20th February 2018

AEB COMMENTS ON THE EUROPEAN COMMISSION'S INITIATIVE ON ENABLING REGULATORY FRAMEWORK FOR THE DEVELOPMENT OF SOVEREIGN BOND-BACKED SECURITIES

The Spanish Banking Association (from now on, "AEB") welcomes the European Commission's inception impact assessment (Ares (2018) 400473) on "*Enabling regulatory framework for the development of sovereign bond-backed securities*" and the opportunity given to be able to send input in this regard.

The creation of Sovereign Bond-Backed Securities (from now on, "SBBS") presents both benefits and challenges, but among all the existing options for the development of a euro-denominated risk free asset, it is the most feasible one. SBBS could help to advance the Banking Union and deepen and strengthen Economic and Monetary Union. We, therefore, support at European level the European Commission's initiative to develop SBBS.

However, it is important to ensure that:

- The European Commission legislative proposal should encompass the holistic treatment of the SBBS covering not only the prudential treatment but also their eligibility criteria to be accepted as a collateral by the European Central Bank, liquidity ratios, and the tax regime of these new financial instruments. It is important to note that SBBS senior tranche should be considered risk-free assets, not just low-risk assets.

- This initiative should address the need to develop a liquid asset that may serve to increase diversification of sovereign debts portfolios. As already acknowledges by the European Commission, it is necessary that the legislative proposal ensures that the overall regulation (prudential, fiscal, eligibility for collateral and liquidity ratios…) sets out the same treatment for both SBBS and sovereign bonds, otherwise, an unequal treatment could hinder the issuance of SBBS and investor will prefer to invest in sovereign bonds directly.

- This solution should pursue incentivizing the diversification of exposures, but not incentivizing fragmentation among jurisdictions, which was already under correction thanks to the banking union. In this sense, the composition of the underlying portfolio should be the central government bonds of each euro-area Member States in a known and pre-determined proportion that favours diversification.

- A clear mechanism should be clearly established at EU level for verification of the compliance of the (privately-produced) securitization of euro area national government bonds with the SBBS criteria, including the control and ongoing monitoring of SBBS.

- This initiative should not affect the regulatory treatment of sovereign exposures. The European initiative must preserve the same prudential treatment agreed at international level in order to avoid potential inconsistencies between European regulation and international standards and to ensure a level playing field across jurisdictions.

The ESRB proposal is still at an initial stage. Even if some important aspects were clarified from the first academic proposals, for example the composition of the sovereign-bond pool (according to the ECB capital key) and the structure of the issuance, differentiating between the senior, mezzanine and junior tranche, there are important aspects still not clarified. This is the case for example of the private / public issuer, which is not specified in the ESRB paper.

That is why we would encourage the European Commission to reconsider its intention not to conduct any further consultation. We consider that the European Commission proposal of SBBS is an important issue and therefore it should be released for public consultation as sovereign exposures play a crucial role for banks risk management and profitability as well as for sovereign debt markets.

Moreover, we support the European Commission's initiative to conduct an impact assessment on this important issue to analyse the potential unintended consequences that SBBS could have at European level.