Viewpoint: Securitisation, capital markets and the role of insurers

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Petra Hielkema, EIOPA's Chair about securitisation as one of the initiatives to further develop capital markets in the EU and the role of insurers

Initiatives to develop further capital markets in the European Union (EU) are high on the EU agenda. A single market for capital would lead to increased investments and savings across borders to the benefit of 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. Securitisation is seen as a possible way 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 with a public consultation, with the objective to revive the securitisation market. Insurers are often viewed as key actors who could increase their investment in this asset class.

While some argue that reducing the capital requirements for insurers' investments in securitisation could help, we believe this might not be the full story. If insurers are required to hold less capital against securitisation products–the argument goes–they may be incentivised to invest more in them. Increased investment from the insurance sector, one of Europe's largest institutional investors, would contribute to further developing the CMU. However, this is not a silver bullet for stimulating insurers' investment in securitisation products.

The Joint Committee of the European Supervisory Authorities, including EIOPA, analysed capital requirements and their impact on insurers' investment behaviour. The findings reveal that capital requirements are commensurate with the risks of securitisation investment. Capital requirements are also not the primary obstacle holding back investment in securitisation products by insurers. Insurers face multiple challenges when considering securitisation as an investment option, and capital charges are just one factor in the equation.

A significant issue is that securitisation products often do not align well with insurers' long-term liabilities. Insurers, by nature, manage liabilities that can extend over decades, such as life insurance policies. These require investments in assets that offer long-term, predictable cash flows. Securitised products, however, are frequently structured in ways that make them less suitable for matching long-term liabilities, creating a mismatch that can complicate asset-liability management.

Furthermore, insurers often perceive securitisation as having a less attractive risk-return profile when compared to other asset classes and its complexity also serves as deterrent. Unlike more straightforward fixed-income products, securitisation requires specialised expertise to manage, given the layers of financial engineering involved. This complexity increases the cost of managing these investments and adds to the perceived risk, further reducing their appeal to insurers who may lack the necessary in-house expertise to navigate this asset class effectively.

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. The standard formula is predominantly used by small and medium-sized insurers who lack the resources to develop bespoke internal models for calculating their capital needs. 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.

While incentivising retail investor participation in capital markets is important, we should address the reasons why insurers are hesitant to invest in securitisation products. The debate is shifting from capital requirements to issues that matter more. Let us not forget the lessons of the Great Financial Crisis and maintain strict standards on transparency, due diligence and risk retention, though adjustments to make them more proportionate could be explored. Allowing unfunded credit protection by insurers for STS (Simple, Transparent, and Standardised) securitisation is worrisome, as it echoes past failures. These concerns should be part of the discussion in the European Commission's consultation on securitisation.