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Policy Brief

Handle with care
How Europe can reap the benefits of securitisation

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Provided it is sufficiently regulated, securitisation can help to fund the economy and share risks within the monetary union. Securitisation combines the advantages of banks in lending and of financial markets in financing. However, a lack of standardisation and legal harmonisation currently prevents the EU from reaping the benefits of this instrument. Weakening the prudential framework will not create a truly European market but may pose new risks to financial stability. Instead, this Policy Brief argues that to scale up securitisation, overcoming the fragmentation in national contract and insolvency laws in the longer term will be key. In the meantime, the European Commission should cut unnecessary red tape and establish an EU-wide standardised securitisation product tailored to an asset class that shows sustainable growth potential. Renovation loans are a promising option.

Securitisation might soon make a comeback in Europe. A technique used by banks to convert illiquid loans into tradable securities they then sell on capital markets, securitisation allows banks to free up capacity on their balance sheets and tap into alternative sources of financing. During the global financial crisis, securitisation issuances fell sharply. Although regulators identified the technique as an important amplifier of the crisis, the United States (US) market quickly recovered from the shock. In Europe, however, attempts to overcome the stigma left over from the financial crisis came to nothing. After introducing a new class of simple, transparent, and standardised securitisations, the European Commission as recently as 2022 rejected further changes to the EU legal framework. However, now the era of expansionary monetary policy is over and banks must compete for depositors, calls for reviving the European securitisation market are getting louder. The latest case is the Eurogroup statement on strengthening EU capital markets.

There are numerous arguments for reviving European securitisation markets now. The securitisation market in the US is ten times bigger than in the EU and many consider this to be a competitive disadvantage for funding Europe's economy. Arguing that securitisation is vital to addressing financing requirements raised by the green and digital transformations, the finance industry urges lawmakers to reduce capital requirements for banks' securitisation positions. And the Governing Council of the ECB envisages public guarantees to support targeted segments of securitisation. According to estimates commissioned by the European Banking Federation, if banks securitised half of their mortgage portfolio, this would result in an additional lending capacity of nearly €1 trillion. Beyond providing banks with capital relief, securitisation can help to channel money from capital markets into bank funded projects and share risks across the entire financial system. That is why central bankers and regulators support the idea of an increase in securitisation transactions.

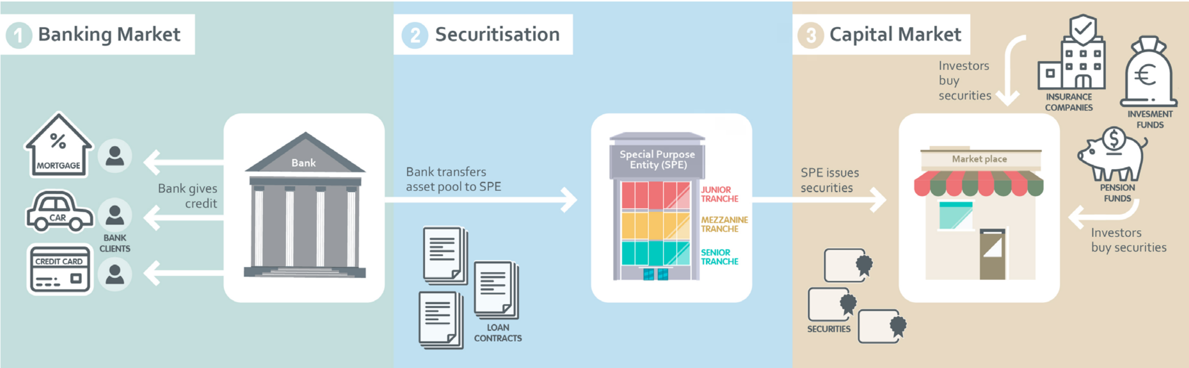
Policymakers should, however, not jump to hasty conclusions. Lowering capital requirements will not create vibrant US-style capital markets in Europe but may pose new risks to financial stability. Still, it is worth reaping the benefits of securitisation for funding the European economy and private risk-sharing in the monetary union. To build a truly European market, this Policy Brief argues that the fragmentation among national markets is still the biggest showstopper to scaling up securitisation. The introduction of a new class of simple, transparent, and standardised securitisations has helped but is still insufficient. As is the case for the Capital Markets Union more generally, harmonising national contract and insolvency laws is key. Yet, while creating a single legal area will take time, the EU should in the meantime cut unnecessary red tape for issuers and investors and further strengthen the EU-wide standardisation of securitisation products. A focus on renovation loans seems particularly useful given the importance of housing retrofits for achieving Europe's climate targets and for mitigating climate risks that endanger financial stability.

