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Secretariat of the Financial Stability Board
c/o Bank of International Settlements
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GFMA response to the FSB's Consultative Documents on Strengthening Oversight And Regulation Of Shadow Banking: (1) A Policy Framework For Strengthening Oversight And Regulation Of Shadow Banking Entities; and (2) An Integrated Overview of Policy Recommendations

The Global Financial Markets Association (**GFMA**)[1] welcomes the opportunity to comment on the consultative document on other shadow banking entities "*A Policy Framework For Strengthening Oversight And Regulation Of Shadow Banking Entities*" published by the Financial Stability Board (**FSB**) on 18 November 2012 (the **Consultative Document**). In addition, we summarise below our high-level thoughts in response to the FSB's related publication entitled "*An Integrated Overview of Policy Recommendations*". This is followed by answers to the individual questions raised in the Consultative Document.

Separately, the GFMA is responding to: (i) the consultation of the FSB "*A Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos*" (WS5), dated 18 November 2012; and (ii) the International Organisation of Securities Commissions (**IOSCO**) report on "*Global Developments in Securitization Regulation*", dated 16 November 2012.

We would be grateful for an opportunity to meet with you at your convenience to discuss our response. Further, we would be pleased to discuss any of these comments in further detail, or to provide any other assistance or data that would help facilitate your review and analysis.

[1] The Global Financial Markets Association brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, please visit http://www.gfma.org.

Executive summary and general comments

The GFMA welcomes the FSB's engagement with market participants and supports the furtherance of the FSB's stipulated objective "*to ensure that shadow banking is subject to appropriate oversight and regulation to address bank-like risks to financial stability emerging outside the regular banking system while not inhibiting sustainable non-bank financing models that do not pose such risks*"[2] in particular to mitigate systemic risk and regulatory arbitrage.

The GFMA believes that shadow banking can contribute positively to the financial system by providing significant funding to capital markets and thus the real economy, and by diversifying risk in the financial system. We would be concerned with any presumption that shadow banking is inherently bad for financial stability and do not believe that activity in the shadow banking system per se should be discouraged. Indeed, we note that this viewpoint is supported by the IMF in its recent publication[3], which stated: "*understanding the operations and demand factors of the shadow banking system is a necessary starting point for a policy response. To the extent that many shadow banking activities have valid and valuable economic and financial market rationales, regulation should not be so strict so as to remove the positive aspects of shadow banking*". Accordingly, the GFMA agrees that regulation of non-bank credit intermediation entities should be "*proportionate to financial stability risks, focussing on those activities that are material to the system*"[4].

As expounded further below, we consider that any proposed regulatory measures should be:
(i) the product of a detailed impact and cost-benefit analysis mindful of the interaction with and broader market implications of other regulatory initiatives;
(ii) targeted to identified systemic risks;
(iii) consistent with the FSB's intention to only take measures that are proportionate;
(iv) mitigating regulatory fragmentation by encouraging consistent standards across the FSB's membership; and
(v) sensitive to other regulatory developments.

Co-ordination of FSB workstreams

The GFMA is mindful that the Consultative Document constitutes workstream 3 (**WS3**) of a broader suite of workstreams that the FSB is undertaking. Whilst this response focuses on the Consultative Document, we are mindful that there appears to be a significant overlap between the various FSB workstreams resulting in some apparent duplication of work. For example, although both areas are considered within WS3, the FSB is running separate workstreams on "Securitisation" (**WS4**) and "Securities lending and repos" (**WS5**). We are unclear how these separate workstreams are intended to interact with WS3. It appears that, structurally, the Consultative Document is the overarching paper for the other FSB workstreams but it is unclear how the workstreams will coordinate. For example, we note that FSB workstream 2 considers money market funds (**MMFs**) but these are not substantively addressed in WS3. In addition, we are concerned that by conducting concurrent workstreams with subject matter that overlaps, this risks creating inconsistencies in policy formulation - both by the FSB and, especially in the context of securitisation, other policymakers (such as IOSCO).

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[2] Page ii of the Consultative Document.

[3] IMF Staff Discussion Note "Shadow Banking: Economics and Policy", 4 December 2012

[4] Page ii of the Consultative Document.

Furthermore, as the output of recommendations for the "Banks' interactions with shadow banking entities" workstream (**WS1**) is not expected until mid 2013, it is unclear how WS1 will form part of the FSB's broader analysis. Consequently, GFMA would encourage the FSB to take steps to coordinate and consolidate the output from its various workstreams, as otherwise this could result in siloed thinking.

Workstreams need to account for broader regulatory developments affecting the financial system

We welcome the FSB's broad acknowledgement that shadow banking activities take a variety of forms, which have evolved in the past in response to changing market and regulatory conditions[5]. Consequently, it is important that the policy framework takes account of contextual developments in regulation and market behaviour.

It is important to note that many of the risks associated with banks' connection with shadow banking activities (such as special purpose vehicle funding, liquidity lines, large exposure limits) are being addressed through various regulatory initiatives, such as new measures on capital, liquidity and leverage standards outlined in Basel III. Other forms of regulation are being introduced to better regulate alternative investment fund managers and preserve the integrity of client assets (and which would impact the ability to use such assets for one's own purposes). Indeed, connections between regulated firms and participants carrying out shadow banking activities are already captured through both capital (capital requirements associated with risk exposures) and liquidity (liquidity lines included in calculation of liquidity ratios) regulation. We would support global co-ordination of the various ongoing regional initiatives, pulling together existing concurrent workstreams - such as those being carried out by the FSB, Basel Committee, ECB, ESMA, IOSCO and US regulatory authorities.

The GFMA believes that the shadow banking system should not be indirectly regulated through further regulation of the regulated sector. Such an approach leads to duplication of regulation and burdens the banking sector with costly regulation without benefit to the economy. We are concerned that failure to adequately co-ordinate and/or take into account recent and planned changes to the broader regulatory framework could be detrimental to the efficient functioning of financial markets. Therefore, to encourage market efficiency and economic growth, we would strongly encourage a detailed assessment to be undertaken of the cumulative impact of regulatory change. Failure to undertake such an exercise risks duplication/overlap of regulation and establishes new, unintended opportunities for regulatory arbitrage.

A risk-sensitive approach focussing on systemic risk – we are concerned that the development of economic functions appears to have redirected the FSB's focus away from systemic risk

The GFMA notes and supports the FSB in its aim to mitigate potential **systemic** risks associated with the shadow banking system. However, as detailed in our response to question 2 of the Consultative Document, we are concerned that the concept of "economic functions" is an imprecise mechanism for identifying systemic risk. The creation of a defined grouping of "economic functions" appears likely to miss future systemic risks and create regulatory distortions/opportunities for arbitrage.

[5] Page 2 of the Consultative Document.

We support the FSB's intention to move away from seeking to identify entities and to focus on identifying systemic risks that merit addressing. We are somewhat encouraged by the direction the FSB has taken with regard to focussing on "economic functions". However, defining specific economic functions may create an unlevel playing field which of itself creates opportunities for arbitrage. We believe the FSB needs to go further and identify systemic risks and, following an appropriate impact assessment, outline mitigation steps.

Given the FSB's remit, we suggest that for a risk to be systemic it should be one of such materiality that it affects a large number of the constituent members of the FSB. We consider that to further the objective of establishing proportionate measures targeted to "systemic risk" it is essential that the FSB carries out further analysis. The proportionality of the scope, tools and measures outlined to mitigate risks can only be judged once the systemic risks are identified. We are concerned that the identified risks are treated as if they are an exhaustive analysis of all systemic risk. We would encourage more transparency of the analysis the FSB has conducted to generate the list of risks, which underpin so much of the Consultative Document's proposals. We are concerned that the systemic risks of the future may not be captured by the FSB's current approach.

We note that the Consultative Document currently identifies: maturity transformation, liquidity transformation, leverage and credit risk transfer as posing systemic risk. Whilst we agree that such activities can cause systemic risk in certain circumstances, it is important that these elements are not characterised as inherently negative to the financial system. Maturity transformation and liquidity transformation are important tools and vital for global economies. Such activities should not be perceived purely in the negative. Furthermore, we do not consider that “undergoing credit risk transfer” is a source of systemic risk or arbitrage. For example, the sale by a bank or non-bank of a loan or asset is a credit risk transfer but this transfer is not necessarily systemically relevant.

Although the FSB states that it has not sought to identify entities, we consider that the Consultative Document nonetheless defines the scope of shadow banking by looking at entities. As iterated elsewhere in this response, we strongly believe that the FSB should focus on identifying systemic risk and measures to mitigate such, rather than identifying entity types. A focus on entity types risks overlooking a systemic risk and/or creating a regulatory gap by failing to capture a relevant entity type. Specifically, the FSB policy framework appears to limit its scope from the outset to non-bank financial entities that perform credit intermediation activities close in nature to traditional banks.

We are concerned that by focusing on non-bank financial entities in the Consultative Document, the FSB could potentially ignore risks arising from non-bank financial activities undertaken by non-financial entities. Examples of risk include: basis or other spread risks – a spread or basis position that is big enough relative to a firm’s capital and sufficiently volatile can create a material risk of financial distress; market liquidity risk, funding liquidity risk and currency risk.

Absent clarification on scope of application, it is difficult for market participants to confidently assess the true impact of the proposals and whether the proposed policy tools are appropriate.

We believe that regulation of the shadow banking system should not result in duplication of existing regulation. Further, we do not consider it appropriate to indirectly regulate the shadow banking system through imposing additional measures on the regulated sector. Such an approach would risk creating duplication of regulation and an overly burdensome regime for firms that are already regulated. In addition, such an approach would likely increase arbitrage opportunities.

A proportionate response should not result in investor freedom being disproportionately curtailed

The level of risk an investor or other entity is willing to take on and the investment strategy should not be restricted by regulation. For example, we are concerned that the FSB's proposed tool to restrict the maturity of portfolio assets disproportionately impinges on investor freedom. Some investors have the sophistication and means to invest in long term funds that lack short-term liquidity. We are concerned that material restrictions on investor discretion is regressive. Investors should be free to determine their appetite for risk. We suggest that regulators should, instead, focus on ensuring prudent risk management is performed.

We are of the view that the FSB should target its measures and not seek to remove a broad spectrum of investor risks that are inherent to participants in a free capital market. Over-zealous use of policy tools would risk limiting investor choice, essential financial innovation and the fundamental ability to take an informed risk and obtain appropriate reward. An unmeasured approach could have drastic ramifications for a large community of investors with a long term agenda (e.g. insurance companies, pension funds, sovereign wealth funds).

A thorough assessment of the ramifications for the macro-economy should be considered before imposing potentially liquidity-draining measures

Many of the policy tools proposed in the Consultative Document seek to manage liquidity risk through mechanisms such as hard limits on the number of illiquid assets held within a portfolio and/or imposing liquidity buffers. To avoid unintentionally adversely affecting funding costs and, consequently, macro-economic growth we strongly encourage the FSB to fully reflect on the views held and measures proposed by other policymakers on liquidity.

Since the onset of the recent financial crisis, both national and global policymakers have highlighted the holding of liquid, short-term assets as important to mitigating risks of runs etc. The focus on short term liquid assets has come from varied angles, such as the EC's Solvency II insurance reforms and the Basel Committee's reforms. We are concerned that, to date, insufficient consideration has been given to the cumulative effect of these measures. Specifically, we are concerned that mandating firms to hold more short term, liquid assets will increase the cost of acquiring such assets and may result in a shortfall. As banks and certain other regulated entities are being required to hold increased amounts of short term liquid assets, this will increase their cost of funding, which in turn will be detrimental to economic growth.

Although we note the FSB's awareness that "*there is a shortage of liquid assets in certain jurisdictions*"[6], we would encourage the FSB to carry out detailed analysis on how the availability of short term liquid assets will be affected by other regulatory initiatives and whether they, combined with the measures proposed in the Consultative Document would be damaging to funding costs. We note that the Basel Committee has recently recognised that its proposal for a Liquidity Coverage Ratio (designed to ensure that banks have sufficient liquid assets readily available to cover net outflows for up to 30 days) should be subjected to a more graduated implementation to allow the market to adjust. Furthermore, we look forward to analysis of the cumulative impact on cost of

[6] Page 13 of the Consultative Document.

funding in the European Commission's planned green paper consulting on the treatment of long-term financing and growth.

Market practice and features have changed

Market practices have evolved since the onset of the financial crisis and many product features in the shadow banking system have been altered to address concerns (e.g. collateral quality, diversification of repo/stock lending providers; prohibiting use of collateral; credit enhancement practices. Today's economic reality is that some of the concerns held by regulators at the time of the crisis are no longer relevant. In light of the FSB's acknowledgment of constant change in the shape and form of the shadow banking system, it is important that the policy toolkits are proportionate and targeted to the concerns/risks relevant to the industry today and remain easily capable of being adapted in the future.

We support consistent standards to mitigate against fragmentation

We are encouraged by the FSB's principle based approach to analysing shadow banking system activities and developing policy measures. However, we believe additional analysis refocusing on systemic risk is necessary before developing tools further. Policy tools should evolve alongside developments in the shadow banking system. Where tools are developed, we consider that such tools should be framed carefully so as to avoid inconsistent use by national authorities, to mitigate the risk of unintended regulatory distortions. Whilst we understand the need to adopt an approach which suits the circumstances of each jurisdiction/region, prior experience demonstrates that given a broad remit, regulators around the globe are likely to end up with a very divergent system. This will only exacerbate fragmentation and contribute to already challenging conditions facing globally active financial services firms. We would encourage an approach by which the FSB: (i) takes a proactive role in monitoring and analysing the success of the systemic risk mitigation tools developed by FSB members; (ii) maintains a dynamic list of policy measures based upon its analysis in (i); and (iii) establishes a forum for the FSB's membership where members focus on the policy measures the FSB has developed, and co-ordinate actions.

Ensuring a level playing field between regulated and unregulated firms providing identical financial services is of crucial importance to avoid the risk of regulatory arbitrage.

Trigger points for toolkits

Where a tool has been identified, we would support more quantitative analysis on the trigger framework for the use of such a tool. We acknowledge that not all triggers will be quantitative and that the trigger framework would benefit from qualitative standards. This would greatly enhance the sense of proportionality and appropriateness of any regulatory measure.

