American Securitization Forum Conference

Global Regulatory Outlook

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Introduction

Thank you Trish for that kind introduction. Good morning ladies and gentlemen. Before I start, I would like to take this opportunity to congratulate the American Securitization Forum on its recent incorporation as an independent entity which heralds a new and exciting phase in delivering its mission to its membership with fully focused resources.

I would also like to congratulate Tom Deutsch on his appointment as executive director. I have known Tom for many years and he is well deserving of this role.

Finally, congratulations should go to the Chairman, Ralph Daloisio for his leadership of the Forum and his successful navigation of the Forum through an extremely difficult year.

Today, I have been asked to speak about the global regulatory outlook for securitisation. I will try to keep it short and punchy and leave enough time for questions afterwards. I believe everyone is aware that we need to restore trust and confidence in securitisation.

The IMF has said: "it is important to recognize the many benefits associated with sound securitization. Given the pivotal role of securitization as an alternative and flexible funding channel, failure to restart securitization would come at the cost of prolonging funding pressures on banks and a diminution of credit."

Indeed, this is the focus of the G20, Financial Stability Board and IOSCO. They have recognised that securitisation is critical in supporting the provision of credit to consumers and businesses.

Securitisation technology has a long track record of lowering the cost of and increasing the availability of credit and in this way the revival of securitisation is seen as critical in terms of assisting in underpinning the global economic recovery. The importance of securitisation is also recognised in the various government support programmes around the world.

Today, my focus in terms of regulatory perspective will follow three themes in reshaping securitisation markets around the world. They are the three C's: coordination, convergence and caution. But I could also add the words **clarity** and c**ertainty** to this.

- **Coordination:** An overall dialogue between regulators and supervisory and legislative authorities at a global level is critical given the global nature of the securitisation market. There needs to be coordination between securities regulators, prudential supervisors and accounting standards setters so that a change in one area does not have an unintended consequence in another.

- **Convergence:** There is a need for regulatory convergence on issues like retention of economic interest (aka 'skin in the game') and standardisation of disclosure.

Implementation may be tailored to the peculiarities of the local market, but mutual recognition or equivalence between jurisdictions needs to be considered. Without convergence of regulation, cross-border capital flows may be constrained and opportunities for regulatory arbitrage may emerge.

- **Caution:** Regulators need to devise a measured response to ensure the sector is not overloaded with too many regulatory initiatives which could stifle the securitisation markets' recovery. Most regulators are aware of the compliance burden that the new initiatives impose but see this as necessary to restoring investor trust and confidence in the market. Regulators believe that in the long run, the market will revive and without many of these new initiatives, the risks inherent in the market leading up to 2007 would continue to exist.

It will take time and money to implement regulatory changes. Transitional arrangements are important in this respect so that measures can be phased in to minimise market disruption. It is a fine balancing act between strengthening regulation and overburdening a market with regulation. Extensive dialogue between industry and regulators is crucial to flush out any unintended consequences. This is why caution is fundamental.

I've now discussed the importance of reviving the securitisation market and the three themes (coordination, convergence and caution) in reshaping the market. So what are the signs of recovery that we are seeing?

Green shoots

Things are slowing but surely beginning to turn around and we've been seeing some positive signs across the markets.

While issuance volumes have been slowly rising, public sector support programmes continue to play a dominant role, again underlining the importance of the sector to financing consumers and business.

The US

In the US, the Fed's RMBS purchase programme and TALF as well as the Treasury's Legacy Securities Public-Private Investment Programme have been supporting issuance.

However, throughout 2009, we have seen the use of TALF gradually diminish in the consumer ABS [auto and credit card] sector. This is a positive signal as more and more Issues are non-TALF financed. We have also seen some tentative signs of recovery in the US CMBS market with a TALF-ineligible issue late last year.

There is talk in the US from investors and originators of further issuances with new collateral, although the RMBS market is yet to reignite.

Europe

In Europe, new issuance ABS volumes are being driven by the European Central Bank's acceptance of own-use ABS as collateral for use in Euro system credit operations.

A few securitisation transactions have recently been placed with private sector investors in the UK and continental Europe. Though these were on a very selective basis and with terms very favourable to investors. [For example, recent issuances have contained put options after five or seven years in place of traditional issuer call options with a coupon step-up.] Prices have also been recovering in the secondary market. Lloyds announced the first European RMBS deal this year and planned for dollar, euro and sterling tranches.

Australia

In Australia, a public sector programme was established to support new issuance in the prime RMBS market. Similar to US consumer ABS, we saw a reduction in reliance on the public sector programme and a contraction of spreads towards the end of 2009.

I believe these positive signs will prevail through this year and markets will continue to recover.

With this in mind, let's take a look at some of the regulatory initiatives that are in progress.

Coordination: Regulatory initiatives

There is no denying that we are all on the same page in wanting to revive the securitisation markets. As mentioned earlier, the IMF has said “it is important to recognize the many benefits associated with sound securitization. Given the pivotal role of securitization as an alternative and flexible funding channel, failure to restart securitization would come at the cost of prolonging funding pressures on banks and a diminution of credit.”

The FSB in its report to the G20 also noted that “the revival of securitisation markets is needed in many countries to support the provision of credit to the real economy.” i.e. to consumers and business, which is necessary to stimulate the economy.