1 Functioning, benefits and risks of securitisations

The underlying idea behind a securitisation is to bundle together a pool of assets, repackage them as tradable securities and place them on the capital market. This allows a bank to assign some of the loans it holds (e.g. mortgages, credit card receivables, auto loans) to investors and thus free up capital that would otherwise have been set aside for covering associated risks. Banks can use this capital relief to do new business, either lending or trading, or to increase shareholders' return on equity. In a "true sale securitisation", the originator bundles similar assets, transfers them to a special purpose entity (SPE) and repackages them into securities with different risk profiles (tranches) that investors can purchase (Figure 1). The involvement of several market participants along an intermediation chain, however, creates considerable costs.

In a "synthetic" securitisation, banks use credit derivatives such as collateralised debt obligations (CDOs) to shift only the credit risk of the asset pool and not the assets themselves. This reduces transaction costs. However, as synthetic securitisations allow numerous CDOs to reference the same underlying asset, any default can have an outsized impact on the CDO marketplace and endanger financial stability.

Figure 1: The technique of securitisation: Illiquid bank loans transformed into tradable securities and sold in the capital market



Source: Own illustration. Design: Burak Korkmaz

Securitisation can bring economic benefits and support financial stability. Beyond providing capital relief to the originating bank, the sale of securitised loans diversifies its funding sources and reduces its refinancing costs. If the bank passes on these advantages to its clients, this may lower borrowing costs for households and firms. For investors, securitisation brings portfolio diversification benefits by providing access to asset classes that might otherwise not be available. From a financial stability perspective, securitisation may enhance the resilience of the financial system by redistributing risk across that system as banks transfer some of their risk to institutional investors such as insurance companies, pension funds or investment funds. Furthermore, the economy may benefit from developed capital markets as they reduce the impact of potential problems in the banking sector upon access to finance.

If securitisation is loosely regulated, it can, however, amplify vulnerabilities across the financial system. The global financial crisis demonstrated the risks that can materialise without adequate prudential oversight: Originating banks applied poor underwriting standards when granting loans that they then sold to third parties ("originate-to-distribute-approach"), the reliability of credit assessments suffered from conflicts of interest at rating agencies, and complex and opaque products led to excessive risk taking by originators and prevented investors from exercising adequate due diligence. More generally, securitisation created excessive leverage in the financial system, fuelling a rise in asset prices and over-indebtedness among borrowers, as well as interconnectedness and greater concentration of risk within the banking sector. When the US subprime mortgage crisis hit in 2007, the opaqueness of the securitisation market together with inadequate risk management led to the meltdown of the entire financial system and governments across the globe had to step in. Overall, the benefits of securitisation were outweighed by the harm it inflicted on the real economy.

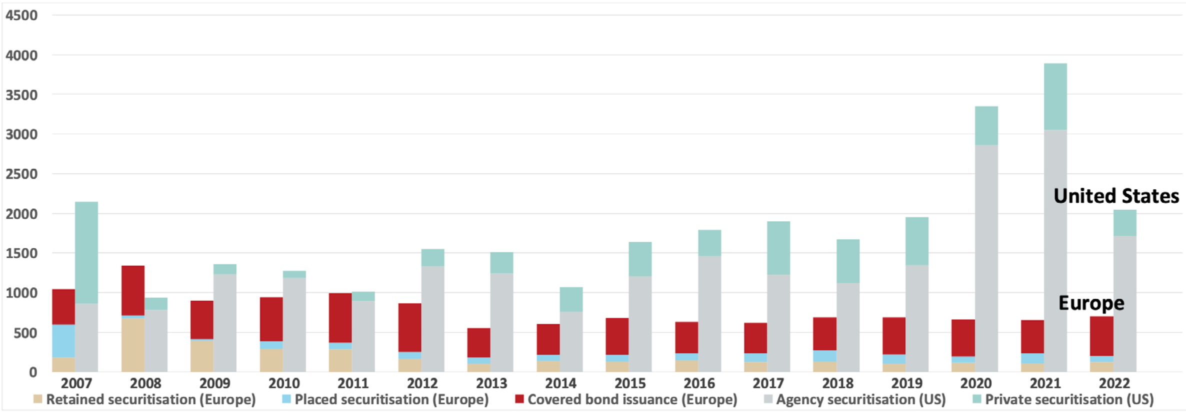
2 Regulatory developments and state of the market in Europe

