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Securitisation – Those who forget the past are doomed to repeat it

Initiatives to further develop capital markets in the EU are high on the agenda. A single market for capital would increase investments and savings across borders, benefiting consumers, companies, and investors irrespective of their location. Integrated capital markets across EU Member States would unlock capital by diversifying funding sources beyond traditional banking.

As part of this initiatives, renewed interest has emerged in securitisation as a means to stimulate capital flows, enhance private risk-sharing across the financial system, and release funding for the real economy. In October, the European Commission initiated a review of the regulatory framework for securitisations to revive the securitisation market. Insurers are often seen as key actors who could increase their investment in this asset class.

While some argue that lower capital charges might incentivise insurers – one of Europe's largest institutional investors – to invest more in securitisation products, EIOPA believes this is not the full story. And this is also the position of the Joint Committee of the European

Supervisory Authorities, which analysed capital requirements and their impact on insurers' investment behaviour. The findings show that the current capital requirements align with the risks of securitisation investment and capital requirements are indeed not the primary obstacle holding back investments.

A key issue is that securitisation products often do not align well with insurers' long-term liabilities. Life insurers, for instance, require assets that provide predictable long-term cash flows. However, securitised products are often structured in ways that make them less suitable, creating a mismatch that complicates asset-liability management.

Furthermore, insurers often perceive securitisation as less attractive compared to other asset classes due to its risk-return profile. Its complexity further serves as deterrent. Unlike simpler fixed-income products, securitisation requires specialised expertise, increasing management costs and perceived risks – especially for insurers lacking in-house expertise.

Finally, any change to the regulatory framework to reduce the capital charge for investment in securitisation would affect only some insurers, namely those using the standard formula to calculate their capital requirements. Since large insurers – who are the most significant players in the market – use internal models, changes to the standard formula are unlikely to have an impact on their investment behaviour.

The debate is shifting from capital requirements to the requirements of the Securitisation Regulation. Here, it is essential that we keep the lessons of the Great Financial Crisis (GFC) in mind and maintain strict standards on transparency, due diligence and risk retention, though adjustments to make them more proportionate could be explored.

**The review of the
securitisation framework
should also adopt a
prudential perspective.**

EIOPA has reservations about unfunded credit protection by insurers for synthetic securitisation, i.e. where banks obtain unfunded guarantees from insurers, while keeping the credit portfolios on their balance sheet. Compared to funded protection, unfunded protection increases the counterparty default risk, may increase the systemic risk and

could be detrimental to policyholder protection. Monoline insurers extended their business to unfunded guarantees for securitisation in the years before the GFC. When the value of the securitisation deteriorated, monoline insurers incurred heavy losses. This eventually resulted in the failure of most monoline insurers, which significantly aggravated the crisis.

Another lesson from the GFC is that the misalignment of interests between the originator and the investor in securitisations needs to be avoided because it may result in poor risk management of the credit portfolios. Therefore, originators should retain a portion of the risk that ensures an appropriate alignment of interest between originator and investor. Investors should be able to assess whether the 5% risk retention ensures a proper alignment of interests and where that is not the case, agree on higher risk retention that would ensure that alignment of interests.

Finally, it is important to understand that a full comparison with the US securitisation market is not possible. While the US market is large, it is important to recognise that approximately 80% of the securitisations are bought by state-funded platforms like Freddie Mac and Fannie Mae. Moreover, the aim of this securitisation market is to stimulate home ownership, not a capital markets union via the banking channel.