On the range of tools, the FSB should be mindful of the powers local regulators already possess, such as: making market pronouncements, risk disclosure and the increasingly intrusive powers they have over the regulated system, which inevitably interacts with the shadow banking system. We suggest that before mandating new regulatory measures, the effectiveness of existing tools should be assessed. A proportionate approach would mandate that the creation of a formal regulatory system (particularly one of an invasive prudential nature) be utilised as a measure of last resort – i.e. where all existing tools are considered inadequate to sufficiently mitigate the objectively measured systemic risks.

As a general matter, we consider that the FSB should avoid suggesting that all regulators "should" adopt any or all of the measures or "should" adopt measures in a certain form (see, e.g., section 3.2.2 Tools 2 and 4, section 3.2.3 Tools 2 and 4, section 3.2.4 Tools 1, 2 and 3, section 3.2.5 Tools 1, 2 and 3).

General comments on economic functions 1 to 4:

Economic functions 1, 2 and 3: as explained above, it is essential that the FSB identifies the systemic risks that require mitigation rather than broad economic functions. GFMA believes the systemic risk associated with these functions is unclear. For example, economic function 1 is concerned with credit investment funds that could lead to runs as a result of redemptions. However, these runs are only of significance if they are systemically important. In the event of a run, the investors of the fund would be adversely impacted; however, the broader impacts are unclear. Further, economic function 2 is concerned with loan providers dependent on short term funding or wholesale funding. Such loan providers would only be systemically important if withdrawal of lending by them had, of itself, systemic impact. Further, for the ramifications on loan providers to be systemically important, the specific withdrawal of funding would need to have a material impact on their ability to lend.

Economic functions 3 and 5: as expressed above, the GFMA would encourage the FSB to recognise cross-over between its workstreams. Specifically, we are concerned that (i) securitisation and (ii) securities lending and repos are captured by economic functions 3 and 5 of the Consultative Document but are also the subject of separate, individual FSB workstreams. The Consultative Document indicates that the output from these separate workstreams will affect the FSB's analysis. We would encourage greater coordination across the separate workstreams to avoid duplication of work and the potential for inconsistency as a result of the overlap. We note that economic function 3 and the corresponding tools the FSB has outlined appear to relate the freedom of firms to rehypothecate. As rehypothecation is captured by the WS5 workstream, we believe WS5 is the appropriate forum for such analysis and not WS3.

Economic function 4: one business that could be impacted is indemnification for securities lending. In particular, banks typically acting as lending agents will take responsibility but in addition will indemnify lenders to ensure they receive full value. Where there is a shortfall, there could be imperfect credit risk transfer, but this is more counterparty risk.

General comments on economic function 5: securitisation and funding of financial entities

Importance of securitisation as a funding tool; need to avoid restrictions on its viability

As a starting point, we strongly encourage the FSB to ensure that its policy framework does not restrict the revival of the securitisation markets. Securitisation, sensibly deployed and prudently regulated, has a crucial role to play in providing finance for "real economy" assets, particularly in light of current economic conditions and as the global banking system continues to undergo major deleveraging. Recent reports have highlighted that high quality securitisation provides a number of economic benefits and that securitisation transactions have performed well over the course of the financial crisis with certain (well-known) exceptions (e.g. transactions backed by U.S. sub-prime

mortgages).[7] It should also be noted that the importance of securitisation has been expressly acknowledged by IOSCO in the context of WS4 as evidenced by the statement in its recent final report that "securitisation, when functioning properly, is a valuable financing technique contributing to economic growth and an efficient means of diversifying risk".

Securitisation in general is not an appropriately targeted economic function

Significant concerns have been raised with respect to the proposed inclusion by the FSB of securitisation in general as an economic function. Such an approach potentially draws in a wide range of arrangements and does not appropriately focus on what is and is not an activity that involves shadow banking giving rise to systemic risk and justifying regulation – which by definition should not include matters already falling within the regulatory perimeter. Moreover, this general reference is confusing given that securitisation is generally understood to be a financing technique (rather than being an economic function in itself). As noted in our general comments above, we encourage the FSB to focus on identifying systemic risks and measures to mitigate such risks. This targeted approach is also more consistent with the extensive work already underway and focused on securitisation in the context of FSB workstream WS4.

Emphasis on maturity transformation in a securitisation context in general is misplaced

We note that the Consultative Document places considerable emphasis on maturity transformation in a securitisation context. This focus is misplaced in that it does not reflect the bulk of the securitisation market and suggests that there may be some confusion between structured investment vehicles (**SIVs**) (which arrangements are no longer operational in general) and securitisation in a manner which could pose systemic risk (see the comparison chart included in Appendix 3 for a discussion of the differences between these arrangements).

Most of the global ABS market is made up of "traditional" term securitisations of real economy assets and a sizeable majority of such transactions are self-liquidating[8]. This means that the investors' rights to repayment of principal are dependent on the securitised assets producing cash and, as a result, no material maturity transformation is involved. In a multi-seller ABCP conduit, to the extent such arrangements are not match-funded, it should be noted that the corresponding maturity mismatch is absorbed through the existence of liquidity lines provided by banks – meaning that there should be no maturity transformation at the level of the ABCP conduit. Such liquidity activities are subject to banking regulation including regulatory capital requirements (which requirements are under review by the Basel Committee) and, under Basel III, new liquidity standards and, as such, are not outside the regulatory perimeter and/or in the "shadows". Moreover, data has shown that, for multi-seller ABCP conduits, through the crisis, such liquidity has

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[7] Please see the September 2012 report by the Association for Financial Markets in Europe (AFME) entitled "The Economic Benefits of High Quality Securitisation to the EU Economy", a copy of which is attached as Appendix 1 and linked here http://www.afme.eu/Documents/Statistics-and-reports.aspx Please also see Appendix 2 for a summary of performance information for certain key asset classes.

[8] There are of course some exceptions to this; for example, CMBS transactions and certain leasing transactions may carry some refinancing risk.

not been susceptible to "runs" and such conduits have continued to fund a very high percentage of their total commitments, as they were designed to do.[9]

Concerns regarding overall tone of Consultative Document with respect to securitisation; need to ensure policy framework is accurate in its assumptions and properly balanced

While there are lessons to be learned from the financial crisis, we consider that care must be taken by the authorities to regulate against a re-occurrence of bad behaviour, rather than labelling a particular financing technique or product (such as securitisation) as bad. In this regard, we find the overall tone of the Consultative Document with respect to securitisation to be inappropriately negative and a number of statements made appear to reflect a misunderstanding of the product and its corresponding market. We encourage the FSB to ensure that its policy framework is accurate in its assumptions and properly balanced so as not to restrict the recovery of sound securitisation activities, and we broadly commend the approach taken by IOSCO under WS4 in this regard. We also consider the findings of the Bank for International Settlements noteworthy[10]. To avoid confusion, we have sought to provide clarification of certain key points in Appendix 5 to this response.

Lastly, we wish to note that, in keeping with the general findings of IOSCO in the context of WS4, when considering the regulatory needs in the securitisation field, GFMA members strongly encourage the FSB and policymakers alike to take into account the substantive steps already taken by regulators and by the market itself (including initiatives such as the Prime Collateralised Securities (PCS) initiative which has been launched in Europe[11] and acknowledged with support by IOSCO) to ensure that securitisations demonstrate sound attributes.

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[9] For further information, please see Appendix 4, being the data submission prepared in December 2012 by the Association for Financial Markets in Europe (AFME) regarding historic liquidity funding for multi-seller ABCP conduits.

[10] For further information please see the BIS Working Paper No.341 dated March 2011 linked here http://www.bis.org/publ/work341.pdf.

[11] Certain basic information on the PCS initiative is set out in Appendix Four to the IOSCO final report on global developments in securitisation regulation. Further information is available via the PCS website at www.pcsmarket.org.

Responses to specific questions

Q1. Do you agree that the high-level policy framework effectively addresses shadow banking risks (maturity/liquidity transformation, leverage and/or imperfect credit risk transfer) posed by non-bank financial entities other than MMFs? Does the framework address the risk of regulatory arbitrage?

We welcome the FSB's approach to developing toolkits which have the purpose of mitigating systemic risks and regulatory arbitrage. The GFMA is supportive of developments which seek to remove inconsistencies in regulation across the regulated sectors, such as banking, insurance etc. We consider it important that any measures developed are created mindful of broader regulatory change to the financial system. Activities that cause similar systemic risks should be regulated in a similar way so as to limit unintended opportunities for regulatory arbitrage.

We share the sentiment, as expressed in the FSB's over-arching principles, that (i) the shadow banking system manifests itself differently across geographical markets; and (ii) the policy toolkits should be deployed appropriately. We are concerned that the policy framework as currently proposed is insufficiently focussed on systemic risk. Therefore, to be consistent with the FSB's stated aims we recommend the FSB to perform more work to understand current and future systemic risk. However, we would expect that, notwithstanding the characteristics of local markets, the risks associated with shadow banking are the same across jurisdictions – even though certain manifestations of the risks may not be currently obvious in a particular location. Therefore, as the shadow banking system is a global concern, to address adequately the risks posed by regulatory arbitrage we suggest it necessary to harmonise the definition of the regulatory perimeter and clarify triggers for the toolkits. Consequently, we are concerned that the first over-arching principle of the FSB policy framework, that "*Authorities should have the ability to define the regulatory perimeter*", may inadvertently exacerbate the opportunity for regulatory arbitrage.

We query the basis on which the FSB has created its list of systemic risks (maturity/liquidity transformation, leverage and/or imperfect credit risk transfer) and are concerned that this list derives from a focus on the crises of the past and fails to be current or exhaustive. Furthermore, we do not agree with depicting these activities as always being of inherent detriment to the economy. Indeed, many of these activities are essential for funding future economic growth.

As both the regulatory landscape and features of products have changed since the onset of the recent financial crisis, we would encourage the FSB to refocus its analysis to current and future risks rather than purely those of the last crisis. Failure to take a future looking approach risks overlooking the systemic risks of tomorrow.

Inconsistent regulatory standards not only exacerbate regulatory arbitrage opportunities but increase the legal risk and costs posed to firms seeking to carry out cross border activities. Therefore, we suggest that the first over-arching principle is counter-intuitive to furthering consistent industry standards. We would encourage the FSB to focus on legal certainty and predictability when developing the policy framework.

As considered further in our response to question 2 below, we are concerned that measures mandating firms to hold certain types of assets, especially short term, liquid assets will create further limits on regulated firms (such as banks) being able to raise funding. Therefore, although the GFMA understands the FSB's objective to mitigate the risk of runs within the shadow banking

system, we are concerned that measures affecting liquidity may have the inadvertent ramification of increasing the cost of funding for regulated firms and, consequently, cause an adverse impact on long term financing and growth. Indeed, if market participants are required to hold more short term liquid assets this will likely reduce the demand for long term assets. A direct repercussion of such measures may be to raise the cost for market participants seeking to raise long term funding, which in turn is damaging to long term economic growth.

We would encourage the FSB to consider further whether mandating firms to hold short term, liquid assets will result in a shortfall of such assets. Further we believe the FSB should carry out a detailed analysis of the ramifications of other measures currently being implemented/planned before imposing new measures relating to the holding of short term liquid assets.

Q2. Do the five economic functions set out in Section 2 capture all non-bank financial activities that may pose shadow banking risks in the non-bank financial space? Are there additional economic function(s) that authorities should consider? If so, please provide details, including the kinds of shadow banking entities/activities that would be covered by the additional economic function(s).

As stated above, we are concerned that establishing the concept of "economic functions" into which services are to be mapped is an imprecise mechanism for identifying systemic risks. Indeed, those "economic functions" that the FSB has identified appear crude. For example we are concerned that the "economic functions" are treated as exhaustive but do not correlate to identified systemic risks. Actual systemic risks may exist outside the economic functions identified and, consequently, are not captured. Failure to focus first on identifying systemic risks may result in some risks being missed and some risks being treated differently where present across economic functions. The GFMA is concerned that such an approach may result in regulatory inconsistency and opportunities for arbitrage.

In addition we are unclear why securitisation is treated as an economic function. We query whether (i) such a characterisation is appropriate for the activity of securitisation per se; and (ii) which parts/roles performed by parties to a securitisation represent systemic risk. Furthermore, we consider that the concerns expressed with regards to "runs" should be focussed only on runs that pose a systemic risk. Such a proportionate approach requires a more detailed consideration of risks, to ensure that tools against runs are only applied where the run relates to a genuine risk of systemic concern. Furthermore, we are concerned that the FSB does not detail how it would apply measures where an entity carries out multiple activities, some of which overlap the economic functions identified. The Consultative Paper does not appear to currently envisage such a scenario.

Whilst we are not opposed to the two-step approach adopted by the FSB as a means to identify participants in the shadow banking system, we are concerned that, outside of the specific examples provided, it remains uncertain for firms as to whether their activity falls within an "economic function". Similarly, we note that the toolkits developed for each economic function are not comprehensive, as the Consultative Document envisages additional tools being developed via other FSB workstreams.

When viewed within the context of the first overarching principle, which defers the regulatory perimeter to local regulators, we are concerned that the policy framework is currently too imprecise. As we articulate elsewhere in this response, the GFMA believes that any new regulatory developments should be consistent with the concept of providing regulatory certainty.

GFMA members support the FSB's approach in avoiding attempting to identify specific entities that pose systemic risk. However, we would encourage the FSB to take a risk sensitive approach based on systemic risk, instead of using the "economic functions" as currently proposed. We believe that the main thrust of the FSB's analysis should be on identifying systemic risks.

Securitisation as an economic function

Securitisation in general should not be included as an economic function

Significant concerns have been raised with respect to the proposed inclusion of securitisation in general as an economic function. Such an approach does not take into account the wide range of activities and structures which are commonly regarded as falling within this and does not properly identify the areas of potential concern from a shadow banking perspective. Such a reference is also confusing given that securitisation is generally understood to be a financing technique (rather than being an economic function in itself). In general, we consider that the FSB's policy framework should remain closely focused on shadow banking activities giving rise to systemic risk and justifying regulation – which by definition should not include activities already falling within the regulatory perimeter.

Need for a systemic risk based approach

As noted in our general comments above, we encourage the FSB to focus on identifying systemic risks and measures to mitigate such risks. A general reference to securitisation fails to properly identify the areas of potential concern from a shadow banking perspective.