In the aftermath of the global financial crisis, regulatory scrutiny over securitisation increased substantially. To address securitisation risks witnessed during the global financial crisis, legislators around the world followed the recommendations of the Basel Committee on Banking Supervision that remove harmful practices and incentivise safe market practices. In concrete terms, the EU introduced a ban on re-securitisation and adopted common rules on due diligence, transparency as well as risk retention to align the interest of originators with those of investors. To remove the stigma attached to securitisation, the EU legal framework was revised in 2017 to create a new category of simple, transparent and standardised (STS) securitisation products that was extended to synthetic securitisations in 2021. Although STS securitisations come with a reduced capital requirement for both banks and insurance companies, STS take-up has been rather limited so far, accounting for approximately just one third of issuances. In 2022, the European Commission took stock of the market and concluded that there was no need to amend the existing legal framework. In the same year, the Joint Committee of the European Supervisory Authorities (ESAs) rejected a further reduction in capital requirements for banks and insurance companies as prudentially unsound.

The US securitisation market is deeper, but European banks have access to alternative funding sources. The number of securitisation transactions fell substantially during the global financial crisis, but while the US market recovered quickly from the crash, activity in the EU remained subdued. Roughly half of the outstanding amounts of European securitisations are linked to residential mortgages, the other half is made up of automobile loans, lending to SMEs and consumer loans. However, Europe's gap in securitisation issuance is partially offset by a deep and liquid covered bond market (Figure 2). A covered bond is a bank funding instrument that is secured by a pool of eligible assets, usually residential mortgage loans, to which the covered bond investors have direct recourse as preferred creditors. As the issuance of a covered bond is simpler than that of a securitisation, the costs can be considerably lower. However, the potential of covered bonds is limited as the EU framework has strict limitations on the assets eligible as collateral. And in contrast to a securitisation, a covered bond does not transfer the risk of the assets out of the originator's balance sheet.

The differences in market size can be attributed to the importance of US government sponsored enterprises in risk-taking and product standardisation. The majority of securitisations in the US are Agency mortgage-backed securities (MBS) that are guaranteed by government sponsored enterprises (GSEs), of which Fannie Mae and Freddie Mac are the most important. With the aim of helping US citizens realise the dream of owning their own home, the GSEs purchase mortgage loans that meet certain guidelines from the originating banks and securitise them in dedicated vehicles to which they give their guarantee. They then place the securitised assets on the capital markets or entrust this task to the originating banks. By purchasing the mortgages from the banks, the GSEs assume the entire credit risk from the banks, because the usual 5% US credit risk retention requirement does not apply to Agency MBS. This unique model has far-reaching implications. First, banks have adapted the contract terms of their mortgages to the uniform criteria set by Fannie Mae and Freddie Mac. This standardisation reduces transaction costs when securitising loans originated by different banks. Second, the originating banks can grant consumer-friendly mortgages with a 30-year fixed rate because they shift the resulting interest rate risk via the Agency MBS to capital market investors. The similarity of loan maturities creates homogeneous asset pools which are well suited for securitisation purposes. Third, as Fannie Mae and Freddie Mac enjoy a de-facto state guarantee, the mortgage loans are underwritten by the US government. As a result, investors in Agency MBS in practice assume no credit risk and thus do not have to carry out cumbersome due diligence on mortgage underwriting. Fourth, with Agency MBS, the GSEs have established a product with standardised transaction structures which reduces transaction costs and significantly increases market liquidity. Taken together, Agency MBS have not only helped millions of Americans own a home, but by combining public risk-taking and product standardisation, they have also contributed substantially to the deep and liquid US securitisation market. The implicit government support enabling this public housing programme is no less impressive. In a mortgage crisis, the US government bears the credit risk that Fannie Mae, the largest company in the United States with over USD 4.3 trillion in assets, and other public mortgage lenders have on their balance sheet.

Figure 2: Issuance volumes of Securitisations and Covered Bonds in the US and Europe (EU-27 plus UK) in billion euro



Source: Own illustration based on data from Afme and ECBC.

