Role of securitisation in funding economic activity and growth

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Introduction

Good morning, everyone. And thank you, Chris, for inviting me to speak today. It is always a great pleasure for me to attend these investor-focused events, even though I now wear the 'hat' of the markets regulator.

Today I have been asked to speak about the role of securitisation in funding economic activity and growth.

To put the comments I will make in context, I have recently been involved as a Global Steward of the World Economic Forum's (WEF) Long-Term Investing, Infrastructure and Development Initiative.

The WEF and others have been doing a lot of work trying to encourage long-term development through the capital markets for a number of years now. However, every time we meet, I am struck by the enormity of the challenge the world faces in funding economic activity – and ensuring finance is channelled to the right areas where it can make a real contribution to development.

As part of this work, we know that there is currently a $1 trillion annual shortfall in available finance for infrastructure projects around the globe. Governments and other traditional sources of funding, including banks, cannot hope to close this gap on their own. Fiscal constraints and increased regulatory requirements since the global financial crisis (GFC) are arguably restricting the ability of these bodies to support economic activity.

The point I want to make is that, when we talk about economic activity and growth, we need to remember that we are not just talking about numbers. We are talking about the ability to provide funds for much needed development and progress. Finance has a real impact on the lives of people around the world.

With this in mind, I would like to cover three topics:

- the importance of securitisation and capital markets as an alternate source of finance
- harmonisation and the risks of fragmentation
- innovation, blockchain technology and the future for securitisation.

Importance of securitisation and capital markets as an alternate source of finance

There is no doubt that securitisation can significantly contribute to economic growth.

With governments and banks now subject to restrictions on extending funds and credit, capital markets solutions like securitisation can help support growth by opening up alternative sources of financing.

Releasing value for originators allows them to reallocate capital to other productive areas. And we should not forget the impact of predictable returns for investors in securitised products and the constructive ways in which those income streams can be used.

As a regulator, I am keenly aware that, in order for capital markets to fulfil this role, we need to create the right environment for growth – and this includes reaching the right level of investor protection.

However, this is not solely a task for regulators. Industry also has a part to play to ensure that the right focus is given to investor protection through incentive alignment and adoption of best practice.

We have come a long way since the initial post-GFC uncertainty about the impact of proposed regulatory changes to securitisation frameworks.

In Australia, the Australian Prudential Regulation Authority released its final revised standard on securitisation last year. The purpose of these revisions is to facilitate a more robust securitisation market by providing:

- more flexibility for authorised deposit-taking institutions in their funding programs
- a simpler set of operational requirements for the use of securitisation
- simpler and more transparent approaches to calculating regulatory capital requirements that appropriately reflect risk.

Although this revised standard has not yet taken effect, I am optimistic that we are on the right path towards realising the potential of securitisation in our market.

Harmonisation and the risks of fragmentation

As I turn to my second topic – harmonisation – I think it is important for everyone here to realise that the story does not end with the completion (or near-completion) of national reform efforts. As many of you are no doubt aware, there is ongoing work happening at an international level to help encourage and support development of sustainable securitisation markets.

One example of this is the work of the joint Basel Committee on Banking Supervision (BCBS)–International Organization of Securities Commissions (IOSCO) Securitisation Taskforce. This partnership is currently progressing two major pieces of work.

The first of these is focused on developing specific criteria for simple, transparent and comparable (STC) short-term securitisations. We hope to publish a consultation report on this soon. I hope many members of the audience here will contribute to this consultation process. Feedback is very valuable as we think about how the STC criteria should apply to asset-based commercial paper.

The second major work stream is aimed at encouraging harmonisation across major securitisation markets. I should emphasise this is not about making the laws of different nations the same – rather, it is about analysing differences in major geographic markets and finding the scope for narrowing differences, while respecting the structures and approaches of different jurisdictions. Indeed, the first phase of highlighting key differences between geographic sectors ought to be a big help to deal structurers and investors as they seek to break new ground and enter new markets.

I cannot stress enough how important initiatives like these are, as we move into the future.

Fragmentation can set up obstacles for issuers and investors wanting to access markets other than their own. Where there are significant differences in regulatory approaches between jurisdictions, this can also have negative implications for cost and efficiency.

As I think we can all see in the current political and economic environment, the risk of fragmentation in global markets is very real. To counter this risk, it is important for us to work together to contribute to broader harmonisation efforts.

I have said before that harmonisation does not mean identical laws and regulations. Instead, regulators need to look holistically at how we supervise and enforce the law and focus on achieving common outcomes.

It is also very important for industry participants to engage with this process and be vocal in the wider public discussion about the risks of fragmentation and what it will mean for the markets and, ultimately, for financing the real economy.