We consider that a systemic risk based approach is also appropriate given the focus by FSB workstream WS4 specifically on securitisation. As noted in the FSB's consultative document which provides an integrated overview of the policy recommendations, a number of regulatory reforms designed to address the systemic vulnerabilities associated with securitisation in general have been put forward since the financial crisis and dedicated work on the need for further policy and regulatory action in this area has been undertaken by IOSCO through WS4. Taking into account the work on securitisation undertaken by WS4, we consider that the inclusion of securitisation as a targeted economic function in WS3 represents an unjustified "doubling up" of focus on securitisation by the FSB.

We also consider that a systemic risk based approach is necessary to avoid the "one-size-fits-all" approach with respect to securitisation which seems to underlie the current proposals set out in the Consultative Document and to ensure that appropriate distinctions are made between different securitisation structures and products.

Current focus on maturity mismatch in a securitisation context is misplaced

We note that the Consultative Document places considerable emphasis on maturity transformation in a securitisation context. This comes up in the securitisation focused sections and also in other sections of the Consultative Document which refer to certain securitisation arrangements. We consider this focus to be misplaced as it does not reflect the majority of the securitisation market by volume of liabilities issued.

Most of the global ABS market is made up of "traditional" term securitisations of real economy assets and a sizeable majority of such transactions are self-liquidating[12]. This means that the investors' rights to repayment of principal are dependent on the securitised assets producing cash and, as a result, no material maturity transformation is involved. In a multi-seller ABCP conduit, to the extent that such arrangements are not match-funded, it should be noted that the corresponding maturity mismatch is absorbed through the existence of liquidity lines provided by banks – meaning that there should be no maturity transformation at the level of the ABCP conduit.

Moreover, such liquidity activities are subject to banking regulation and, as such, are not outside the regulatory perimeter and/or in the "shadows". Relevant banking regulation in this regard includes the regulatory capital requirements which apply to risk exposures (which requirements are under review by the Basel Committee), and will also include (once Basel III is implemented) requirements to hold liquid assets against relevant liabilities (thereby further reducing any risks related to exposures to conduit vehicles). Such regulation (which should operate to effectively remove various ABCP conduit related exposure points from any realm of shadow banking), and the need to achieve an appropriately calibrated treatment of securitisation in general, is not acknowledged in the current proposals. It should also be noted that data has shown that, in a multi-seller conduit context, through the crisis, such liquidity has not been susceptible to "runs" and such conduits have continued to fund a very high percentage of their total commitments, as they were designed to do.[13]

In general, we note that a sizeable majority of securitisations do not operate to fund long-term illiquid assets by raising short-term funds in a manner which results in shadow banking giving rise to systemic risk. This activity is more consistent with structured investment vehicles (SIVs), which arrangements are no longer operational in a manner which could pose systemic risk and certainly not reflective of the wider securitisation market used to fund real economy assets. We do not consider it appropriate to equate securitisation in general with SIVs and the comparison chart included in Appendix 3 to this response provides an overview of certain key differences between the two arrangements.

Number of regulatory initiatives have already been put forward with respect to securitisation

Given the significant number of regulatory initiatives which have been put forward with respect to securitisation,[14] we do not consider that our suggested shift away from including securitisation in general as an economic function would give rise to risk of regulatory arbitrage. While we do not agree with certain statements made by the FSB with respect to securitisation and regulatory

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[12] There are of course some exceptions to this for example, CMBS transactions and certain leasing transactions may carry some refinancing risk.

[13] For further information, please see Appendix 4, being the data submission prepared in December 2012 by the Association for Financial Markets in Europe (AFME) regarding historic liquidity funding for multi-seller ABCP conduits.

[14] Such initiatives would include those related to risk retention and transparency referred to in IOSCO's final report in the context of WS4, the proposed changes to the regulatory capital treatment of certain related positions in the context of CRD4 and Solvency II, further recent proposals on risk-based capital treatment by the Basel Committee, the multitude of specific securitization-related provisions of the Dodd-Frank financial reform legislation in the United States, and other independent efforts of the global regulators.

arbitrage,[15] as a bottom line we would note that it is clear that the regulatory capital position of securitisation is under examination and any perceived deficiencies in this regard are under review already.

We also wish to note that, in keeping with the general findings of IOSCO in the context of WS4, when considering the regulatory needs in the securitisation field, GFMA members strongly encourage the FSB and policymakers alike to take into account the substantive steps already taken by regulators and by the market itself to ensure that securitisations demonstrate sound attributes. Such market-led initiatives have been acknowledged with support by IOSCO, and include the Prime Collateralised Securities (PCS) initiative which has been launched in Europe.[16] We encourage the FSB to take account of IOSCO's observation that "it will be beneficial if the impact of the recent legislative and regulatory changes in securitisation (almost all of which have been in effect for less than two years) are given time to have their impact assessed before any further (and potentially duplicative) additional regulations are introduced".

We note that the Consultative Document fails to acknowledge the current regulatory treatment of securitisation in certain respects. For example, the proposals refer to the preferential regulatory capital treatment of certain liquidity facilities under Basel I, notwithstanding the fact that this treatment was revisited under the Basel II framework and has not applied in general in many key jurisdictions (including the EU and the U.S.) for many years. It is not clear why reference would be made at this point to the regulatory capital treatment of positions under Basel I and any consideration of shadow banking related risks now must take into account the latest regulatory position and treatment.

General concerns regarding level of understanding of securitisation and potential negative signalling effect under FSB proposed approach

Concerns have been raised with respect to certain remarks made in paragraph 2.5 of the Consultative Document regarding the nature and use of securitisation, certain of which remarks we believe are based on mistaken assumptions. For example, in the main, securitisation was not used by banks to "avoid bank regulation" and, as acknowledged by IOSCO in the context of WS4, a range of regulatory initiatives have been put forward since the beginning of the financial crisis to address perceived deficiencies in the market. If there is evidence available to demonstrate a significant regulatory avoidance trend we would be very interested to see it and to discuss it further with the FSB.

Paragraph 2.5 further suggests that securitisation may possibly aid in the creation of (amongst other things) excessive maturity transformation. As we have explained above, the composition of the securitisation market indicates that concerns regarding maturity transformation are misplaced in the context of the majority of securitisation transactions.

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[15] For example, in FSB's consultative document which provides an integrated overview of the policy recommendations, it is stated that "securitisation was designed to circumvent the bank capital framework (Basel I) in place before the crisis". We refer to Appendix 5 for clarification with respect to this and certain other statements made in the FSB consultative documents.

[16] Certain basic information on the PCS initiative is set out in Appendix Four to the IOSCO final report on global developments in securitisation regulation. Further information is available via the PCS website at www.pcsmarket.org.

Lastly, we note that the inclusion of securitisation as an economic function and any approach taken by the FSB which is based on mistaken assumptions along the lines referred to in the Consultative Document will have a negative signalling effect with respect to the securitisation market in general. We encourage the FSB to ensure that its policy framework is accurate in its assumptions and properly balanced so as not to restrict the recovery of sound securitisation activities.

Q3. Are the suggested information items listed in the Annex for assessing the extent of shadow banking risks appropriate in capturing the shadow banking risk factors? Are there additional items authorities could consider? Would collecting or providing any of the information items listed in the Annex present any practical problems? If so, please clarify which items, the practical problems, and possible proxies that could be collected or provided instead.

As stated above, we query the basis on which the FSB has created its list of shadow banking risks (maturity/liquidity transformation, leverage and/or imperfect credit risk transfer) and are concerned that this list derives from a focus on the crises of the past and fails to be current or exhaustive. We consider that before developing regulatory tools it is necessary to conduct a detailed analysis of systemic risk, framed in the context of all other regulatory developments.

To ensure data requests are proportionate and necessary, before requiring the provision of data we would encourage the FSB to carry out a gap analysis of existing data provision.

Securitisation

The information types referred to in the table do not focus on particular types of securitisations (e.g. those involving targeted economic functions). This suggests that, under the proposals, the relevant information would be required to be reported for all arrangements regarded as being a securitisation. This is problematic given that securitisation is not defined and that many securitisation-related activities would not give rise to any shadow banking concerns involving systemic risk. As indicated above, we do not think securitisation in general should be included as an economic function.

Concerns have been raised that the use of the proposed data points will result in misleading information being taken into account by authorities in their corresponding shadow banking risk assessments. For example, the data points relating to weighted-average remaining maturity of assets/liabilities should not be relevant in the context of securitisations which do not involve maturity transformation (or which involve certain mitigating factors, such as regulated bank-provided full liquidity lines, which effectively remove any mismatch at the vehicle level). In addition, reporting on the amount of "liquid" assets for any securitisation that is not reliant on the sale of the assets (which includes a sizeable majority of securitisations of real economy assets) would be misleading.

The proposed reporting requirements are unclear in a number of respects. For example, it is not clear why reporting should be required with respect to the interest retained by the originator or sponsor when it is expected that interest alignment requirements will set minimum obligations in this regard. It is also unclear why it should be necessary to report on the attachment point for the equity tranche only, particularly if other tranches in the transaction have been placed with third party investors.

More generally, to the extent that the information is not already available, it is not clear which entity involved in a securitisation would be required to provide the information referred to in connection with the proposed economic function. We note that the relevant non-bank entity involved (i.e. the securitisation special purpose vehicle or conduit) will not have access to all of the required information. While originators may be able to provide certain information, it should be noted that certain transactions (including typical multi-seller ABCP conduits) may involve more than one originator and certain transactions (such as managed CLOs) may not involve an originator per se.

Lastly, to the extent that any further reporting requirements are proposed to be put in place in connection with any shadow banking targeted regulatory regime, we respectfully remind the FSB of the need to consider the considerable volume of data that is already made available with respect to public securitisations in general and then consider whether there are any gaps that require additional data to be provided.

Q4. Do you agree with the policy toolkit for each economic function to mitigate systemic risks associated with that function? Are there additional policy tool(s) authorities should consider?

We welcome the concept of developing a policy toolkit but are concerned that the FSB's limited focus on systemic risks renders the proposed measures imprecise and difficult to assess for effectiveness/appropriateness. We would encourage the FSB to expand its analysis of tools to expand beyond mechanisms for regulatory intervention but to include non-legislative tools.

We note that many of the policy toolkits proposed for the differing economic functions overlap with each other. To this end, we consider below the policy tools by type. As an over-arching comment, we encourage regulatory authorities to focus on effective supervision rather than invasive/regressive tools which restrict product innovation and investment choice. Invasive measures should be a last resort, used only where objectively proportionate.

As detailed further above, we are concerned that many of the tools risk disproportionately infringing on investor freedom and product innovation. Therefore, deployment of such tools would be highly sensitive. Before their use such tools would need to be backed by detailed objective reasoning. Furthermore, inconsistent application of such tools between FSB constituent members would risk creating global market distortions as well as opportunities for regulatory arbitrage.

Tools to manage liquidity risk and capital requirements

As stated elsewhere in this response, we are concerned that mandating firms to hold more short term, liquid assets will increase the cost of acquiring such assets and may result in a shortfall. As banks and certain other regulated entities are being required to hold increased amounts of short term liquid assets, this will increase their cost of funding, which in turn will be detrimental to economic growth. Instead of limiting investor freedom and product innovation, we believe that regulators should ensure that firms prudently manage risk.

In addition to the comments on the tools detailed above, we have the following additional comments on tools for specific economic functions.

Economic function 1: Management of client cash pools with features that make them susceptible to runs policy toolkit (EF1)

The GFMA recognises that pooled investor funds, which seek to offer low principal risk and rapid redemptions, historically have been viewed by some investors as deposit-like. Consequently, where pooled investment funds or broader market conditions are stressed and negative sentiment prevails, such funds may be exposed to investor "runs".

We consider the proposed policy toolkit for EF1 particularly invasive, seeking to impose requirements on the types of asset funds can hold, leverage ratios and liquidity etc. It is important that the requirements imposed through such tools are calibrated at a level proportionate to reducing systemic risks EF1 entities may create.

In practice, the GFMA notes that the product features of pooled investor funds currently brought to market are markedly different from those demonstrated at the outset of the financial crisis. Consequently, we consider that the systemic risk posed by new funds is low and part of this is the fact that investors' expectations post crisis are much more realistic and measured.

We would reiterate the role of other, non-invasive, tools such as appropriate disclosure and investor education as a way of changing investors' perceptions as to the risks assumed in making particular investments which are understood to be highly liquid.

Any discussions regarding bank interconnectedness should be outside the scope of EF1 proposals as they are dealt with separately through a different workstream.

Economic function 2: Loan provision that is dependent on short-term funding policy toolkit

The toolkit proposed for EF2 is predicated on the abundant availability of equity funding to support all non-bank lending activities. We would encourage the authorities to focus on particular types of lending activities the failure of which given a certain scale could pose systemic risks. This is likely to contribute to a much lower number of entities providing loans to be captured and these are likely to be those engaging in activities comparable to banks.

Economic function 5: Securitisation policy toolkit

Confirmation of proposed available policy tools in securitisation context

It is our understanding that the Consultative Document seeks to provide for two securitisation-focused policy tools in the context of the proposed securitisation economic function – i.e. proposed tool 1 (referring to restrictions on maturity/liquidity transformation) and proposed tool 3 (referring to restrictions on exposures to, or funding from, banks or other financial entities).

Given the reference to the funding of illiquid portfolios held "on-balance sheet" in the context of proposed tool 2 (referring to restrictions on eligible collateral), we have assumed that proposed tool 2 included in the section relating to securitisation and funding of financial entities is not intended for direct use in a securitisation context (which would be consistent with examples provided which refer to synthetic ETF arrangements). As such, we have limited our comments in this regard to certain (indirect) issues which may arise from a securitisation perspective if this tool is applied to restrict the use of transactions such as liquidity swaps.

For the avoidance of doubt, we have also assumed that it is *not* intended that the economic function referring to "loan provision that is dependent on short-term funding" and the corresponding full package of policy tools (set out in paragraph 3.2.2) would apply in a securitisation context in general. It is our understanding that this economic function and corresponding toolkit would be relevant from a securitisation perspective only to the extent that a relevant finance company used securitisation as a funding tool. We consider that this reading of the relevant provisions is supported by the text of the proposals and the description provided in paragraph 2.2 of the Consultative Document. However, if it is intended that the full package of policy tools set out in paragraph 3.2.2 may be applied in the context of securitisation vehicles, then we would have further comments as, for example, the application of capital and liquidity requirements in respect of ABS vehicles would be highly problematic.

