FSB FINANCIAL STABILITY BOARD

30 August 2023

Evaluation on Effects of G20 Reforms on Securitisation

Summary Terms of Reference

1. Objective

The objectives of the evaluation are twofold:

1. To assess the extent to which the G20 reforms on securitisation implemented to date have achieved their financial stability objectives. Specifically, the evaluation will assess whether the reforms have addressed misaligned incentives that weakened lending standards in the credit origination process, as well as opaque and complex structures that prevented proper due diligence and led to the mispricing of risks by investors.

2. To examine broader effects (positive or negative) of the reforms on the functioning and structure of the securitisation markets and the implications for financing to the real economy. This type of analysis will help identify any material unintended consequences that may have to be addressed, without compromising on the objectives of the reforms.

The evaluation will take the form of a streamlined and targeted exercise from both a substantive perspective (by focusing on a subset of the relevant reforms and markets) and from an operational perspective (by streamlining internal and other processes).

2. Relevance to financial stability

This evaluation will cover a core area of post-crisis reforms relevant for financial stability. At the 2011 Summit in Cannes, the G20 Leaders agreed to develop policies to deal with the fault lines exposed by the financial crisis in that part of the financial system that extends credit but is outside the regular banking sector.[1] The complex structuring and multi-step distribution chains involved in much securitisation prevalent in the run-up to the crisis generated misaligned incentives among the originator of a securitisation and its investors while encouraging a rapid and largely undetected build-up of leverage and maturity mismatches.

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[1] See FSB (2013), _An Overview of Policy Recommendations for Shadow Banking_, August.

A number of regulatory reforms have since been introduced to address the information asymmetries and incentive problems associated with these forms of securitisation. They involved increases in required capital in relation to banks' securitisation-related exposures; improving disclosures and facilitating standardisation; and addressing incentive problems through retention requirements and by enhancing the rating process.[2] This topic involves both banking and non-bank financial intermediation (NBFI) sector reforms given the intermediary chains in the securitisation market and the strong linkages between the two sectors, so the cross-sectoral nature of the topic makes the FSB well placed to carry out an evaluation.

Implementation of the securitisation reforms is advanced and has progressed to a stage where an evaluation of their effects is feasible.[3] The evaluation offers a timely opportunity to assess the impact of these reforms in FSB member jurisdictions. Moreover, the global economic outlook and tightening financial conditions may put more pressures on bank lending and therefore incentivise greater use of securitisation as a tool for capital management and funding.

3. Tasks

The evaluation will cover the most relevant securitisation aspects from a financial stability perspective. To this end, in pursuing the objectives of Section 1 it will focus on:

- (in terms of reforms) Revisions to prudential requirements related to banks' securitisation-related exposures,[4] and minimum retention requirements to address incentive problems. Other reforms – such as measures to improve disclosures, facilitate standardisation and improve ratings – while relevant and important, would be more difficult to assess and their effects will be covered in a qualitative manner.

- (in terms of market segments) Those segments of the securitisation market that are material from a global perspective; relevant in several FSB jurisdictions; have grown in recent years; and involve cross-border issuers or investors. These segments include, in the first instance, the collateralised debt/loan obligation (CDO/CLO) market, given the linkages with leveraged loans and the rising interest rate environment;[5] and the non-government-guaranteed part of the residential mortgage-backed securities (RMBS) market, given the linkages with and vulnerabilities associated with the housing sector.[6] These two market segments account for almost one-fourth of the global securitisation market in terms of outstanding amount, or around three-fourths if one excludes the US agency (government-backed) MBS part from the global securitisation market.

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[2] See FSB (2017), *Assessment of shadow banking activities: risks and the adequacy of post-crisis policy tools to address financial stability concerns*, July.

[3] See FSB (2023), *Implementation of G20 Non-Bank Financial Intermediation Reforms: Progress report*, January.

[4] These relate mainly to the regulatory capital treatment of banks' securitisation exposures, including with respect to simple, transparent, and comparable securitisations.

[5] See FSB (2019), *Vulnerabilities associated with leveraged loans and collateralised loan obligations*, December.

[6] In particular, the evaluation would exclude from its scope the US agency RMBS segment as it is government-backed (with Fannie Mae, Freddie Mac or Ginnie Mae acting as guarantors).

The FSB may decide, in the course of the evaluation, to expand the scope of its analysis to other reforms and market segments as well, given their linkages with the above areas of focus and relevance for financial stability.

The evaluation will cover all FSB jurisdictions and include, to the extent possible, cross-border and cross-sectoral effects from the implementation of these reforms.