Innovation, blockchain technology and the future for securitisation

The last topic I want to touch on today is how innovation and new technologies will shape the future for securitisation.

Innovation is not always about technology. By constantly challenging ourselves to see if we can do things better or differently, we can open up new possibilities for securitisation.

One emerging trend I have been following with some interest is securitisation that promotes broader goals related to growth and inclusion. In Australia, we are seeing this through some recently developed 'green' or climate-focused asset-backed securities related to the financing of solar energy equipment.

On the technology side of things, there are opportunities for the securitisation industry to revolutionise the way it works. For example, these should aim to reduce intermediation costs, speed up settlement, and improve transparency and security in the value chain – and so benefit all parties: originators, issuers, servicers, ratings agencies, trustees, auditors, investors, market makers and regulators.

A recent Deloitte research report commissioned by the Structured Finance Industry Group and the US Chamber of Digital Commerce titled 'Applying blockchain in securitization: opportunities for reinvention' is quite a compelling look into the way the sector may evolve.

Blockchain has three key features that I think are particularly relevant to this discussion:

- First, it is a vehicle for transferring value and holding records – each transaction or record is evidenced by a unique data set or 'block' that attaches to the continuously growing blockchain. Each block contains the previous block's time-stamped digital signature, so that it is linked and easy to track and verify.
- Second, it does not involve a central authority or third-party intermediary overseeing it, or deciding what goes into it. The computers that store the blockchain are decentralised, and are not controlled or owned by any single entity.
- Third, it creates its own trust mechanism – 'distributed trust'. Every block in the ledger is verified by parties interacting on the blockchain through a consensus algorithm. Each block is connected to the prior one in a digital chain algorithm. It is this verification process and decentralised nature that creates the trust. Consensus is achieved by a majority of the relevant nodes (i.e. parties on the blockchain) validating the information based on pre-agreed criteria.

In the securitisation space, the creation of a single, accessible source of truth for all parties can reduce or remove all the problems currently associated with information asymmetry.

For example, instead of developing payments models in isolation, parties could agree on a model and record it on the blockchain. By incorporating smart contracts into the blockchain, the model could even self-execute based on specified trigger events.

As another example, the unique identifiers associated with individual loans in the blockchain can be used to identify and 'tag' loans that have been transferred into a securitisation trust. Blockchain technology can use a token system to map rights to an asset and allow for straightforward transfers by the execution of smart contracts operating on the chain – clearly something that's potentially good because it could simplify the true sale that securitisation relies on. This would also increase transparency and, potentially, prevent loans from being double-pledged through manual error.

In addition, the growing ability to collate massive volumes of data in a standardised form also has the potential to significantly reduce time spent on due diligence. Already, free and open data standards, developed by consortia like XBRL, aim to reduce the cost of reporting and collecting data and ultimately improve financial information quality. Incorporating similar standards with blockchain technology should also lead to better comparisons being made on products and transactions – helping issuers and investors alike. This will also open up new opportunities for other parties, like rating agencies and regulators, to undertake independent analysis of the transactions.

Risks and challenges of blockchain technology

While the benefits of adopting blockchain are obvious, we should not overlook or downplay the risks and challenges associated with this technology.

Privacy

'Permissioned' or 'private' blockchains can be adapted to provide tiered information access. So, originators could restrain the release of private personal data, while allowing regulators to have broader access to data that shows whether, for example, responsible lending obligations are being complied with in areas such as debt/income ratio, credit rating, and loan to value ratio.

However, we do need to strike the right balance between providing necessary privacy protections and ensuring that, as far as possible, benefits associated with transparency are preserved.

Cybersecurity

Before we outsource our records to a decentralised system, we need to be sure that the systems we have created are truly immutable, and are not able to be easily manipulated or undermined by either internal or external actors.

This is something of course that is front of mind after the events of recent weeks.

Vetting the technology

It is important to remember that this technology has not yet been fully vetted. Proof of concepts and pilots of specific uses of blockchain are presently still in progress in financial markets.

Legal and regulatory issues

A fourth challenge is the need to resolve legal and regulatory issues, for example, concerning digital contract enforceability.

Standards

Finally, agreement of uniform data and security standards will be critical to facilitate the development of successful blockchain solutions.

Conclusion

In conclusion, I think the future for securitisation looks very promising. We have all done a lot of hard work since the GFC on building more robust and sustainable markets.

Now, as we face the challenge of stimulating economic activity and growth, we cannot afford to sit back and wait for change to occur around us. We need to be proactive and embrace opportunities to innovate and try new things.

Thank you. I would be happy to take any questions.