Securitisation and funding of financial entities – proposed policy tool 1 – restrictions on maturity/liquidity transformation

As noted above, a sizeable majority of securitisations do not involve significant maturity transformation and those that do involve an element of this (e.g. certain ABCP conduits) will also typically involve certain key mitigating factors which operate effectively to remove the maturity mismatch at the conduit level and to remove the relevant arrangements from the scope of shadow banking (e.g. via regulated bank-provided full liquidity lines). We consider that, in order to achieve outcomes properly focused on appropriate shadow banking activities (i.e. those giving rise to systemic risk and justifying regulation), the policy framework should allow for the application of the policy tools in a manner which takes account of these mitigating factors and acknowledges the activities already effectively within the regulatory perimeter through banking and other regulation and does not require more rigid application.

In the context of liquidity transformation, we note that a sizeable majority of traditional securitisations of real economy assets do not provide for or rely on the sale of the assets[17]. This reflects the self-liquidating nature of such transactions and that it is intended that investors will be repaid from the asset cashflows (rather than from amounts received via a portfolio sale or refinancing of the assets). As above, such deals are either match-funded or they involve mitigating factors such as regulated bank-provided full liquidity lines.

More generally, we would caution the FSB against the introduction of potentially rigid restrictions with respect to maturity and liquidity transformation. Any restrictions introduced in this regard should be proportionate and justified and should take into account the accompanying risks and the benefits of relevant transactions. Quantitative analysis of the activity and its impact on the wider economy should be undertaken. Account should also be taken of wider bank regulatory pressures, including increasing regulation of liquidity risk and the current re-examination of regulatory capital requirements for securitisation by the Basel Committee, and of the presence (or not) of other options available for the funding of real economy assets.

We agree with the concern noted in the Consultative Document that authorities may face difficulties in assessing the appropriate maturity mismatch beyond which restrictions should be imposed and consider that, once again, sufficient flexibility would be required to allow authorities to identify appropriate outcomes based on all elements of the relevant arrangements. Lastly, we welcome the

[17] There are of course some exceptions to this; for example, CMBS transactions and certain leasing transactions may carry some refinancing risk.

acknowledgement that any restriction would have to be tailored to different securitisation structures, taking into account their respective strategies. These strategies should include any mitigating factors and acknowledge activities already effectively within the regulatory perimeter, as noted above.

Securitisation and funding of financial entities – proposed policy tool 3 – restrictions on exposures to, or funding from, banks/other financial entities

With respect to the proposed restriction on exposures to, or funding from, banks or other financial entities, we would note that aspects of this are unclear and alarming. The Consultative Document refers to restrictions "on the exposures of banks or of other financial entities to such funding vehicles" which appears to be intended to operate as a limit on the availability of securitisation as a funding tool in general. We strongly object to the highly negative tone implied for securitisation here and oppose any proposed restriction on the exposures of banks and other financial entities to securitisation vehicles. Indeed, in current economic conditions and as the global banking system continues to undergo major deleveraging, the policy objective should be precisely the opposite – to encourage new, especially non-bank, investors to enter into the securitisation market to help provide funding for real economy assets and thereby assist in global economic recovery.

To the extent that positions are held by the banks, such exposures are already within the regulatory perimeter given the existing bank regulatory framework which regulates (or will soon regulate) various points of connection between banks and non-bank entities, including through regulatory capital, liquidity and large exposures provisions. Similarly, regulatory capital requirements apply with respect to the exposures held by insurance undertakings and these will be further strengthened in the EU via the Solvency II regime. In principle, exposures which are already regulated should not be construed to constitute shadow banking.

The policy tool also refers to "limits on non-banking entities' overall exposure to banking counterparties (including intra-group), as well as diversification limits to single counterparties". As anticipated by the FSB in its corresponding comments, any such limits run the risk of significantly reducing the feasibility of certain securitisation arrangements, as market participants may struggle to identify a wider range of funding providers and other counterparties on a basis which is feasible from a cost perspective. More generally, it is not clear that the introduction of the proposed restrictions would address the concerns referred to in the context of the relevant proposed tool (such concerns being described relate to bank reliance on securitisation funding and origination standards deterioration). In the case of concerns relating to asset underwriting standards and the alignment of incentives between originators and investors, we would note that FSB workstream WS4 has already focused closely on these issues through its work on risk retention and other methods of aligning incentives.

Securitisation and funding of financial entities – proposed policy tool 2 – restrictions on eligible collateral

As noted above, we have assumed that it is not intended that this policy tool will be available for direct use in a securitisation context. However, we wish to make certain comments on this tool to the extent that it could be used to restrict liquidity access arrangements such as liquidity swaps. Such arrangements may involve the borrowing of cash or other relatively liquid assets in exchange for ABS (including ABS originated by the liquidity buyer, or "own-name" ABS) or other securities as collateral.

We consider that collateral upgrade transactions and other collateralised lending transactions provide a key method by which firms may lower their liquidity risk (an issue of increasing importance given the coming further requirements in this area). Any restrictions on the ability to use securitisation collateral in this context may further restrict the liquidity of the ABS markets. Further, such restrictions limit the ability of investors to undertake prudent long term financing investment strategies and thereby could impact long term financing of the global economy.

We consider that it should not be necessary to introduce a rigid restriction with respect to such transactions because, as with any collateralised lending transaction, it is our understanding that a liquidity seller will typically apply prudent risk management practices to address any liquidity transformation risk, including the application of collateral haircuts and policies to hold the collateral to maturity (rather than applying a policy which permits a fire sale of the relevant securities). In addition, data indicates that transactions involving own-name ABS should not necessarily be regarded as involving heightened correlation risks, provided that the underlying assets are of sufficiently high credit quality and that there is a sufficient haircut to cover short-term price correlation.

For further information, please see the joint comment paper prepared in 2011 by the Association of Financial Markets in Europe (AFME) and the British Bankers' Association (BBA) in response to the UK Financial Service Authority's Guidance Consultation 11/18 on liquidity swaps.[18]

Loan provision that is dependent on short-term funding – proposed policy tools 6 and 7 – restrictions on types of liabilities and monitoring of the extent of maturity mismatch between assets and liabilities

Certain other proposed tools referred to in the Consultative Document may also be significant from a securitisation perspective. For example, in connection with the proposed economic function described as "loan provision that is dependent on short-term funding", proposed policy tool 6 refers to a restriction on the use of certain funding instruments such as ABCPs and possible concentration limits with respect to lenders/sectors/instruments and proposed policy tool 7 refers to the need to monitor the extent of maturity mismatches between assets and liabilities.

Our concerns noted above with respect to the proposed securitisation policy tools 1 and 3 would apply equally in the context of these proposed tools to the extent that they may be used in a manner restricting the availability and use of securitisation as a funding tool. In particular, as noted above, in the context of ABCP conduits, we consider that it is necessary to take account of certain key

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[18] The Consultation Paper can be accessed via http://www.fsa.gov.uk/pubs/guidance/gc11_18.pdf. The AFME/BBA joint comment letter can be accessed via www.bba.org.uk/download/7174.

factors which operate to mitigate the potential maturity transformation issues (e.g. regulated full liquidity lines provided by banks).

It is helpful that the FSB has acknowledged, in the context of proposed policy tool 6 (referring to restrictions on types of liabilities), that restrictions should not apply where there are appropriate securitisation and risk management processes in place, although we note that it is not clear what features are intended to define "appropriate" processes for these purposes.

Guiding principles for securitisation-related policy tools

In conclusion, we wish to emphasise that we consider that the need to maintain securitisation as a viable financing option should shape the policy tools available under the proposed framework. Securitisation, prudently deployed and sensibly regulated – as it already is – along with secured and unsecured wholesale funding and retail funding has a key role to play in the overall funding of global banks' balance sheets and should be encouraged. As recent reports have highlighted, high quality securitisation provides a number of economic benefits and securitisation transactions have performed well over the course of the financial crisis, with certain (well-known) exceptions (e.g. transactions backed by U.S. sub-prime mortgages).[19] Please refer to Appendix 2 for a summary of performance information for certain key asset types.

With respect to transactions backed by U.S. sub-prime mortgages, we note that the key point is that the problems in this specific sector, which of course were material and systemic, do not mean that high quality securitisation in general is not a sound financing technique. Regulation should not seek to scapegoat securitisation. This is consistent with the findings of the Bank for International Settlements[20].

Moreover, we consider that it is necessary, in the course of developing any securitisation-related policy tools, to take into account the significant number of regulatory and other initiatives which have been put forward with respect to securitisation since the beginning of the financial crisis. As IOSCO has acknowledged in the context of WS4, time should be provided for the impact of these other initiatives to be assessed before any further (and potentially duplicative) additional regulations are introduced.

We urge the FSB to resist the adoption of general restrictions that do not take account of the diversity of the securitisation market by seeking to apply a "one-size-fits-all" approach, do not acknowledge the activities already effectively within the regulatory perimeter through banking and other regulation and do not provide authorities with sufficient flexibility to identify appropriate outcomes based on all relevant factors. Lastly, wherever possible, we encourage the FSB to strive for global consistency.

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[19] Please see the September 2012 report by the Association for Financial Markets in Europe (AFME) entitled "The Economic Benefits of High Quality Securitisation to the EU Economy", a copy of which is attached as Appendix 1 and linked here http://www.afme.eu/Documents/Statistics-and-reports.aspx

[20] For further information please see the BIS Working Paper No.341 dated March 2011 linked here http://www.bis.org/publ/work341.pdf.

Q5. Are there any costs or unintended consequences from implementing the high-level policy framework in the jurisdiction(s) on which you would like to comment? Please provide quantitative answers to the extent possible.

Our high level views are as detailed above in this response. However, we set out below our thoughts on securitisation

Given the considerable uncertainties that seem to us to exist in the Consultative Document regarding the proposals for regulating securitisation-related activities as part of shadow banking, we are not able to provide specific quantitative answers to this question. Depending on the precise intention behind the proposals, however, the costs and unintended consequences of an inappropriate approach could be very considerable indeed. Categories of costs in such a scenario would include not just the direct compliance costs for already regulated institutions of complying with a new, over-lapping, regime, but also the indirect costs of reduced funding being available through securitisation as a result of negative signalling driving yet more investors away from the market, increasing financing costs for issuers and, ultimately, for the consumers, home owners and small businesses who create the real economy assets being securitised.

<u>Conclusion</u>

Thank you once again for the opportunity to comment in response to this consultation. Should you have any questions or desire additional information regarding any of the comments, please do not hesitate to contact Sidika Ulker at sidika.ulker@afme.eu on +44 207 743 9305 or Richard Hopkin at richard.hopkin@afme.eu on +44 207 743 9375.

Yours sincerely,

Simon Lewis
CEO, GFMA

APPENDIX 1

AFME REPORT - THE ECONOMIC BENEFITS OF HIGH QUALITY SECURITISATION TO THE EU ECONOMY

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The Economic Benefits of High Quality Securitisation to the EU Economy

November 2012

About AFME

The Association for Financial Markets in Europe is the voice of Europe's wholesale financial markets. We represent the leading global and European banks and other significant capital market players.

Our purpose is to provide a practical, constructive market view to policymakers on the significant reforms taking place in the European financial system.

We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

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Table of Contents

1) Executive Summary – the specific rationale for change

2) State of the EU Economy

3) Changes in the European banking sector

4) State of European securitisation market

5) Assisting the funding of SMEs and the real economy

6) Implications of certain regulatory measures

Appendix - Overview of PCS initiative

Executive Summary – the specific rationale for change

Given the current state of the European economy, the impact of the Eurozone crisis, pro-cyclical changes to banking regulation, the inability of many European banks to directly access the capital markets, collateral encumbrance constraints, and investor capacity constraints on bank debt, it is important that European policymakers recognise and take proactive steps, together with the industry, to help encourage investment in high quality securitisations. According to recent estimates, by the end of 2012, the level of bank assets in the Eurozone will decrease by approximately 4.9% (€ 1.64 trillion) compared to 2011. Corporate loans are expected to contract by 4.7% (€ 224 billion) and are not expected to surpass their pre-crisis peak of € 4.8 trillion until 2015.[1]

The purpose of this report is to: a) summarise as well as provide details on the specific economic benefits of high quality securitisation to the overall European economy, b) provide information which is beneficial to investors, c) provide relevant highlights on changes to banks and regulations, d) provide data on the state of the European securitisation market, including its strong credit and secondary price performance, and e) provide highlights of recent industry initiatives to identify industry best practices in securitisation, such as the Prime Collateralised Securities ("PCS") initiative.

The specific rationale for increased investment in high quality European securitisations is highlighted below. Points 1-8 focus on funding issues, while the remainder focus on investor issues, financial stability, regulatory measures to date and industry initiatives. Supporting data is provided in the text which follows this Executive Summary.

1. Europe's economy is highly dependent on banks for funding, much more so than other major economies such as the US. In the EU, the size of the banking sector relative to GDP is large; bank assets total approximately 300% of GDP. The US bank sector is substantially smaller as a proportion of GDP than in Europe, with total bank assets just under 100% of GDP. This enables proportionately more borrowers more direct access to the capital markets than in Europe. Further, there is a funding gap estimated to be $43-46 trillion globally between 2012 and 2016, of which Europe accounts for at least one quarter.[2] Securitisation is a direct means to the capital markets and is an important means for closing the funding gap.

2. Current regulations have a pro-cyclical impact on banks, which forces them to adjust their balance sheets drastically at a time when the economy is faltering. Securitisations provide a means for banks to raise cash directly from capital markets investors, which enables the banks to continue lending directly to companies and consumers. Many of the regulatory changes create permanent, rather than temporary, changes to lending incentives. EU GDP shrank by 0.2% in the most recent quarter, while growth in the US was +0.5%.

[1] *Outlook for financial services*, Ernst & Young, Summer Edition 2012
[2] Standard & Poors

3. The specific impact of renewed securitisation on growth has not been quantified, but could be significant in terms of GDP. If securitisations provide funding which is incremental to banks' ability to place bank debt (in other words, is not a substitute for bank debt), and if the cash is used to support new lending (rather than refinancing), even a small net incremental increase in lending that meets these criteria would have positive impact on European GDP, currently € 12.6 trillion[3]. Further research is required on this specific relationship, but in any event, if increased securitisation can lead to increased volume of lending and/or lower prices to borrowers, increased securitisation will be a success.

