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Role of securitisation in funding economic activity and growth

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Introduction

Good afternoon, everyone. And thank you, AFME, for inviting me to speak today.

It is always a great pleasure for me to attend these industry-focused events, even though I now wear the 'hat' of the markets regulator. This is because engagement between regulators and industry is critical.

Today I wanted to comment on 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. The same applies to funding the real economy in many parts of the world, whether it be consumers or business. 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, digital disruption 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 funding 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 – whether by pension funds or others.

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 promoting the right level of investor trust and confidence.

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 trust and confidence 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 Europe, the criteria for simple, transparent and standardised (STS) securitisation was recently finalised. This starts to level the playing field, but there is still a long way to go, for example in working out the implications of Solvency II.

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 (ADIs) 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.

Also, in contrast to Europe, the Australian authorities have not imposed mandatory risk retention requirements, recognising that ADIs have ‘skin in the game’ as servicers, as well as through entitlements to residual income and brand risk.

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 regional and 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, which I have co-chaired with the Bank of England since 2014. The taskforce was established in 2014 to review developments in the securitisation market. Its objectives were two-fold:

- to identify factors that may be hindering the development of sustainable securitisation markets, in line with the Financial Stability Board’s sustainable market-based financing objective
- to develop criteria to identify and assist the financial industry’s development of simple and transparent securitisation structures.

The taskforce collected data, surveyed and conducted roundtables with national authorities and market participants (particularly non-bank investors, such as insurance companies and pension funds). In July 2015, the BCBS and IOSCO published the final criteria for identifying simple, transparent and comparable securitisations.

Fast forward to the present: 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 and 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, digital disruption 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.

In the late 1980s and the 1990s, we pioneered new markets and assets in securitisation. The early 2000s were probably the 'golden years' until the GFC. But, based on the recovery we have seen since then, I think we are about to see a new renaissance for securitisation based on that same pioneering spirit.

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. 'Just because it has not been done does not mean it can't be done' is one of my favourite sayings. Also, I believe that you start making progress where others stop.

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 securites (ABS) related to the financing of solar energy equipment. Another example is the securitisation of small-to-medium enterprise loans by Alibaba in China.

On the technology side of things, the industry is already engaging with the opportunities that derive from marketplace lending, and blockchain will provide further opportunities for the securitisation industry to change the way it works.

Blockchain

Blockchain could significantly 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.

Benefits of using blockchain

There are a number of benefits associated with using blockchain:

- In the securitisation space, creating a single, accessible source of truth for all parties can reduce or remove the problems currently associated with information asymmetry.
- Blockchain can provide an immutable and identifiable audit trail for transactions.
- Increased speed and certainty through the elimination of time delays in information and payment flows could result in better valuation and price discovery, reducing counterparty risk on intermediaries.
- Finally, there is a lot of potential for security improvements in a system where each asset and piece of data relating to it is recorded on the chain.

Risks associated with blockchain

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* – 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* – Legal and regulatory issues need to be resolved, for example, concerning digital contract enforceability.
- *Standards* – Agreement of uniform data and security standards will be critical to facilitate the development of successful blockchain solutions.

To be sustainable, the industry needs to be proactive and forward-looking, concentrating not just on short-term risks and opportunities, but also at how these issues play out in the long term. For example, consideration needs to be given to such questions as:

- What does good look like in a sustainable securitisation industry?
- What impact will driverless vehicles have on ABS markets?
- What is the potential for digital fiat currencies to reshape banking and, in doing so, add to assets that may be usefully securitised?

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.