There is no equivalent in Europe to the generous public support available in the US. While GSEs have been heavily engaged in building a US market for MBS since the 1960s, European development banks did not play a crucial role in promoting securitisation in the EU. In the 1990s, national development banks (NDBs) in Germany, Spain and some other EU member states started to engage in securitisation transactions. Their efforts in developing a securitisation market for SME loans were soon complemented by the European Investment Fund (EIF). The launch of the European Fund for Strategic Investments in 2015 then provided additional funds that allowed the European Investment Bank (EIB), the EIF and NDBs to take on more risks. In these schemes, the EIF grants a guarantee to mezzanine tranches of SME securitisations to make such products attractive to investors, while the EIB and NDBs act as investors in mezzanine and senior notes of such issuance. The latest institutional step to increase the capacity of European development banks to support the market for SME securitization was the creation of a joint securitisation platform (ENSI), which brings together seven national development banks, the EIF, the EIB, and the European Bank for Reconstruction and Development. Compared to the US, the impact of this scheme on the EU market is, however, rather small given the limitations in available EIF money (in 2022, the EIF committed EUR 2.2bn to securitisation) and a mandate focused on promoting SMEs.

The European securitisation market is highly concentrated. 86% of the outstanding amount of EU securitisations was originated in just five countries, namely France (25%), Germany (21%), Italy (17%), Spain (13%), and the Netherlands (10%). Over the last ten years, the dominance of these five countries has risen as the market share of other EU member states fell from 13% to just under 10%. Furthermore, just ten banking groups headquartered in the very same five leading member states originated 66% of all the EU residential mortgage-backed securities (RMBS), the dominant type of securitisations. The stark concentration of the securitisation market in Europe has two implications. First, as highlighted by the European Systemic Risk Board, the intended distribution of risks across the financial system as a whole falls short. Second, providing the instrument of securitisation with regulatory relief will not automatically build an integrated EU securitisation market but is likely to favour a limited number of countries and dominant market players.

European banks sit on their own securitisations. Typically, insurance companies, pension funds and investment funds purchase securitisations. In Europe, however, banks are currently the main holders of euro area securitisations with 84% of total market value, followed by investment funds (7%) and insurance corporations (5%). In 2023, banks retained more securitisations (EUR 118bn) than they placed in the markets (EUR 95bn).

As the increase in interest rates over the last two years makes bank depositors demand better remunerated products, banks retain securitisations mostly for use as collateral in central bank operations to obtain fresh liquidity or for use as high-quality liquid assets to fulfil their regulatory liquidity coverage ratio requirement. However, this practice goes against the very goal of securitisation which is to transfer assets out of the originators' balance sheet and spread risk more widely across the financial system. Reducing capital requirements for securitisation holdings, as suggested by the financial sector, would therefore be counterproductive. Incentivising banks to sell their securitisations to investors outside the banking sector and thus reap securitisation's benefits for financial stability would in fact require an increase in capital requirements, not a reduction.

3 Obstacles to the development of a truly European securitisation market

Until now, the muted securitisation market has not been a major problem for the European economy. As banks had access to cheap central bank funding, ample deposits and a liquid covered bond market, the share of EU firms considered financially constrained stood at just 6% on average in 2022. However, if companies and households increase their investment in line with the needs of the green and digital transition, credit demand will rise. One solution to solve banks' projected refinancing needs is securitisation, but regulatory and legal barriers as well as a lack of suitable assets are inhibiting a truly European securitisation market.

3.1 Regulatory and legal barriers

A lack of standardisation in loan contracts hampers the potential of securitisation in Europe. Securitisation issuers prefer large and homogenous asset pools when repackaging loans into securities. Thanks to the standardisation of loan terms and maturities driven by Fannie Mae and Freddie Mac, mortgages in the US are quite similar regardless of where they have been originated, making them ideal for securitisation purposes. The EU internal market, however, is built on 27 different contract laws and mortgages look very different in each member state. While in some countries fixed-rate mortgages prevail, mortgages with a variable rate dominate in others. This lack of standardisation makes it difficult for issuers to assemble sufficiently large pools of assets and increases the costs for transactions covering assets originated in different countries. The restriction to national asset pools alone penalises in particular smaller EU member states where issuers cannot reap the economies of scale offered by large tickets. Accordingly, most securitisation transactions in Europe are done at national level and the five largest European economies are leading the market, as highlighted above. What's more, the difficulty in pooling loans from different countries prevents the diversification of risks across Europe that could be achieved if loan contracts looked as similar as in the US.

