

Rebuilding securitisation: What went wrong, and how to fix it

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Securitisation is not going away

- When it's working properly, a powerful way to channel long-term investment into diffuse markets
 - Offers advantages to borrowers, intermediaries, and investors
 - Until the crisis, was growing steadily in Asia and elsewhere
 - Shortcomings critical, but not fatal
 - Role of lenders, packagers, investors, regulators, CRAs.
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About the FSF

- Established 1999
 - Small secretariat, hosted by the BIS
 - Membership:
 - Finance ministries (G7)
 - Central banks (G7, NL, CH, HK, SG, AU, ECB)
 - Regulators (G7)
 - International organisations (IMF, WB, BIS, OECD)
 - International groupings (BCBS, IOSCO, IAIS, IASB, CGFS, CPSS)
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The FSF Report on Enhancing Market and Institutional Resilience (April 2008)

A collaborative effort across authorities in the main financial centres and the key international supervisory and regulatory bodies

- joint diagnosis;
 - joint assessment of actions required;
 - recommendations that are coordinated across areas of responsibility;
 - processes for implementation in place.
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What went wrong?

- Innovation ran ahead of risk management
 - Weak incentives → poor underwriting
 - Lack of transparency
 - Poor investor due diligence
 - Poor performance by CRAs
 - Inappropriate regulatory incentives (Basel I)
 - Maturity mismatches in undercapitalised vehicles
 - Excessive reliance on wholesale funding markets
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Guiding principle

A financial system

- that is more immune to the perverse incentives seen;
 - where leverage is ultimately lower;
 - where leverage and its risks are correctly identified and addressed.
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Strengthening prudential oversight of capital, liquidity and risk management

- **Basel II Pillar 1:** Capital charges for CDOs, default and event risk in the trading book and for OBS liquidity lines will be raised (end 2008).
 - **Basel II Pillar 2:** Guidance for supervisory reviews under Pillar 2, including management of securitisation-related exposures – with capital implications (2008-9)
 - **Institutional investors:** Market regulators to strengthen practices for investments in structured products.
 - **Compensation schemes:** Better aligned with long-term profitability.
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Enhancing transparency and valuation

- Robust risk disclosures, following leading disclosure practices; new Pillar 3 requirements
 - IASB Standards for OBS vehicles and valuations in illiquid markets
 - BCBS will set out supervisory guidance for valuation processes
 - Transparency in structured products
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Transparency in the securitization process (cont'd)

Looking for industry - on initial and ongoing basis - to:

- Strengthen information flow at each stage of the securitization chain
 - Be explicit about underwriting standards in OTD and disclose due diligence results
 - Make available to investors much expanded information on underlying asset pools
 - Improve transparency of prices and volumes in structured credit market
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Changing the role and uses of credit ratings

- Implementation of revised IOSCO Code of Conduct Fundamentals for CRAs (end-2008);
 - Differentiated ratings and expanded information on structured credit products (2008 -);
 - CRA assessment of data input in SF transactions;
 - Regulators to review the role of ratings in regulatory rules and prudential frameworks (end-2008).
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Processes for implementing the recommendations

- Recommendations linked to specific committees now part of their work programs;
 - For other recommendations, FSF setting processes in train;
 - Rely on industry for number of recommendations - but authorities will retain option of regulation.
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Implementation is underway:

- BCBS consultative document on IRC, liquidity risk, stress testing issued. Revised weights on securitisation to be issued soon.
 - National authorities working to strengthen stress-testing, underwriting practices, investor due diligence.
 - Improved risk disclosure in mid-2008 reports
 - Revised accounting and disclosure standards for OBS entities
 - Revised IOSCO code of conduct fundamentals for CRAs
 - CRA work to address conflicts of interest
 - Industry work on aggregate data, instrument-level transparency, investor risk assessment
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More work needed on:

- CRAs, esp differentiation of ratings
 - Compensation schemes
 - Exchange-based trading of standardised products?
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