4. Covered bonds and high quality securitisations are both a means of tapping the capital markets for funding for pools backed by good quality assets. There is clearly a further need for more combined issuance of these two instruments. In Q2 2012, the amount of placed securitisations outstanding was €842 billion (€1.8 trillion including retained tranches), while the balance of mortgage-backed covered bonds outstanding at December 2011 was €1.7 trillion (€2.5 trillion including public sector covered bonds; the breakout of placed vs. retained for covered bonds requires further research). The combined placed balance of these two instruments is relatively small compared to balances outstanding in December 2011 of Eurozone business loans of €4.7 trillion, residential mortgages of €3.8 trillion and consumer credit of €630 billion[4]. Of course, there are additional "real economy" securitisable assets owned by insurers and other institutions on top of this €9.1 trillion total for Eurozone banks.

5. Funding provided by new placed issuance activity in both of these sectors is declining. H1 2012 placed securitisation issuance is down approximately 20%, with issuance at €42 billion, down from €53 billion the prior year. Placed covered bond issuance is down 33% year-on-year through the end of August 2012, with YTD issuance volume of €164 billion, down from € 246 billion recorded at the same point last year[5]. For the full year 2011, there were €90 billion of European securitisations placed with investors, with issuance of placed covered bonds at €302 billion. This compares to pre-crisis placed securitisation issuance levels of €450 billion per year in 2006 and 2007[6]. Central bank liquidity initiatives may be one factor in this decline, but there are also other longer-term structural factors impacting investment, such as proposed capital charges and liquidity buffer eligibility.

6. The amount of funding that can be provided through securities/securitisation cannot simply be replaced by loans, although growth in the trading of secondary loans should be encouraged. Tradable "whole loan" pools are significantly less liquid than high quality, large size securitisations. Many institutional investors have the ability to purchase both bonds and loans, so an absence of securitisations can be viewed as wasting potential investment capacity.

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[3] *World Economic Outlook*, IMF, April 2012
[4] *Outlook for financial services*, Ernst & Young, Summer Edition 2012 .Note: outstanding levels of assets in the Eurozone
[5] *J.P Morgan Covered Bond Handbook 2013*,September 2012
[6] AFME

7. Securitisation increases banks' flexibility to tap additional sources of cash and liquidity, since securitisation investors look to the performance of asset pools, rather than credit of the bank, for repayment. This significantly broadens the pool of cash to be tapped to support economic growth. Also, unlike other products, given a fixed allocation of capital, securitisations enable originators to increase the amount of cash available to the economy, for those securitisations which transfer sufficient amounts of risk to third parties.

8. SMEs are a sector which is particularly sensitive to changes in bank lending, since SMEs cannot access the capital markets directly. In addition, SME lending can be impacted by a multiplier effect since SMEs are often customers of large corporates, and any impact of bank regulations on corporate lending impacts both sectors. Although over €103 billion of SME securitisations have been issued, not enough have been placed with third party investors.

9. From an investor standpoint, high quality securitisations can provide a very high-performing asset class for European insurers, and be potentially large in size. In 2011, European insurers held €7.7 trillion of assets and had new cash inflows from new premium of €1.1 trillion for investment in all types of instruments[7]. Securitisations backed by European receivables have performed well during the crisis, from both a credit and price perspective. The potential for additional funding provided by securitisation is significant; AFME estimates that if sufficient changes were made to the regulatory environment, combined with private sector initiatives such as the PCS initiative, that approximately €200-300 billion or more of funding could be provided through securitisations sold to third party investors, including insurance companies, pension funds, banks and others.

10. Given policymakers' growing concerns about asset encumbrance, securitisations provide a collateral-efficient means of raising cash as compared to other long-term secured funding techniques. Asset encumbrance reduces the ability of the financial system to absorb shocks; there is currently a shortage of good quality collateral in Europe and globally.[8]

11. Significant regulatory changes in Europe have already addressed pre-crisis concerns of policymakers and investors. Specifically, CRD 2, which has already been implemented, requires issuers to retain at least 5% economic risk in order to better align interests. In addition, investors are also required undertake significant due diligence prior to investment. Similar regulations will take effect for EU insurers under Solvency II. A summary of regulatory measures impacting securitisation is included in the text of this document.

12. To codify best practices in European securitisation, the industry is implementing PCS. PCS is a label which identifies best practices in securitisation quality, simplicity/standardisation,

[7] Asset levels provided by InsuranceEurope
[8] *Financing European Growth; The Challenge for Markets, Policymakers and Investors*, Llewellyn Consulting August 2012, available on AFME website www.afme.eu.

and transparency, which are attributes that lead to improved secondary market liquidity. In short, PCS helps define "high quality," although it is recognised there are additional securitisations that are high quality which are currently not included in the PCS label for a variety of reasons.

In summary, there are a wide variety of very sound economic reasons why high quality securitisation can provide significant benefits to European growth.

Discussion

State of the EU economy

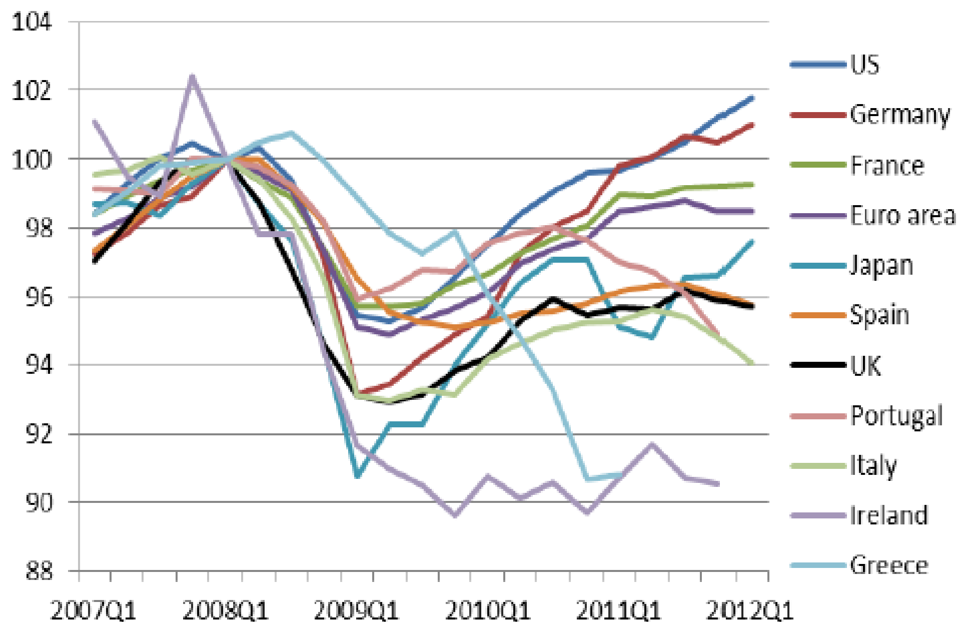
European vs. US economic growth

Europe is facing negative growth and weak investment. According to estimates released by Eurostat in August 2012, Eurozone GDP shrank by 0.2% compared with the previous quarter. A resilient economic performance from the Eurozones's biggest economy, Germany (which grew by 0.3% quarter on quarter) was offset by sharp contractions in the economies of Italy (- 0.7%), Spain (-0.4 %) and Finland (-1%). Meanwhile, he Greek economy shrank a year-on-year rate of – 6.2%.

Other leading countries are showing signs of progress: as a comparison, GDP in the United States increased by 0.5% in the second quarter compared with the previous quarter.

Chart 1 below shows the trend in the GDP level of various countries from the onset of the financial crises in 2007. Over this period, the Eurozone's GDP has risen from a low in Q1 2009, but this increase has gradually subdued and growth flatlined in January-March 2012.

Chart 1 - GDP Levels 2007- Q1 2012



Source: Eurostat. Notes 2008 Q1= 100

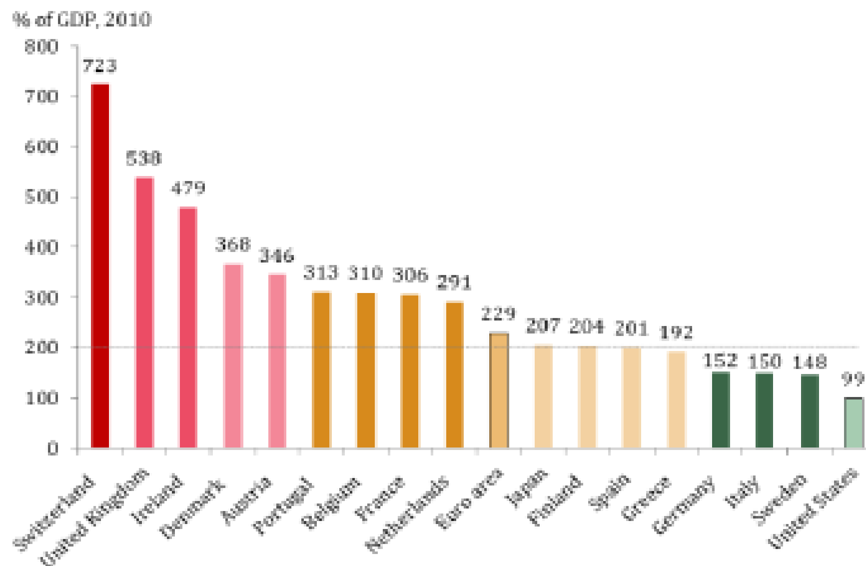
Unemployment

The EU area's seasonally-adjusted unemployment rate was 10.4% in June 2012, a clear indicator that the European real economy remains depressed. The estimates are that 25.112 million men and women in the EU were unemployed in June 2012. Compared with June 2011, unemployment rose by 2.165 million[9].

Changes in the European banking sector

Historically, European banks have provided a significant proportion of funding to the European economy. As Chart 2 shows, for the Eurozone, bank assets total around 250% of GDP; for the EU as a whole the number is closer to 300%. In the US, the capital markets are more developed and larger than in Europe, enabling borrowers more easily to bypass banks. As a result, the US bank sector is substantially smaller than in Europe, with total bank assets just under 100% of GDP In 2010, stock market capitalisation was $17.3 trillion in the US, significantly higher compared to $10.1 trillion in the EU.

Chart 2 - Banks' activities as a percentage of GDP



Source: IMF GFSR April 2012

[9] Eurostat Press Release ,July 2012

The banking sector has been severely affected by the financial crises. According to an EBF report, by the end of 2010, the number of banks in the EU had fallen by 2.2% to 6,825; of these, 5,404 were Eurozone based banks. Bank branches registered a decline as well, of 1.9%, to 215,000[10]; however, it is when focusing on banks' balance sheets and funding activities that the negative impact becomes clearly visible. Table 1 provides an overview of the Eurozone's banking sector, highlighting the recent trend in the banks' main asset classes and the prospects for the future.

Table 1 - Overview of bank asset composition in the Eurozone

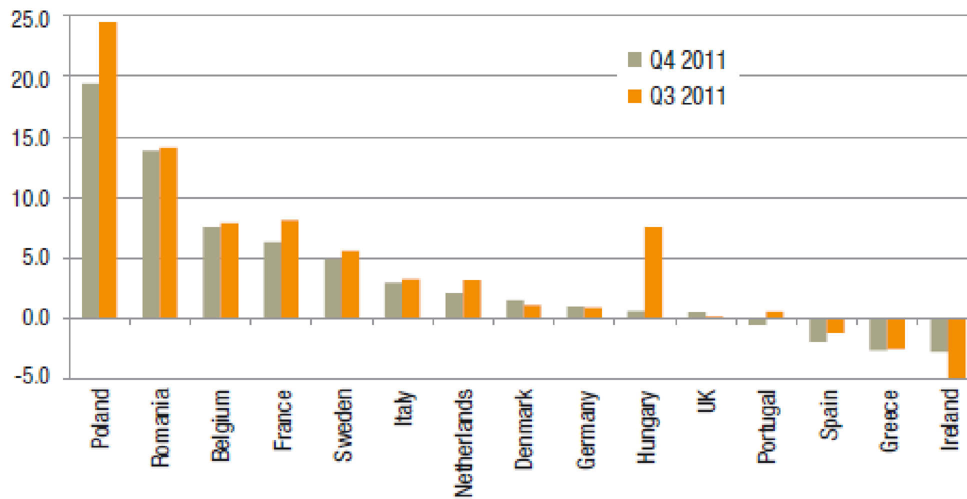
€ Billions	2011	2012	2013
Total assets	33,543	31,900	31,495
Total loans	12,322	11,841	11,849
Business/corporate loans	4,720	4,496	4,535
Consumer credit	628	587	587
Residential mortgage loans	3,784	3,743	3,770
Loan/deposit %	113	108	104

Source: Ernst & Young

[10] *Facts and Figures 2011/2012*, European Banking Federation (EBF).Note: figures are calculated on values expressed in local currencies for non-euro area countries.

With regards to the specific asset class of residential mortgage loans, Chart 3 shows, for each country listed, for Q4 2011 and Q3 2011, the growth in this asset class compared with the same quarter of 2010.

Chart 3 - Total outstanding residential lending, year-on-year growth rates (%)



Source: EMF

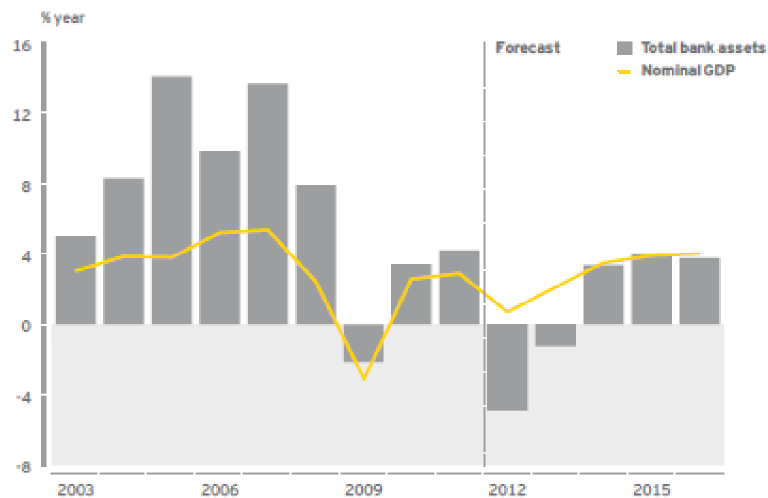
Year-end figures reveal that new mortgage lending continued to be affected by low demand, a result of ongoing macroeconomic tensions (poor GDP growth, high unemployment rates, continued sovereign debt crisis and subsequent high yields). Outstanding values were higher than Q4 2010 in most markets, but with rather modest increases. Overall, mortgage markets across the EU in Q4 2011 experienced their toughest moment since Q4 2008 and Q1 2009[11].

