regulatory at the bottom – across supply and demand.

Did the Commission listen?

[SLIDE 8 | SEVEN OF EIGHT ADDRESSED]

Yes, they did! The 2025 Securitisation Package addresses seven of eight issues – that's genuine progress. But improvements are uneven – see the traffic-light colours, that's a hint.

Prudential issues: a risk-sensitive risk-weight floor (RWF) – the flagship change; tamer p-factors; better Solvency II charges for insurers as investors; more flexible LCR for STS and more eligible asset classes.

Regulatory issues: more due diligence and reporting flexibility – with a small (or big if you are an asset manager) asterisk about sanctions; a less prescriptive SRT process; and opening STS unfunded credit protection so more non-life insurers can finally underwrite risk in this market. The big remaining gap: access to non-EU markets.

So bear with me, I've got four crystal balls of my own on the slide to show how the future could look if co-legislators make a few targeted tweaks. Indeed, they still have a chance to enhance the EU securitisation

framework further, to make the system both stable and economic.

[SLIDE 9 | RWF BASICS]

Let's start with the Risk-Weight Floor – the part that mostly affects seniors.

Today, it's one-size-fits-all: 10% RW for STS senior, 15% RW for Non-STS – with no link to the pool's risk. That distorts markets: riskier pools get securitised; high-quality pools often don't.

The fix: take a scalar times the pool's RW – so capital tracks underlying risk, and make it subject to a low absolute floor.

But here is the secret sauce for calibration: not only are the levels important, but also the ordering across buckets – so safer structures don't get harsher or similar floors than riskier ones. Thus, at the top you have the Commission's proposal, and at the bottom, we have shown how one could improve it to make it consistent.

[SLIDE 10 | RULE OF FOUR]

Do the various proposed calibrations respect the grain of risk? That means lower values for STS Resilient compared to STS Non-Resilient, which are themselves lower than Non-STS Resilient, and the highest for Non-STS Non-Resilient – in this order. So, a green tick means yes; a red tick means watch for distortions.

- Commission: 1 green tick; the absolute floors 5, 7, 10, 12 are neatly ordered.
- Council: 2 green ticks; the absolute floors, and the scalars are neatly ordered: 7, 9, 12, 15.
- Parliament: 1 green tick. The third line, the ratio between the absolute floor and the scalar is not ordered: 57, 100, 83, 100.

There is time to fix things. Here is an example of how a 'rational' Trilogue could get 3 green ticks by blending the best of all three institutions. That's consistency.

Now, here is my crystal ball prediction. Take the lowest absolute floor – that is for STS Resilient. Multiply it by four. No need for a calculator or a computer. This will give you the RW threshold of the pools that are securitisable economically with risk transfer. Below it, you will hardly see any. Above it, you will have a market.

In December, Parliament had the lowest value at 4% RW; so 4% times 4 gives you a threshold of 16% RW.

[SLIDE 11 | REAL-WORLD IMPACT]

Here's what the political calibration choice means for real portfolios. On the chart, you see about 1.8 trillion euros of residential mortgages across ten large EU IRB banking groups, ordered by their individual risk weights. On the right of the black vertical line is what is not securitisable with risk transfer – either too risky or not eligible under the STS rules at time of issuance. So, the left side shows what's available.

Today's 10% RW floor, times 4, implies a 40% RW threshold, leaving very little eligible.

With an absolute floor for STS Resilient at 3%, as currently discussed in Parliament, the RW threshold is 3% times 4, i.e., 12%. The green olive dashed horizontal line will cross the portfolio curve. At that point, to the right, you have what is securitisable, to the left, what is not securitisable with risk transfer. This means that about 23% of Total EAD (or more than 400 billion euros) becomes eligible.

At a 2% absolute floor, availability almost doubles again.

At 6%, as per the Council's choice in December, availability shrinks to about 10% of Total EAD.

Pick a number! 1%, 2%, 3%, 4%, 5%, 6%? It's not a decision from a dice. It's a political decision that has real-economy consequences.

And as you can see, covered bonds won't run out of non-securitisable prime collateral – if anything, they'll get safer as underlying quality improves, if, and only if, securitisation with risk transfer occurs.

[SLIDE 12 | ENTER THE P-FACTOR]

Now let's move to the second item, the p-factor – the mysterious dial everyone blames.

To understand this slide, we first need to recognise that regulators and academics rotate their heads by 90 degrees and look at capital structures horizontally. At

the top, you see a rotated structure with the senior tranche on the right and the junior tranche on the left. They are right to do so, because there is no point in having a gigantic chart showing quasi-zero risk for the senior tranche.

Bottom row: you have the experts' view.
The 2002 Pykhtin-Dev model gives the correct shape, with a maturity adjustment we published in 2014 with Professor Perraudin. The unexpected loss is the yellow area, and thus a risk-based capital requirement for a tranche is the yellow area between the attachment point and detachment point of the tranche, shown in purple on this diagram.

