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Bachelor thesis topic: How Does Loan Securitisation Affect Bank Capital Requirements in Different European Jurisdictions?

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Executive Summary

Credit risk allocations through securitisation has been the backbone of the debt market in the period before and after the financial crisis. In the pre-crisis era, one observed relatively large room to manoeuvre, where the originator may shift all credit risks to the third parties without any concrete screening process and/or thorough risk analysis for the securitised debt, hence resulting in a generous form of equity reliefs. This was closely linked with the phenomenon of moral hazards and was believed to be the main cause of the financial crisis 2007-2008.

Following the financial crisis, regulators urged caution, especially for securities such as ABS, MBS, CDO and CDS. Although ongoing regulatory changes and the unstable environment for securitisation initially caused securitisation volumes to decline, they later recovered and returned to their earliest "glorious" days.

This thesis analyses different jurisdictions across Europe and their regulations as to the bank capital requirement with a particular emphasis on risk-weighted assets, retention requirements, preferential treatment for certain assets (e.g., STS framework or capital relief for CDS structure). It also examines the particular rules for globally systemically important banks and institutions.

Recent developments in Greensill case once again underlined that risk factor in securitisation must be adequately addressed. In this case, Credit Suisse lost billions in Swiss francs in a deal which involves purchasing of securities from Greensill, an Australian-British firm (Neghaiwi et. al, 2021). Following the outburst of the scandal, Swiss Financial Market Supervisory Authority ("**FINMA**") has already taken short-term measures to require capital surcharges (FINMA, 2021). However, risks arising from such practices are beyond the scope of stopgap measures. This thesis holds that we are in grave need for uniform regulations worldwide.

In this thesis, the focus lays on the post-crisis regulatory environment and examine the risk weight, credit risk retention requirements and resulting capital requirements, and preferential treatment and the system for systemically important institutions in the EU and several non-EU European countries.

The EU countries and their close non-EU trade partners in Europe such as Switzerland, Iceland, the UK and Turkey were the particular focus of this thesis. The EU countries have not been separately examined. This choice pertains to the fact that all EU regulations directly applies to the EU members without having to be adopted into national law, creating an overall relatively uniform approach between EU member states. Although, it is a major challenge for banks, financial institutions, regulatory advisors, and all parties involved to adapt to the ever-changing EU regulations. Recent regulatory updates of the EU acquis exacerbate the vast complexity of the EU regulatory environment and poses a threat to transparency. While it is difficult to cut through the red tape in the EU countries, some non-EU countries suffer from lack of regulations, which leads to a number of questionable practices and tendency to interpret the law in a way that allows for lenient capital requirements.

Non-EU countries were hand-picked to facilitate a better comparison between jurisdictions. Iceland, as an EEA country, bears particular significance since the financial crisis in 2008 severely strained the country's financial system with the collapse of one major bank after another within a few days (Baudino et al., 2020). Further, a comparison to Switzerland is also thought-provoking, firstly because it is neither part of the EU nor of the EEA; secondly because Switzerland has been the cornerstone of banking and finance throughout the years; and lastly it proves to be a jurisdiction with leniency towards banks and financial intermediaries. Moreover, the UK currently proves to be the most unstable regulatory environment, as it has yet to shape specific regulations in the post-Brexit era. Moving to the opposite direction, Turkey has adopted various EU regulations into their national laws. On the brink of an EU membership, it takes the EU regulations with a grain of salt and as a result lacks the ground rules for a sound banking capital system.

Admittedly, the fragmented regulatory environment in Europe poses a hardship for directly comparing any commonalities and differences between countries. However, this thesis overcame those difficulties by summarising important aspects of capital requirements directly linked with loan securitisation in a given jurisdiction, drawing comparisons in relevant parts throughout the thesis as well as in the final section. Some aspects of regulations have been left out, as they did not allow a relevant and/or fair comparison. A list summarising the compared aspects can be found below in section 12.

Subsequent to the analysis and comparison, this thesis establishes that the European jurisdictions tend to converge in their system of capital requirements for banks. Then, it concludes with an appeal for clear, transparent, and uniform regulations across the continent.