Over the course of 2011, pressures on European banks to deleverage increased, as funding strains intensified and regulators imposed new capitalisation targets. It is estimated that European banks will have to raise €200 billion in new capital or reduce their balance sheets by nearly 20% to achieve the new Basel III banking reform rules that start taking effect in 2013[12].As a result, many of these banks have shed assets, both through sales and by cutting lending. It is estimated that by the end of 2012, the level of bank assets in the Eurozone will fall by approximately 4.9% (€1.64 trillion) compared to 2011 levels; the amount of corporate/business loans will also decline, by approximately 4.7%, (€224 billion) and the downsizing will also affect residential mortgage loan and consumer credit classes.

[11] *Quarterly Statistics Q4 2011*,European Mortgage Federation (EMF)
[12] www.ft.com, referencing a Boston Consulting Group Report, *Facing New Realities in Global Banking: Risk Report 2011*

According to a recent Ernst & Young report, deleveraging by banks in the Eurozone is set to gather pace, as a result of high funding costs and the regulatory pressure to increase capital ratios (see Chart 4 below). The outlook is for banks in the region to reduce their assets by some €1.64 trillion this year. This would be a steeper asset decline than that experienced during the financial crisis. While this partly reflects low demand for loans, the amount of credit available to households and companies is also expected to shrink, curtailing consumer spending and business investment and, hence, overall economic growth.

Chart 4 - Eurozone banking sector assets and GDP



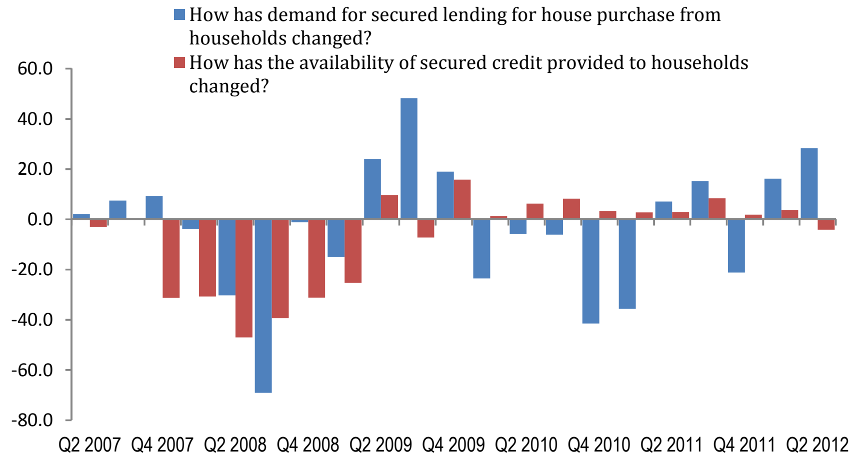
Source: Ernst & Young

According to the same report, the worsening outlook for loan quality will cause further tightening of credit conditions, while demand for loans will remain subdued, reflecting a forecast 0.6% contraction of GDP.

Against this background, corporate loans are forecast to contract by 4.7%. Corporate borrowers, especially SMEs, which rely on debt finance for 80% of their funding needs, are likely to face increased difficulties in accessing funding. As the funding gap widens, an open question is whether other financial institutions will be able to substitute for European banks as the latter continue to deleverage.

The supply and demand of credit to households has also been impacted during the crisis, as indicated in Chart 5 below.

Chart 5 - Demand and supply of credit to households

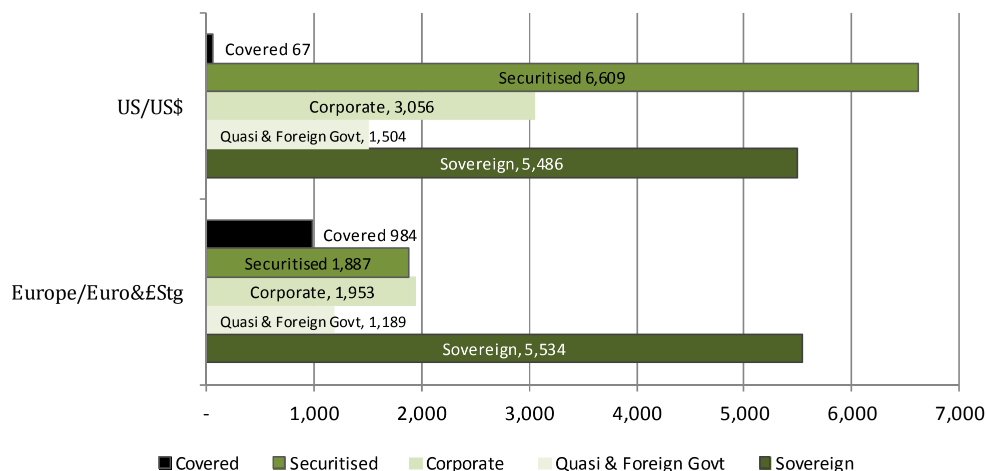


Source: Bank of England Survey Q2 2012

State of the European securitisation market

The major global securitisation markets are in the US and Europe. Chart 6 shows the substantial size of the securitisation market relative to other markets in these regions, reflecting the major role that it plays in financing real assets in the European and US economies.

Chart 6- Bond market relative sizes in US and Europe, € billions



Source: All data sourced from Banc of America Merrill Lynch fixed rate bond indices, except for Securitised. Securitised sourced from AFME Q1 2012 report. Note: All data in Euro billions or equivalent. "Securitised" categorisation is by region of collateral not currency. All data other than Securitised are for fixed rate index qualifying bond denominated in EUR, GBP or USD only. Index qualification criteria include minimum issue size of Euro250 million, GBP100 million and USD250 million. Covered Bonds: Index data used as full data not available as at 31March2012. The currency selection excludes DKK, NOK, SEK and CHF bonds among others from the index data used above. Total covered bonds outstanding globally in all currencies amounted to €2,501 billion equivalent at 31 Dec 2010 (Source: ECBC) of which €562 billion equivalent was floating rate and only €920 billion equivalent (47% of the fixed rate remainder) qualified for fixed rate index inclusion. Of the full 2010 total, €1,700 billion was denominated in Euro of which only €870 billion (51%) qualified for fixed rate bond indices at that date.

Securitisation grew significantly in Europe and in the Eurozone before the crisis[13]. In 2006 and 2007, pre-crisis issuance of European securitisation placed with third party investors reached €450 billion per year. With the outbreak of the financial crisis, issuance dropped to almost zero in 2008.

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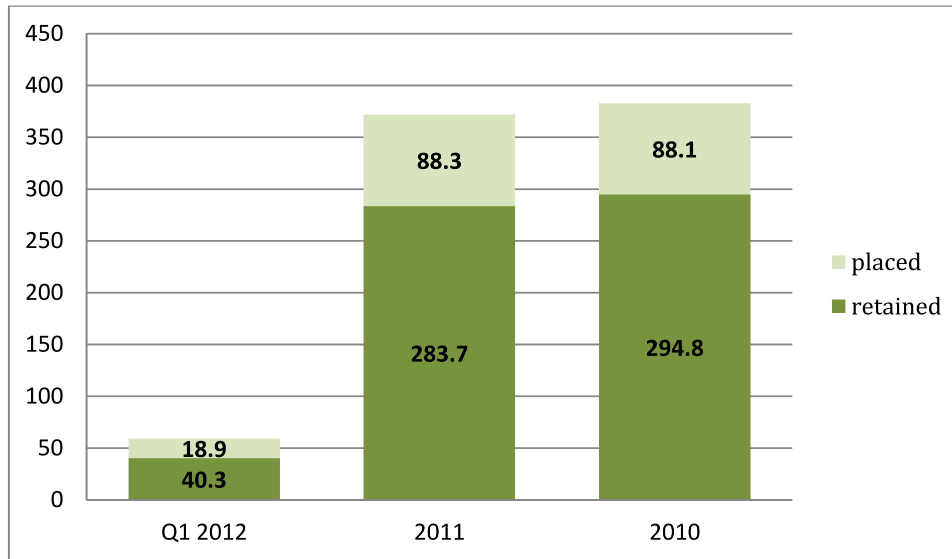
[13] *Shadow Banking in the Euro Area*, ECB Report 2012

As Chart 7 below illustrates, in 2010 and 2011, placement with third party investors was still only €80-90bn per year, due in large part to macro volatility, regulatory uncertainty and government/central bank liquidity programmes.

Chart 7 - European securitisation issuance 2010 –Q1 2012, € billions

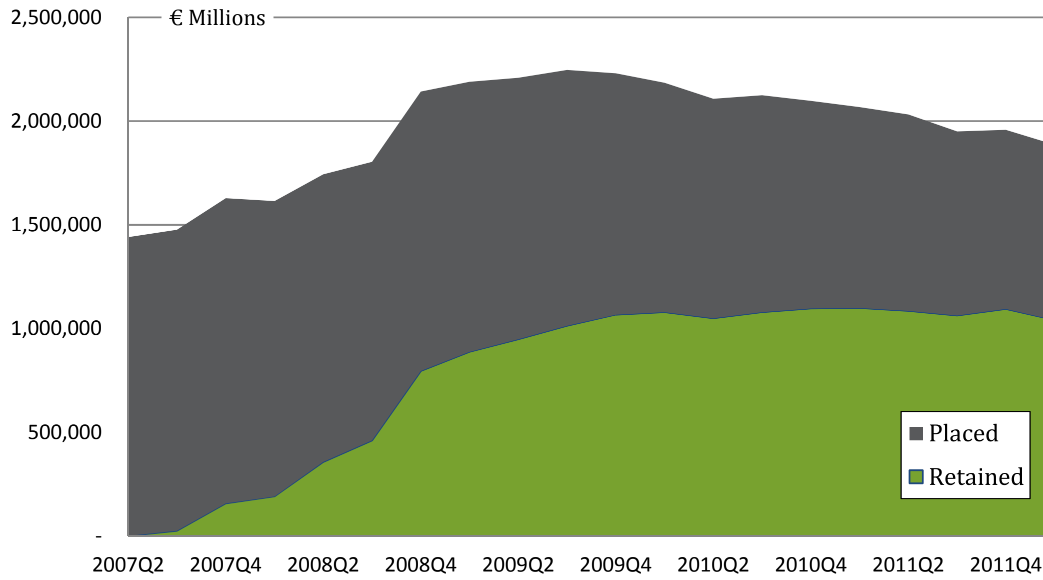


Source: AFME Securitisation Data Report Q1:2012

With regard to outstanding levels of securitised products, Chart 8 below illustrates the trend of placed vs. retained levels from Q2 2007 to the end of 2011. As highlighted, retention activity initiated around Q2 2007, as a result of the financial crisis. As of Q1 2012, approximately 45% of the total outstanding was placed with third party investors, while approximately 55% was retained on bank balance sheets, to be used for repo, or used for other secured funding. As a result, approximately €900 billion of currently outstanding securitisations has been placed with investors, down by one-third from approximately €1.4 trillion before the crisis[14].

[14] *AFME Securitisation Data Report Q1 2012*

Chart 8 - European securitisation outstanding 2008- Q1 2012



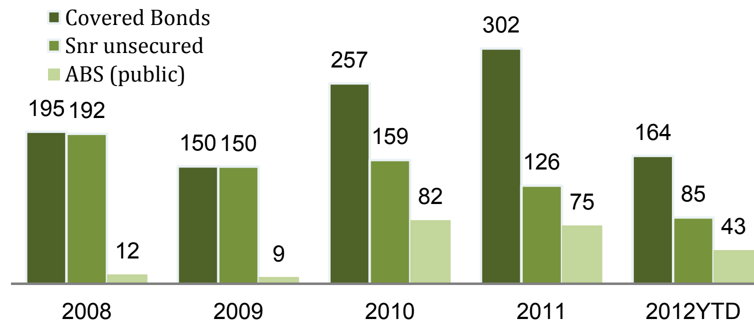
Source: AFME/SIFMA Members, AFME, Bloomberg, Dealogic, Thomson Reuters, SIFMA

Note: Retained outstandings do not contain retained, then subsequently placed, issues.

Covered bond market

In the covered bond market in 2012 there has been a drop in new issuance levels; at the end of August, distributed covered bond issuance was €164 billion, a sharp decline of 33 % from the €246 billion recorded at the same point last year, as shown in Chart 9.[15]

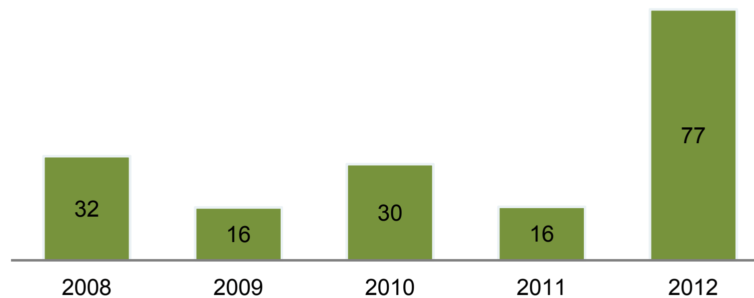
Chart 9 - Covered bond, ABS and senior unsecured issuance, € billions



Source : JP Morgan

The decline in issuance has coincided with higher covered bond retention levels, in particular from peripheral issuers (accounting for 99% of 2012 YDT retained issuance, broadly split between Italy and Spain), as highlighted in Chart 10.

Chart 10 - Retained covered bond issuance YTD, € billions

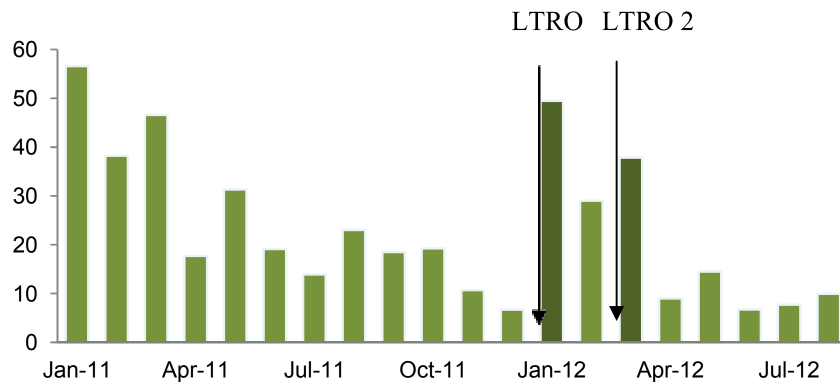


Source : JP Morgan

[15] *J.P Morgan Covered Bond Handbook 2013*,September 2012

Overlaying the timing of two of the non-conventional monetary policies adopted during the crisis (Chart 11), this year there have been see spikes of retained issuance occurring alongside central bank facility participation windows, in addition to the more traditional cycle of clusters of retained issuance at half-year and full-year points[16].