The starting point for the evaluation will be to set out the reforms' original objectives and the primary issues that they intend to address. The evaluation will then identify possible indicators to assess progress with these objectives; establish post-crisis trends based on such indicators and descriptive statistics; identify transmission channels through which the reforms have operated; and analyse the effects by conducting empirical and other analyses (see below).

The evaluation will build on relevant work undertaken by the FSB, its member authorities and standard-setting bodies in this area. The evaluation team will coordinate closely with the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO), as well as other standard-setting bodies (SSBs) as needed, to identify relevant information and determine types of analysis that it should carry out.

Time permitting, a variety of approaches will be used to ensure that the evidence on the effects of securitisation reforms is comprehensive. This is particularly the case given that methodological and data challenges (e.g. difficulty to establish suitable benchmarks, implementation of multiple reforms over the same time period, data constraints) mean that only a subset of the relevant hypotheses can be examined empirically. As a result, the evaluation will in some cases have to rely on qualitative evidence. While none of the approaches individually can offer conclusive evidence on its own, collectively they may form the basis for reaching robust conclusions on the effects of reforms. The approaches to be used include:

- An initial stocktake to collect and synthesise available information in this area. This would include a review of any ex-ante impact or ex-post evaluation studies on securitisation reforms; information on the implementation of the relevant reforms (e.g. in terms of their timing and calibration); analytical work by FSB members relating to trends and risks in securitisation markets (e.g. types and credit quality of securitised assets, securitisation structures, role in funding and capital management for issuers and investors, linkages with other markets); research or other analytical work by the private sector and academia; and an overview of relevant industry and regulatory data sources that could potentially be used in the analysis.

- Qualitative analyses, such as a questionnaire to members and outreach to stakeholders to understand their perspective on the structure and functioning of these markets, including during periods of stress, and on their outlook. The outreach may take the form of targeted sessions with particular types of stakeholders (e.g. issuers, investors, rating agencies, academics, think tanks) and/or a roundtable. In addition, the FSB's session at the Central Bank Research Association (CEBRA) Annual

Meeting (July 2023) focused on the effects of financial reforms on securitisation markets, so that it can feed into the evaluation.[7]

- Quantitative indicators and descriptive statistics on the evolution and performance of securitisation markets (e.g. type of securitisation, maturity, market size and liquidity, securitised loan ratings, investor and issuer data, underlying loan characteristics), analysis of implementation across relevant reforms (e.g. to potentially construct an implementation index for FSB jurisdictions, and to identify major barriers to the implementation or effectiveness of the reforms), and sensitivity analyses (e.g. to compare key securitisation variables before and after the introduction of the reforms).
- Quantitative analysis on the growth and performance of relevant securitisation markets, aiming to disentangle the effects of the reforms from other developments and to assess the implications for the transfer of credit risk out of the originators' balance sheet and the distribution of risk across the financial system. Such analysis will be decided on the basis of availability and ease of use of relevant data across FSB member jurisdictions.

4. Process

The evaluation of securitisation reforms will be streamlined to provide more flexibility on the modalities and timing of the work and better align with limited resource availability. To this end, and with the objective of completing the work within around one year, the evaluation will:

- reduce the number of interim deliverables;
- rely as much as possible on existing data available to members (thereby minimising the need for any new large data collections);
- rely on other FSB groups to provide analytical support, as well as the CEBRA session and stakeholder outreach to solicit input/feedback on the analysis; and
- conduct the public consultation process on an interim findings note instead of a draft report, as it would allow the evaluation team to continue its work during the consultation period.

5. Expected final deliverable

The team will prepare an evaluation report that will describe the motivation, objectives, scope and approach of this exercise; describe relevant reforms, their implementation status across jurisdictions and possible transmission channels; summarise the main findings from the analyses; and provide an overall assessment of the effects of the reforms. The report will include Annexes (e.g. on the literature review, data sources, design of any empirical analysis, takeaways from stakeholder outreach and other relevant issues).

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[7] See Call for papers: 2023 Annual Meeting of the Central Bank Research Association (CEBRA) (15 February 2023).

The results of the evaluation will not contain specific policy recommendations, but rather findings for consideration by the appropriate bodies. As noted in the FSB Evaluation Framework,[8] if their findings warrant, the SSBs and the FSB may recommend that a standard or policy in their respective areas of responsibility be considered for amendment, in accordance with their established policy development processes. The final responsibility for deciding whether and how to amend a particular standard or policy remains with the body that is responsible for issuing that standard or policy. The FSB and relevant SSBs will cooperate closely to ensure such work is carried out in a coordinated and effective manner, consistent with the G20's mandate to the FSB.

The FSB expects to publish a note with preliminary findings in early 2024 for public consultation, and the final evaluation report around mid-2024.

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[8] See FSB (2017), *Framework for Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms*, July.