Differences in national insolvency law hinder cross-border investment in securitisations. Investors want to know the position of their claims in the creditor hierarchy and the available legal safeguards to evaluate the risk of their investment. While in the US there is only some variation in state level consumer protection and debt collection laws, insolvency regimes vary substantially across the EU. The co-existence of 27 insolvency laws creates considerable legal uncertainty. Although investors might prefer more diversified risks, the lack of a European insolvency law prevents investors from purchasing securitisations whose performance depends on unfamiliar national insolvency laws. As a result of these variances, investor appetite for securities backed by loans originated in other EU countries is muted.

The STS securitisation label did not bring the necessary standardisation of transaction structures. To qualify as STS, a securitisation must meet a number of substantive term requirements, including homogeneity of the underlying assets, clarity on the duties of the parties involved, and disclosure of the performance of the collateral prior to securitisation. However, the standardisation provisions of the STS label are rather high level and allow significant variation in the structure of STS securitisations. This prevents investors from forgetting about the details of the legal structuring and from basing their evaluation of transactions solely on the economic aspects of the underlying assets. As a result, a STS securitisation is not a label as standardised as Agency MBS in the US and market participants use it primarily to benefit from the preferential regulatory treatment attached to it.

Reporting and due diligence requirements are disproportionate. Learning the lessons from the global financial crisis where complex and opaque products prevented investors from exercising adequate due diligence of the risks associated with their investment, the EU Securitisation Regulation requires originators and issuers to provide detailed information and submit it to securitisation repositories by means of standardised templates. Investors, in turn, are asked to conduct thorough due diligence of available information before purchasing a securitisation position. The result of these regulatory efforts is a high level of investor protection and facilitated monitoring of possible risks by supervisory authorities. However, investors do not always find the data provided useful or, in the case of private transactions that take place directly between originators and investors, prefer to contact the issuer directly to obtain information that better suits their needs. Even the Joint Committee of the ESAs acknowledges that the applicable due diligence requirements constitute an "assessment premium" that renders securitisation a costly investment and may prevent further market growth.

Data collection and supervisory practices lack harmonisation. Credit institutions are subject to a patchwork of reporting obligations in the context of securitisation. The absence of an integrated reporting framework that would make relevant information centrally available creates an unnecessary administrative burden that may discourage potential originators and investors. Furthermore, banks can benefit from any capital release only if their supervisor confirms that a bespoke securitisation meets the regulatory criteria for significant risk transfer. However, supervisors do not apply the regulatory framework in a consistent manner. As a result, the approval process currently creates substantial uncertainty on the side of originators and raises unnecessary obstacles to the smooth functioning of the securitisation market.

3.2 Many asset classes are unsuitable for scaling up securitisation

Securitisation can help channel money from capital markets into the bank-funded part of the economy. However, many asset classes do not qualify for scaling up securitisation, either now or in the future.

Conventional mortgages risk becoming stranded assets. The liquid US securitisation market is built on mortgage loans, but Europe is well advised not to follow suit because of the climate transition risk attached to conventional mortgages. Existing buildings with poor energy efficiency risk becoming stranded assets in the course of the green transition. Buildings are the single largest energy consumer in Europe, using 40% of our energy, and creating 36% of our greenhouse gas emissions. The latest revision of the Energy Performance of Buildings Directive (EPBD) therefore introduces important measures to reduce their energy use and emissions across the EU. This will increase valuations for the most energy-efficient properties and depress them for the least efficient. Consequently, securitisations backed with collateral consisting of older, less energy-efficient buildings face a bleak future.

European SMEs provide insufficient capital market information. Investors in securitisations require comprehensive information on the underlying pool of assets. However, the majority of SMEs in Europe are not market oriented, they are reluctant to reveal information on grounds of commercial secrecy or shy away from the administrative burden attached to it. This is a problem for banks that intend to securitise SME loans because without detailed information, investors cannot properly assess the risk of their investment. This lack of information creates a risk-premium that makes securitisation of SME loans often unprofitable. Boosting SME securitisations in Europe will thus be possible only if banks require borrowers to provide more information. However, this will create considerable resistance on the part of SMEs. For the time being, securitisation of SME loans seems to work only if supported by public guarantees. To ensure that banks still provide sufficient financing to SMEs, they benefit from a discount in the applicable risk weight and thus lower capital requirement when granting loans to SMEs.