Chart 11- Distributed covered bond issuance and ECB measures timeline, € billions



Source : JP Morgan

[16] *J.P Morgan Covered Bond Handbook 2013*,September 2012

The Securitisation Market

Size of issuance

As indicated in Table 2, at the end of Q1 2012, €58.9 billion of securitised products were issued in Europe. RMBS issuance was the highest at €40.5 billion, followed by consumer securitisations (€7.4 billion) and SME loans (€7.7 billion). Table 3 offers a breakdown of total issuance levels, highlighting placed vs. retained issuance by asset class; approximately €18.9 billion of securitised products were placed with third party investors, representing 32% of issuance. In 2011 and 2010, placement of securitised products was respectively, 24% and 23% of total issuance. Despite an increase in placed levels over the last two years, the share of retained issuance is still significant. This is a stark reminder of both the funding difficulties faced by European banks and the important role the ECB is playing as liquidity provider to the European Banking system[17].

Table 2 - European issuance by country and collateral Q1 2012, € billions

	ABS	CDO	CMBS	RMBS	SME	WBS	TOTAL
Belgium				1.0			1.0
Denmark							0.0
France	0.5			1.4	1.4		3.3
Germany	3.7	0.2					3.9
Greece							0.0
Ireland							0.0
Italy		0.0		20.9			20.9
Netherlands				5.2			5.2
Portugal				1.1			1.1
Spain	0.4			0.5	4.5		5.4
UK	2.5		2.0	10.4	1.8	1.1	17.9
PanEuropean							0.0
Other Europe	0.3						0.3
European Total	7.4	0.2	2.0	40.5	7.7	1.1	58.9

Source: AFME Securitisation Data Report Q1:2012

[17] *Outlook for the Securitisation Market*, OECD Report, 2011

Table 3- European issuance by collateral retained vs. placed Q1 2012, € billions

RETAINED	2012:Q1	2011	2010
ABS	2.7	44.0	17.2
CDO	0.2	8.6	26.2
CMBS		0.2	1.7
MBS- Mixed		1.5	0.6
RMBS	30.7	170.1	209.6
SME	6.7	59.3	38.2
WBS			1.4
Total	40.3	283.7	294.8

PLACED	2012:Q1	2011	2010
ABS	4.7	29.5	14.2
CDO		0.6	3.5
CMBS	2.0	2.2	4.4
MBS-Mixed			
RMBS	10.1	52.5	61.5
SME	1.0	1.3	1.5
WBS	1.1	2.2	3.1
Total	18.9	88.3	88.1

Source: AFME Securitisation Data Report Q1:2012. Note: Numbers in Table 3 have been selected from the revised Q1 2012 figures, performed in Q2 2012.Total sums may differ slightly from Table 2 above.

Balances outstanding

As indicated in Table 4, at the end of Q1 2012 European securitised debt outstanding was approximately €1.89 trillion. Securitisations backed by real economy assets such as RMBS were the largest asset class, with approximately € 1.1 trillion outstanding. Consumer ABS outstanding was €199 billion, and securitisations backed by SMEs were €172 billion.

Table 4 - Summary of outstandings by collateral Q1 2012, 2011, 2010, € billions

	2012:Q1	2011:Q1	2010:Q1
ABS	199.5	205.5	229.6
CDO	186.8	235.6	260.9
CMBS	123.1	139.0	146.9
RMBS	1,149.1	1,268.8	1,346.3
SME	172.2	166.3	154.8
WBS	55.9	54.7	49.0
Total	1,886.7	2,069.8	2,187.5

Source: AFME Securitisation Data Report Q1:2012

Table 5 below offers a breakdown of total securitisation outstanding in Europe by asset class and country. The largest outstanding levels are in the UK market (€523.2 billion), the Netherlands (€307.2 billion) and Spain (€266.5 billion).

Table 5 - European outstanding by country and collateral 2012 Q1, € billions

	ABS	CDO	CMBS	RMBS	SME	WBS	TOTAL
Austria	0.0		0.2	2.0			2.2
Belgium	0.1		0.1	71.1	14.5		85.9
Finland				3.7			3.7
France	18.1	0.2	3.8	18.3	3.8		44.2
Germany	35.3	2.5	16.2	19.0	8.5	0.1	81.6
Greece	15.2	3.0		6.0	9.4		33.6
Ireland		0.3	0.4	57.4	2.5		60.5
Italy	47.8	4.8	10.2	131.0	17.1	1.4	212.3
Netherlands	5.7	1.3	6.3	281.6	12.2		307.2
Turkey	3.2						3.2
Portugal	6.5			38.2	9.6		54.3
Russia	0.9			2.7			3.5
Spain	21.7	1.2	0.3	163.0	80.4		266.5
UK	38.0	7.8	61.9	354.6	7.2	53.8	523.2
Other	2.2	1.8		0.3	0.4		4.6
PanEuropean	2.8	40.2	20.9	0.2	5.8	0.1	70.1
Multinational	1.9	123.7	2.7	0.2	0.8	0.6	130.0
European Total	199.5	186.8	123.1	1149.1	172.2	55.9	1886.7

Source: AFME Securitisation Data Report Q1:2012

Asset credit quality performance

Despite the fact that the performance of European securitisation has been very good, it still has a bad reputation which is undeserved. Unlike certain products such as US subprime and CDOs squared, the vast majority of European securitisations have performed well through the crisis from three perspectives.

1. Credit performance

Credit performance has been excellent, for almost all product sectors. As Chart 6 below shows, only 0.07% of European RMBS outstanding before the crisis started in 2007 have defaulted (all tranches, including those below AAA).

Table 6 - European securitisation default performance, by asset class

Credit Performance, by asset class, Europe vs US Mid-2007 to end Q4 2011

By Asset Class	Original Issuance (EUR billion)	Default Rate (%)
Europe		
Total PCS eligible asset classes	**957.8**	**0.09**
Credit Cards	33.2	0.00
RMBS	753.0	0.07
Other Consumer ABS	68.7	0.13
SMEs	103.0	0.20
Only senior tranches to be PCS labelled, the default rate for which is zero, like Covered Bonds		
Total Non-PCS eligible asset classes/ structures	**736.8**	**3.41**
Leveraged loan CLO	71.3	0.10
Other ABS	71.0	0.16
Corporate Securitisations	67.7	0.22
Synthetic Corporate CDOs	255.1	1.99
CMBS	165.2	3.76
Other CDOs	77.8	6.09
CDOs of ABS	28.9	30.47
Total European securitisation issuances	**1,694.7**	**1.53**
Covered Bonds	**901.4**	**0.00**
Total European issuances	**2,596.1**	**1.00**
Select US asset classes		
Credit cards	295.4	0.00
Autos	198.2	0.04
Student loans	266.8	0.22
RMBS	3,255.0	12.65

Source: Standard & Poor's

A recent study further attests the resilience of EMEA ABS and RMBS in crisis years. Between 2007 and 2011 the migration of investment-grade securities to impairment/default was minimal:

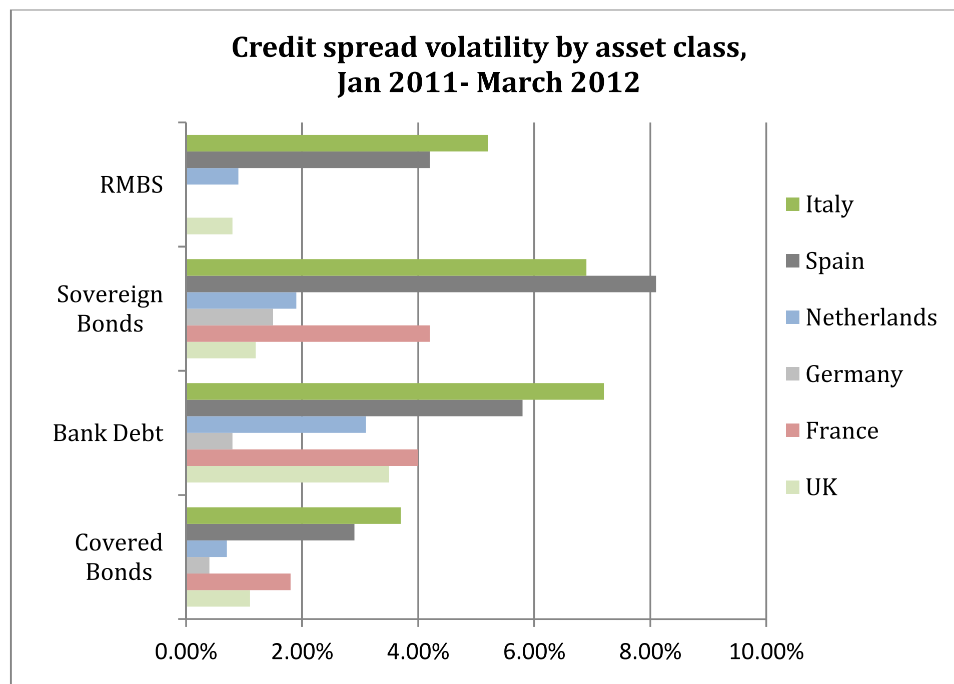
- 1.0% of total investment-grade ABS tranches became impaired and 2.0% of total transactions issued;
- 1.47 % of total investment–grade RMBS tranches became impaired and 3.8% of transactions outstanding during the period[18].

2. Secondary market price performance

As Chart 12 and Table 7 below show, during the period of market turbulence in 2011, the market price performance of European RMBS was superior to most EU sovereign debt, senior bank debt and many covered bonds (except for Pfandbriefe).

Chart 12 - European RMBS market price performance in 2011

vs. sovereign debt, bank debt and covered bonds



Source: BAML

[18] *EMEA Structured Finance Report*, Standard & Poors, June 2012.

Table 7- European RMBS price performance vs. other instruments

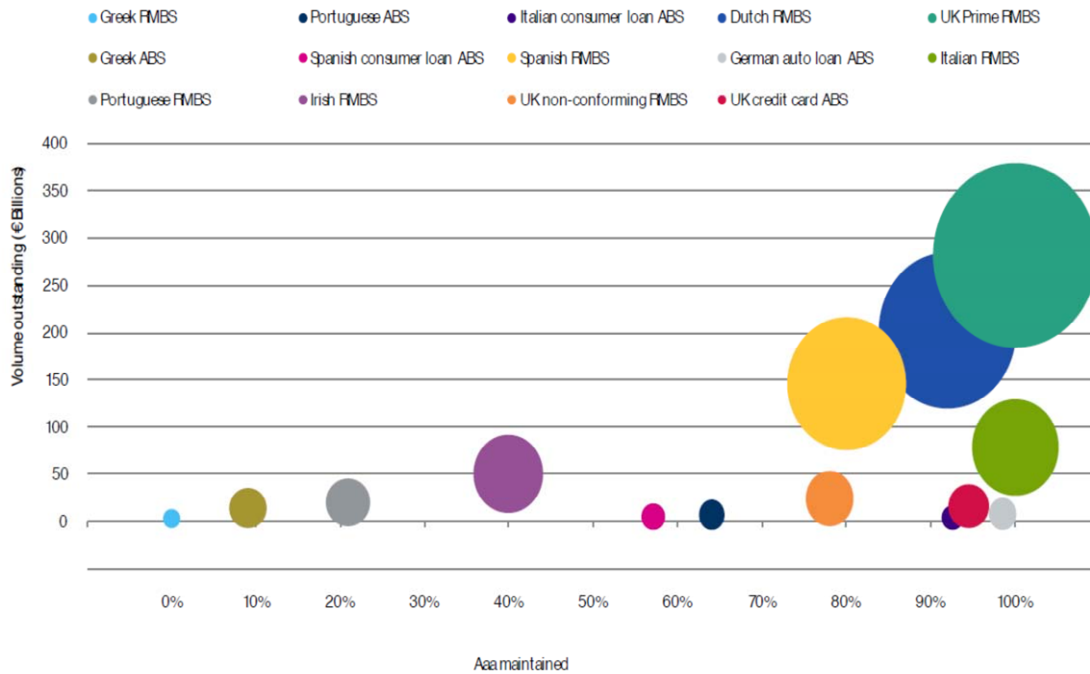
	Spread volatility by sector (%)															
	H1 2011				H2 2011				Increase H2 vs. H1				Jan 2011 – Feb 2012			
	CB	Bank	Sovs	RMBS	CB	Bank	Sovs	RMBS	CB	Bank	Sovs	RMBS	CB	Bank	Sovs	RMBS
United Kingdom	0.5	1.8	0.5	0.6	1.3	4.1	1.5	0.9	0.8	2.2	1.0	0.3	1.1	3.5	1.2	0.8
France	0.6	1.1	0.9	NA	2.2	5.2	5.6	NA	1.6	4.1	4.7	NA	1.8	4.0	4.2	NA
Germany	0.3	0.6	0.9	NA	0.5	0.9	1.8	NA	0.2	0.3	0.9	NA	0.4	0.8	1.5	NA
Netherlands	0.6	1.1	0.7	0.8	0.7	3.7	2.6	1.0	0.1	2.6	1.9	0.2	0.7	3.1	1.9	0.9
Portugal	3.2	8.1	9.6	NA	8.5	17.8	18.6	NA	5.3	9.7	8.9	NA	7.9	14.6	15.5	NA
Spain	2.4	3.4	4.5	2.6	2.7	7.5	10.4	3.9	0.3	4.1	6.0	1.3	2.9	5.8	8.1	4.2
Sweden	0.4	1.3	1.1	NA	0.5	3.7	0.9	NA	0.1	2.4	-0.2	NA	0.4	2.8	1.0	NA
Italy	1.9	1.7	2.5	0.8	4.4	9.5	8.8	5.5	2.5	7.8	6.3	4.8	3.7	7.2	6.9	5.2

Source: BAML

3. Ratings performance

As Chart 13 shows, the credit ratings performance of most AAA tranches has been very good, with downgrades mostly in countries experiencing sovereign downgrades.