Top row: you have 30 years of regulatory thinking. Capital is a big, fat rectangle that has lived its life on the left since 1997. There is a historical reason for this, but we don't have the time to go into details now. Regulators tried to rectify the situation in 2006 by adding a bit of capital, but not enough in the right place. Post-crisis, we got an exponential surcharge (the blue diamond area) governed by the p-factor. So the blue diamond area is simply the p-factor times the yellow area.

What happens if the p-factor is too low? The shape behaves like the 2006 SFA: you get unstable but cheap securitisations. And if the p-factor is too high? You get stable but uneconomic securitisations, like today's rules. And if it's super high, it is literally rigor mortis stable; it almost happened in 2012-2013 with Basel.

At the bottom right, you have the situation as it was designed in 2013 for SA banks, and still is today for Non-STS. You see the excess capital requirement that is not needed.

[SLIDE 13 | EUROPE'S P-FACTOR PROBLEM]

But wait! It gets worse… In 2013, we imported a US secret calibration via Basel. It was never published for academic scrutiny and never implemented in the US. We all see a formula, but we don't know how it was developed. The output is awful, as it can reach extremely high values, especially for residential mortgages.

Europe's answer was to develop the STS regime. Since nobody can replicate the calibration of the sensitivities of A, B, C, D, and especially E – because the US methodology is unpublished – a European political decision was taken by the ECB and the Bank of England, with the help of the EBA. Like Alexander the Great taking his sword and slicing the Gordian knot in two, the same was done here. We know it is not calibrated scientifically, because it is implausible for a calibration to divide by two each individual sensitivity… The output, not the sensitivities, was divided by two. That's the "p-scaling factor" of 0.5.

But without a p-cap, even divided by 2, the p-factor can still drift to outlandish surcharges for the safest assets. Hence the Commission's proposal to introduce a p-cap, a very important technical detail, which was unfortunately rejected by the Council in December.

However, playing with the p-factor will not solve the functional form – or, if you prefer, the problem created by the 1997 big fat yellow rectangle. But there is hope. There are competent technical experts at the EBA – we know, we have read their published technical papers – who are aware of the problem. This is why the Securitisation Package includes a new CRR Article 506d that gives Europe a pathway to a transparent, Europe-led redesign to be worked on over the next five years, with implementation possibly in seven years.

[SLIDE 14 | PUTTING P IN ORDER]

Top row: Commission's numbers.
Beneath: our consistency check, aligning p-factor with the grain of risk across STS versus Non-STS, and originators versus investors.

Credit where credit is due (pun intended): saner values, p-caps, refined p-scaling factors, and harmonisation between IRB and SA methods, that should lead to more countries accessing the securitisation markets.

[SLIDE 15 | INSURERS AS INVESTORS]

Let's move on and assess the Solvency II capital charges that apply to Standard Formula insurers investing in traditional securitisation, i.e., on the asset side of their balance sheets.

What you see here is a regulatory crime scene. The victim? Insurers' investments in European securitisation.

It all started with the ideas of CEIOPS in 2010; they were horrific: stressing all tranches with AAA credit stresses and other shocks to see if they could survive

these concocted scenarios. Insurers heard about what was happening in their laboratory, and this is how the insurers' exodus began. They stopped investing in securitisation, both foreign and domestic.

EIOPA's rules in 2013 were moderate compared to CEIOPS, but they still confirmed insurers' worst fears: a AAA tranche was considered riskier than investing in the stock market.

The Commission intervened in 2015 for Type 1 securitisations, and again in 2018 with better calibration for STS only, while Non-STS was still subject to rules developed in 2010 and 2013. In fact, until the recent adoption of the new Solvency II Delegated Act, the rules have been a patchwork of different methodologies and data periods – or, if you prefer the film version, Frankenstein's work.

Finally, in 2026, the Commission produced the correct calibration for Senior STS, even aligning AAA and AA with Covered Bonds. It's much better for Non-Senior STS, but it is still not right for Non-STS. We know what is correct – that's what was published with William Perraudin. It's here, in the top right corner. You can click on the papers.

Now, there is a chance to reopen the 2026 calibration once the notion of 'Resilient position' is settled. If not, at the speed at which things have been moving, insurers will get appropriate calibrations for the full investment spectrum sometime in the twenty-forties.

[SLIDE 16 | INSURERS AS UNDERWRITERS]

The fourth and last item: insurers as credit underwriters – that's my day job.

We write insurance contracts that sit on the liability side of our balance sheet. Think of it like car or home insurance, but for a bank's junior/mezzanine slice: we take the non-senior credit risk in exchange for a premium.