New green technologies show poor credit ratings. Great hopes are pinned on green securitisations to finance the ecological transition of the European economy. However, little attention is paid to the fact that many green technologies are still relatively new with only a short credit rating history. Without available data on default rates and loss given default, clean technologies have an unknown asset performance and cannot reach the high credit ratings that are required to package loans in senior tranches. As a result, cleantech investment is rather ill-suited to serve as underlying asset in securitisation transactions. Private equity or venture capital is much better placed to finance risky projects that have not yet reached market maturity. The lack of scale-up finance in Europe cannot be addressed by securitisation but is an issue for the wider Capital Markets Union agenda.

4 How Europe can reap the benefits of securitisation for financial stability and funding the economy

Building a truly European securitisation market would benefit the funding of the European economy and private risk-sharing in the monetary union. To address the barriers presented in the previous section, overcoming the legal fragmentation in the EU's Single Market is key. As harmonising national contract and insolvency laws will take time, the EU should in the meantime cut unnecessary red tape and establish an EU-wide standardised securitisation product that focuses on asset classes with strong growth potential such as renovation loans.

4.1 Short-term recommendation: Cut unnecessary red tape for issuers and investors

To increase the appetite of originators and investors for securitisation, Europe should review reporting and due diligence requirements. Transparency is key to minimise the risks involved in securitisation and the additional requirements introduced following the global financial crisis have improved the quality and robustness of the European market. However, after five years of experience with the EU Securitisation Regulation, streamlining reporting and due diligence obligations to reduce the "assessment premium" involved in securitisation transactions seems warranted. While the European Commission did not see the need for legislative changes to the EU Securitisation Regulation, it asked the European Securities and Markets Authority (ESMA) to review the disclosure templates for underlying exposures in securitisation. ESMA undertook a public consultation on the revision of the Disclosure delegated and implementing acts and is now about to prepare the next steps.

Data collection and supervisory practices should be harmonised. To further reduce the reporting burden and simplify due diligence, the various reporting frameworks relevant for securitisation transactions should be fully integrated within a single system. The European Single Access Point set up by ESMA and the Integrated Reporting Framework merging the ECB's statistical regulatory requirements will streamline data flows. However, in the short term, the publicly available Banks' Integrated Reporting Dictionary (BIRD) could be used as a platform to describe securitisation requirements within a single model and thus build a truly integrated reporting system. This would not only reduce the burden on market participants but would also facilitate supervision. Furthermore, the European Commission should follow the advice of the European Banking Authority to harmonise the application of the framework governing significant risk transfers. This would speed up supervisory decision-making and improve the predictability of the supervisory approval process.

4.2 Medium-term recommendation: Create a standardised EU securitisation product

Standardisation is key and renovation loans show great potential for spurring securitisation in the EU. If the EU wants to scale up securitisation across member states, it needs a product that is as standardised as Agency MBS in the US. Standardisation is crucial because it reduces transaction costs and boosts market liquidity. Regarding the assets underlying such a standardised EU securitisation product, renovation loans reducing energy use and emissions of buildings are a promising option. Housing retrofits are crucial for achieving Europe's climate targets and for mitigating climate risks endangering financial stability. And thanks to the recently adopted EPBD that sets minimum energy performance standard targets over time for existing properties, demand for loans to finance energy efficient building retrofits will rise throughout Europe.

Box 1: EU rules on renovation loans

The EU Green Taxonomy is the European-wide classification system for economic activities contributing substantially to environmental objectives. A loan for the renovation of an existing building is in line with the EU Green Taxonomy if it achieves a reduction in primary energy demand of at least 30%. Renovation loans that clear the high bar set by the EU Green Taxonomy qualify for securitisations under the voluntary EU Green Bond Standard label that requires any proceeds to be used for Taxonomy-aligned purposes. However, since Europe is still at an early stage in the transition, Taxonomy-aligned lending currently represents only a limited share of the overall lending by the banking sector. As a result, Taxonomy-aligned collateral that could be used in securitisation is scarce too.