The FSB has been overseeing and endorsing work related to securitisation by IOSCO and the Basel Committee for Banking Supervision, and has also been liaising with the IASB and FASB.

Each of these bodies is focused on distinct aspects of the securitisation market. For example:

- IOSCO is focused on securities regulation principles such as disclosure, retention, due diligence and investor suitability;
- The Basel Committee for Banking Supervision is focused on prudential supervision such as risk-based capital requirements, governance and risk management; and
- The IASB and FASB are working together to achieve convergence of accounting standards and revise consolidation and derecognition standards.

I will touch on some of the regulatory initiatives by each of these bodies, beginning with IOSCO.

In September last year, IOSCO released recommendations designed to restore confidence to the securitisation markets. The **main recommendations** relate to disclosure, investor suitability, a skin in the game, and international coordination.

I will briefly run through these:

- **Disclosure** to investors must be improved. This is straightforward. It relates to both initial and ongoing disclosure, including disclosure of collateral, delinquencies and due diligence efforts that were undertaken. We have seen the American and European Securitisation fora release industry standards last year to improve and standardise disclosure and the Australian Securitisation Forum is implementing similar standards this year. Importantly, as embodied in the ASF's Project Restart, there is a global focus on investors having transparent loan level data for valuation, pricing and risk management purposes.

- Regulators should consider a **retention requirement** to align the interests in the securitisation value chain. In making this recommendation, IOSCO set out some principles to follow. The requirement should be **risk sensitive** and have regard to the underlying quality of the collateral. The requirement should consider the value chain of securitisation and the impact of increased capital charges, accounting de-recognition treatment and legal true sale issues in the relevant jurisdiction. In my view, a ratings based approach rather than a flat percentage is more risk sensitive. For example, a requirement to retain all tranches that have a credit rating of BB or below would be more risk sensitive than a flat percentage. Alternatively a vertical slice percentage which takes into account the risks of the underlying collateral may be appropriate.

- IOSCO also recommended that regulators **review investor suitability requirements** as well as the definition of sophisticated investor and strengthen it as appropriate. This addresses a global need to eliminate mis-selling. Work on this is underway.
- **Convergence and Caution.** Finally, IOSCO stated that we need to implement these recommendations in a manner promoting the **international coordination of regulation**. This is critical given the global nature of the securitisation market. We need to ensure there is international regulatory consistency to facilitate cross-border capital flows and avoid regulatory arbitrage.

Most of these recommendations were influenced by and were in response to the industry's own McKinsey Report *(McKinsey & Company, The Future of U.S. Financial Regulation and its Implication, 15 December 2008).* The recommendations are therefore largely in line with industry views and were developed in partnership with industry following an extensive IOSCO global consultation process.

IOSCO is also undertaking further work:

- Its Task Force called the Task Force for Unregulated Financial Markets and Products ('TFUMP') will **monitor the implementation of IOSCO recommendations** relating to securitisation that I just mentioned.

- TFUMP will also **monitor industry initiatives** and continue to act as a **single liaison point** between industry and regulators. Monitoring regulatory initiatives and acting as a coordination point for all of IOSCO's work on securitisation is vital.

- **IOSCO Standing Committees** will continue their work on issues relating to: disclosure, post-trade transparency, and investor suitability, investor due diligence and credit rating agencies.

The IOSCO **Task Force for Supervisory Cooperation** is currently finalising a report containing principles on regulators collaborating to analyse and assess regulatory risks across borders to develop a coordinated supervisory response.

Through the Basel Committee, we have measures to strengthen the capital treatment of securitisation and establish clear rules for banks' management and Pillar 3 disclosure. These measures were adopted in July 2009 **for implementation by end of thi**s year, including:

- higher **risk weights** for certain re-securitisations;
- requirements on banks to conduct **more rigorous due diligence** of externally rated securitisations;
- tighter prudential guidance for bank management of **off-balance sheet exposures**; and
- Improved **Pillar 3 disclosures** of securitisation exposures in the trading book and sponsorship of off-balance sheet vehicles.

Moving on to accounting initiatives. The IASB and FASB have a long-term project to achieve **convergence** of International Financial Reporting Standards (IFRSs) and US Generally Accepted Accounting Principles (GAAP). The G20 recently called for this convergence project to be completed by June 2011.

The project focuses on:

- Alignment of **fair value** measurement.
- Revised **consolidation** requirements.
- Simplifying **derecognition** standards.

[Convergence] Once coordination has been achieved, we need to look at mutual recognition and equivalence to create a level playing field across the market.

[Caution: Risk of overburdening markets]: Transitional arrangements and phased implementation will be important, which will require time for technological enhancements and incur operational costs. Extensive industry dialogue is important in terms of ensuring that we don't have unintended consequences.

Conclusion

In summary, we are seeing green shoots in markets around the world, but restoring trust and confidence is still an issue, as is removing pubic support mechanisms. Regulators have an important role to play in partnership with industry in restoring confidence and reshaping global securitisation markets.

I will remind you of my three themes today – coordination, convergence, and caution to facilitate cross-border capital flows, reduce the risk of regulatory arbitrage and avoid stifling the market before it recovers. We must focus on achieving mutual recognition and equivalence and take care that the sum of the measures does not result in unintended consequences.

Thank you. I will now take questions.