Under current rules, insurers can provide unfunded credit protection (UFCP) in Non-STS, but not in STS – the safer, growing segment.

In regulatory speak, "unfunded" simply means the insurer doesn't post collateral up front. It has nothing to do with funding the bank.

What's the business model of insurance? Let's take an example. When you take a car insurance, you pay the premium, you don't expect the insurer to give you your car's value as cash collateral, for you to use the day you have an accident. The same applies here with banks taking credit insurance.

Because EU insurers are locked out of STS UFCP, about 75% of funded STS SRT investors are now from outside the EU. If you consider that three-quarters of the risk-bearing capacity offshore should be accounted for as financial strategic autonomy… you are in the wrong profession; creative accounting may be more suited for you!

[SLIDE 17 | OPENING THE STS DOOR]

Let's start with the good news: the Commission's Securitisation Package finally opens the door. It allows EU insurers to provide UFCP in STS – with safeguards – so insurers can underwrite credit within the safest part of the market, not just outside it. The principle of access to the STS market on an unfunded basis is also accepted by the Council and Parliament.

Now comes the political question: how many insurers do you want for the European market? To help answer this question, remember that in the US mortgage market of the GSEs, there are more than 40 active ones (more than 70 since inception in 2013). In Europe, you have 14 active ones (more than 17 since inception in 2018).

So, show me the text you are drafting – I'll show you the number of eligible insurers, not theoretical ones, but real ones with a presence in the market.

It's zero with the Commission, due to easily fixable technicalities that show that the devil is in the details, and that there can be a disconnect between good intentions and the operational implementation of the law.

The Council tried to fix some of the technicalities but created other problems, so it's only 2 with their text.

And with Parliament's December version, you have the largest 9 insurers out of the 14. With Parliament's version, not everybody qualifies, but you can have a thriving market that can grow with hopefully others joining later.

[SLIDE 18 | 'RESILIENT' CLEANUP]
Remember the "resilient position" conceptual prototype – five criteria, three good, two… less so.

The two problematic bits were: (i) originator-only eligibility, and (ii) a requirement that insurers collateralise the existing non-senior tranche so a bank's senior tranche can benefit from better resilient risk weights. The second is, frankly, absurd. I've got a special colour scheme on the slide for Kafkaesque ideas.

Keep the very good ideas, improve on the good if possible, fix the bad and eliminate the ugly ones. But how to deal with Kafkaesque ideas in the legislation? They can't be fixed, just remove them.

Here is the good news first: a recent compromise from Parliament version removes the two problematic criteria and has even gone further, by applying the criteria at origination only – which reduces capital-cliff risk and improves stability over time.

Now the bad news: the Council text would wipe out today's Non-STS UFCP market – even for insurers that would otherwise qualify for STS. This is how the market would look like by literally implementing their text: 14 active in Non-STS Non-Resilient, 0 in Non-STS Resilient (the large majority of today's existing market), and 2 left in STS, whether Resilient and Non-Resilient. That's not a market; that's chaos, for banks and insurers.

So, here is a design test for lawmakers: before finalising, ask one question: how many insurers qualify on day one? If the answer is zero or just two, you probably didn't mean that – so revise the text.

[SLIDE 19 | AVOID TOXIC CLIFFS]

And here is my personal bugbear.

The Council wants to revive Article 249(3) with ongoing tests creating toxic capital cliffs – banks lose 100% of relief overnight on an insurer's rating move, even though they have a valid insurance contract.

It's a risk that used to exist in CRR 2, and which the Commission got rid of in CRR 3. Why resurrect dead risks? With my academically inclined co-authors, we are writing a brand new academic paper to discuss this point. It will be published by the end of April.

But there is hope. There is one amendment (#185) I saw in Parliament that addresses this issue. It proposes a landscape with robust insurers at origination and no ongoing toxic capital cliffs.

[SLIDES 20 | TO THE CRUX]

Here is the crux: Does financial strategic autonomy matter?

If your answer is "no," then we're comfortable being policy-takers, like when we imported into our laws the 2013 secret US calibration, which we still implement on billions of European securitisations – or, if you prefer the medieval version, a vassal.

If your answer is yes, two consequences follow.

First: prudential calibration matters. Floors, p-factors, Solvency II, LCR – these are political choices with balance-sheet outcomes.

Second: the regulatory framework matters. Eligibility rules decide who can play, and on what terms. Will those terms make the market stable and economic – or neither? Do the terms broaden the risk-bearing channel – or shrink it? Do the terms increase financial strategic autonomy – or increase dependence on non-EU capital?

You don't need to be a securitisation expert to make good laws, but you need to talk to them. Show them the text you write, and they'll show you the market that results, with their informed crystal balls.

Where to find them? They are often found on panels at conferences, such as the one that follows me.

Thank you.