For achieving the 2040 EU climate target, it will be crucial to spur housing retrofits that may not fulfil the "dark green" requirements of the EU Green Taxonomy but still contribute to environmental objectives. The European Banking Authority (EBA) therefore invited the European Commission to adopt an EU label for green loans and green mortgages with requirements that are less strict than the EU Green Taxonomy. This would solve the problem that the Taxonomy does not provide for a definition of transition finance. The Commission could establish the definition of EU renovation loans under the revised EPBD that includes an empowerment to adopt a delegated act to encourage financial institutions to increase the volumes provided for renovations.

The European Commission should establish a standardised EU securitisation product. The STS securitisation label did not go far enough to create a product as straight-forward as US Agency MBS. The European Commission should therefore establish a new category of securitisations based on the existing STS label but improve it in two respects. First, the term requirements of the standardised EU securitisation product should go further than the existing STS label and include detailed provisions on standardising representations, warranties and enforcement provisions. This would ensure that investors can be confident that they are assuming only the economic risks of the underlying assets and not those associated with the legal details of the transaction. Second, the standardised EU securitisation product should be tailored to an asset class that shows big and sustainable growth potential. For the reasons set out above, renovation loans following a European-wide accepted definition could be the ideal underlying assets (see Box 1). The standardisation of renovation loans across the EU would facilitate the bundling of collateral from different member states. This would benefit financial stability through risk diversification. Additionally, smaller countries currently lacking large asset pools could reap the economies of scale offered by a European market. To help the new definition of renovation loans to take off, national development banks in the different EU member states and the EIB could align their existing green housing programmes with the new standard.

4.3 Long-term recommendation: Harmonise contract and insolvency law across EU member states

The EU must create the legal conditions for cross-border securitisations. The creation of a new category of standardised EU securitisations is only a provisional measure. In the longer term, national differences in contract law that currently limit the creation of homogeneous asset pools with collateral from several EU member states must be addressed. To overcome national fragmentation and create standardised loan contracts, the next European Commission should submit a proposal for a Regulation to create a European contract law. Already in 2010, the Commission under José Manuel Barroso set out the case for a uniform European contract law, but the project never got beyond the stage of a Green Paper. To make it politically acceptable, the European contract law should be designed as an optional instrument for contracting parties who wish to use it, with national laws remaining in place too.

National insolvency frameworks should provide for common minimum standards. Past initiatives to tackle certain divergencies in national insolvency laws have proven insufficient to help investors evaluate the risks of their investment and their chances for recovery in case of default. To invest in another member state, investors need equal safeguards and predictability of insolvency proceedings. Therefore, the next European Commission should put forward a proposal to establish common minimum standards in national insolvency laws, including the definition of and possible triggers for insolvency as well as collateral enforcement.

The EU must tackle the legal fragmentation that also hampers financial market integration more generally. Only if securitisations are collateralised with assets from different EU member states and are sold across national borders, can they deliver the promised benefits for financial stability and building integrated financial markets. Harmonisation of national contract and insolvency laws will not happen overnight, but it is a sine qua non for a truly European securitisation market and fully integrated financial markets.

5 Conclusion

Overcoming legal fragmentation at member state level is key to making progress on the integration of capital markets in the EU. What distinguishes Europe from the US is that America is, by and large, a single legal area. In Europe, we have one internal market, but 27 different contract and insolvency laws which increase transaction costs for both issuers and investors. To build a truly European securitisation market and make progress with the broader capital markets union project, this legal fragmentation must be overcome. EU governments should increase their level of ambition in pursing the goal of harmonisation.

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To scale up securitisation, the EU needs a product that is standardised across all member states. Provided it is sufficiently regulated, securitisation can combine the advantages of banks in lending and of financial markets in financing while strengthening financial stability through risk diversification. However, if the EU wants to scale up securitisation across member states, it needs a product that is as standardised as Agency MBS in the US. Via securitisation, the capital market could for example be involved in reducing energy use and emissions of buildings.

To deliver on the Green Deal, public investment and policies that unlock private investment will be key. Environmental and economic policies must make companies and households invest in reducing CO2 emissions. Securitisation can only help to channel private money from capital markets into bank-funded green projects. Greater financial integration to unlock private capital flowing into capital markets is no substitute for public investments. Beyond private money, the sustainable transformation of the European economy requires public support that is targeted and available across all of Europe. As long as it does not reward private actors with risk-free returns, it can take the form of de-risking private investment. To spur investment in areas that serve European goals, public support may also target securitisation, provided that sufficient funding is available at EU level.

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