Chart 13 - European securitisation AAA tranche ratings performance



Assisting the funding of SMEs and the real economy

SMEs are the backbone of the EU economy, accounting for 99% of the number of enterprises in the EU and for 85% of new job creation between 2002 and 2010. A mix of bank regulatory reforms and the current economic downturn has hindered bank lending significantly, consequently affecting SMEs, whom rely on debt finance as their prime funding source. A recent ECB survey, has found that the gap between SMEs' demand for funds and their supply is widening[19]. In the six months to March 2012, the percentage of SMEs requiring bank loans (8%) and bank overdrafts (14%) was higher than the previous six months (up from 5% and 10% respectively).

A possible source of liquidity for banks providing finance for smaller companies is the loan securitisation market. Publicly-available statistics from Standard & Poor's show that in the period from 2007 to 2011, the amount of funding provided through SME loan securitisation has been significant and performed very well: €103 billion of SME loan securitisation was issued and rated by S&P, with a very small cumulative default rate across all tranches of 0.20% of total issuance.

Therefore, securitised products could play an important role in reducing the funding gap by helping to free up banks to clear their balance sheets for further SME lending.

[19] *Survey on the Access to Finance of Small And Medium-Sized Enterprises in the Euro Area*, October 2011 to March 2012, www.ecb.europa.eu.

Implications of certainregulatory measures

As Table 8 below indicates, the financial industry and investors in the securitisation market are being targeted with a significant amount of regulatory reforms, the full cumulative impact of which could be excessive and damaging. The table below highlights the advantages and disadvantages of each regulatory measure. One of the most pressing issues is the negative effects that Basel III, CRD4 and Solvency II will have on corporate lending. The combined impact for businesses across Europe could be higher funding costs, lower availability of longer term credit and a lower equity investor base[20]. The effects will particularly harsh on SMEs, the smaller and less creditworthy companies, at a time when they are already facing significant difficulties in their access to finance.

Table 8 - Increased global regulatory burden on ABS issuers and investors

Regulation	Effective Date	Advantages	Disadvantages
CRD Art 122a investor due diligence	Jan 2011	Forces less investor reliance on CRAs	Increases investor compliance process
CRD Art 122a retention for originators	Jan 2011	Forces originators to keep "skin in the game"	Increases investor compliance process; raises cost of securitisation
CRD 3 for traders	Jan 2011	Discourages negative basis trades	Discourages dealers from providing liquidity through increased compliance burden
Solvency II	Jan 2013	Investor due diligence provisions are consistent with CRD Art 122a	Level of capital charges discourages investment
CRD 3 complex resecuritisations	Dec 2011	Discourages bank investment in CDO squared	Affects other products
CRA rotation	TBC	None	Negative signalling, could increase not reduce volatility of credit ratings
CRA Article 8(a)	TBC	Increased disclosure	Overlaps with existing CRD requirements; compliance uncertainty
Basel III and CRD 4 Net Stable Funding Ratio	2019	Encourages matched funding, incentivises securitisation	
Basel III and CRD 4 leverage ratio cap (33x)	2018	Encourages securitisation for highly levered banks	Discourages investment by capping leverage
Basel III and CRD 4 liquidity buffer restrictions	2015	Increases liquid assets as a means of improving financial stability	ABS investment may be considered eligible for liquidity book
ECB and Bank of England increased investor reporting, standardised definitions and prospectuses, cash flow models	2011/12	Improves investor confidence through improved data granularity and transparency	Increased IT and compliance costs for issuers; need for consistency
MIFID – post-trade price reporting changes	2014 [TBC]	Potential changes to pre- and post-trade reporting	Potential changes to pre- and post-trade reporting

[20] *Why Basel III and Solvency II Will Hurt Corporate Borrowing In Europe More Than In the US*, Standard & Poor's, September 2011

Conclusion

Securitisation is a key funding tool in Europe and a channel for borrowers to access the capital markets. Traditionally, it has contributed to funding real economy assets such as residential mortgages, auto loans and SME lending and other assets. At a time when businesses and households across the EU are experiencing difficulties in accessing finance, securitisation can improve the availability of credit, by allowing banks to free up their balance sheets for further lending.

The European securitisation market has been significantly affected by the financial crisis and current macroeconomic volatility. Placed issuance levels have dropped to €80-90billion from €450 billion of pre-crisis years (2006-2007). Moreover, investment in the market has stalled due to uncertainty and negative signaling surrounding the new set of regulatory measures.

While a regulatory framework which creates a well–functioning, transparent securitisation market is necessary, its unintended consequences need to be considered. Under Basel III/CRD IV, banks, traditionally the key investors in the securitisation sector, will now be forced to increase capital, deleverage and change the mix of assets they have available to meet regulatory standards; as a consequence, a reduction in their exposure to securitized products is likely.

With Solvency 2, very harsh capital requirements are likely to eliminate altogether demand for securitised products from insurance companies.

With key players pulling out of the market, serious doubts are being raised about which part of the investor community would be capable of filling the void. In general, the new regulation regime risks imperiling the region’s already struggling securitisation market, further constricting credit supply to Europe’s economy.

From the industry side, AFME has been active in trying to revive the securitisation market in Europe with important initiatives such as its Prime Collateralised Securities (“PCS”) securitisation labelling project. The purpose of PCS is to identify market best practices in terms of securitisation quality, transparency and simplicity/standardisation, leading to improved secondary market liquidity; however, it is necessary that initiatives from the private side be complemented by appropriate policy measures.

A recovery in the securitisation market should play an important role in unlocking credit markets and supporting a wider economic recovery across Europe. In the light of this, it is important for policymakers to support the sector through well calibrated regulatory measures.

Appendix- Overview of PCS initiative

Note: Concurrently with the announcement below, ECB President Draghi provided a very helpful and public supporting note, and EBA chair Andrea Enria also provided helpful remarks

PCS Press Release June 2012

Finance Industry Launches 'PCS' Securitisation Label to Revitalise Market

The Association for Financial Markets in Europe (AFME) and the European Financial Services Round Table (EFR) today announce the launch of Prime Collateralised Securities (PCS) - an industry-led, nonprofit project to develop a label for high quality securitisations which meet best practice in terms of quality, transparency, simplicity, and standardisation.

With the first label expected to be granted by the PCS Secretariat towards the end of this year, a number of key milestones have been reached:

- establishment of the PCS Association and the PCS Secretariat as bodies to respectively govern and operationally administer the PCS label;
- the appointment of the Head of the PCS Secretariat;
- identification of asset classes and structures which are eligible and not eligible for the label;
- compliance with required loan by loan reporting standards of the ECB and Bank of England;
- the fundraising target was fully achieved.

Access to securitisation markets for issuers is becoming increasingly important to overcome a real economy funding shortfall[21] in Europe. Asset Backed Securities can be an important component of the instruments that investors have available to them, especially as they do not use up the same credit line capacity as other investments, such as corporate bonds and covered bonds.

Yet, despite the very strong underlying performance of European asset-backed securities since 2007, a smaller investor base and the reduced level of issuance over this period could have knock-on effects for companies reliant on capital markets funding, as well as Europe's broader economic recovery.

The PCS initiative - developed by a broad group of market professionals comprising issuers, investors arrangers, and other market participants, in collaboration with other European industry associations, as well as observers such as the European Central Bank, European Investment Bank and Bank of England - will comprise a two-tier governance structure:

- a PCS Association, comprising independent non-industry directors, as well as a mix of industry professionals;

[21] Recent estimates show that €650 billion of senior unsecured and covered bond funding will mature in 2012 for European banks; for sovereigns, funding of over €900 billion will be needed and that an additional €1.5 – €1.9 trillion of funding will be needed to power any growth. Sources: Bloomberg and BAML Global Research Dec 2011, Standard & Poor's May 2012.

- a PCS Secretariat, led by experienced industry professional Ian Bell, responsible for the day-to-day administrative and managerial operations. The PCS Secretariat will grant the PCS label to securities, certify a transaction and monitor the label after it is issued.

PCS is more than just a positive label for eligible securitisations – it provides the basis for a definition of agreed market standards, as well as an enforcement mechanism of these agreed standards, based on a label which can be granted and withdrawn depending on compliance and as verified by the PCS Secretariat.

Rick Watson, Head of Capital Markets at AFME, commented:

"Investors and regulators need a clear reference point, setting out best practices around which to build investment guidelines and regulations, which, in turn, will encourage issuance as well as investment and support the real economy. Combining the expertise and market coverage of both AFME and EFR members has resulted in the ability to move forward on this very important initiative.

"PCS will bring added quality, transparency and standardisation to the market, which will deepen the securitisation investor base in Europe and, in turn, improve overall liquidity. Europe needs a healthy securitisation market and we are confident that this initiative, alongside regulatory changes, will provide a significant boost to the market."

Sebastian Fairhurst, the EFR's Secretary-General, commented:

"The PCS label will be awarded on a deal-by-deal basis and subjected to a verification process by the newly established PCS Secretariat. It will be granted to transactions backed by asset classes that have performed extremely well through the financial crisis and are of direct relevance to the real economy, including European auto, residential mortgage, SME, consumer and credit loans.

"Issuers will need to provide high quality reporting on an ongoing basis, in accordance with the relevant ECB and Bank of England reporting standards."

Ian Bell, PCS's newly appointed Head of Secretariat, commented:

"It's exciting to be part of such an important industry initiative, which has seen so much support from investors, issuers and policymakers alike. With commitments to fully fund PCS' first two years of operations from over 30 institutions in the industry, PCS demonstrates the seriousness of the industry's intent to establish a vibrant, yet robust European securitisation market capable of funding the growth Europe so badly needs."

PCS Fact Sheet (as of June 2012)

Overview

- PCS is a market-led initiative developed to apply a label to securitisation issues which meet specific eligibility criteria with the aim of increasing the funding of real economy assets through securitisation thereby supporting the recovery and future growth of the European economy.

- The PCS label is intended to be a simple way of communicating and identifying securitisations that meet predefined best practice standards with regard to quality, transparency and simplicity/standardisation. The aim of setting these standards is to increase the depth of the securitisation investor base so as to allow for an increase in primary issuance and improve secondary market liquidity.

- PCS is not intended to replace investor due diligence or credit ratings or to act as an alternative form of credit analysis. PCS eligibility is, however, limited to the most senior tranches in a securitisation capital structure.

- An independent, not-for-profit, organisation has been set up to develop, launch, promote and administer the PCS label. The PCS organisation will comprise the PCS Association which will own the label and the PCS Secretariat which will be responsible for day to day operations including label issuance and monitoring.

- PCS will be governed by an independent Board made up of a mix of senior non-industry professionals and senior financial services industry professionals.

- The PCS organisation will be a self-financing entity after an initial period of pre-funded operation.

- PCS will appoint a small panel of specialist firms with extensive experience in documentation review, audit and checking to assist it with verifying whether a securitisation satisfies the PCS eligibility criteria.

- PCS benefits from the support of large group of stakeholders including investors, public authority bodies, industry associations, Issuers and other securitisation industry participants. This diverse stakeholder group has developed PCS taking into account the views of a wide range of constituents from across Europe.

Eligible Asset Classes and Requirements of PCS

- The PCS label will only be awarded to securitisations that are backed by asset classes that have performed well through the financial crisis and also that are of direct relevance to the real economy. These include European auto loans and leases, residential mortgage loans, loans to small and medium enterprises, consumer loans and credit card receivables.

- PCS has intentionally excluded certain asset classes from its eligibility criteria. These excluded asset classes currently include CMBS, CDOs, synthetic securitisations, resecuritisations and residential mortgages which do not meet defined quality criteria.

- The PCS eligibility criteria may be adapted in the future, without ever compromising its quality standards, to allow it to cater for material developments in the European securitisation and financial markets. The PCS Board will govern any decisions to amend the PCS eligibility criteria (advised a by a Board sub-committee known as the Market Committee).

- PCS eligibility criteria will include a requirement on issuers to meet certain ongoing obligations for PCS labelled securities (e.g. reporting standards). PCS will monitor these issuer obligations and will withdraw the PCS label from securities which do not comply with any of the ongoing PCS eligibility criteria

- PCS eligibility criteria have been developed to include existing market standards where these are considered by PCS to be current best practice (e.g. ECB, Bank of England and HFC reporting standards).

- PCS will not replace credit ratings although the existing PCS eligibility criteria include the requirement for a security to have been rated by at least two credit rating agencies and to be the most senior tranche in a securitisation capital structure.

- All securitisations which meet the PCS eligibility criteria at the time of request for a PCS label are in principle eligible. Therefore, securitisations issued prior to the creation of PCS are capable of obtaining a PCS label if they meet the PCS eligibility criteria.

Labeling Process

- The PCS label will be awarded on a deal by deal basis following a review of the relevant transaction documentation to ensure that an issue complies with the PCS eligibility criteria.

- The PCS Secretariat will engage a small panel of respected specialist firms to assist it with verifying that a securitisation meets the PCS eligibility criteria. PCS has selected this outsourced model to ensure that it can respond to labelling requests promptly and so that it has the best possible expertise for documentation review, audit and checking at its disposal.

- Granting of the PCS label will follow a strict, rigorous and standardised review procedure.

- Issuers seeking a label for their securities will pay a fee in order for the PCS Secretariat to undertake the evaluation as to whether a security is PCS eligible. The fee remains payable irrespective of whether the security is found to be PCS eligible or not.

Corporate Framework and Governance

- The PCS organisation will comprise the PCS Association and PCS Secretariat. The PCS Association will be based in Brussels, where the Board will also sit, and will own the PCS label. The PCS Secretariat will be based in London and be responsible for day to day operations including label issuance and monitoring.

- The PCS Board will be the executive oversight body for PCS and will govern the activities of PCS.

- The PCS Board will be made up of senior independent non-industry professionals as well as senior professionals in the financial services industry, with experience of securitisation and other financial instruments.

- The PCS Board will appoint certain Board sub-committees which will specialise in advising the Board on certain topics (e.g. the Market Committee will advise on matters relating to the PCS eligibility criteria and the securitisation market in general, Audit Committee, External Affairs Committee). The Board sub-committees will be chaired by a PCS Board member and will include individuals from outside the PCS Board with specialist knowledge of the focus area of the sub-committee (e.g. in the case of the Market Committee, industry specialists including traders, investors, issuers, lawyers etc).

PCS Funding Members (as of June 2012)

1. Allen & Overy
2. Barclays
3. Bank of America Merrill Lynch
4. BBVA
5. Bishopsfield Capital Partners
6. Bloomberg
7. BNP Paribas
8. BNY Mellon
9. Clifford Chance
10. Credit Suisse
11. Deutsche Bank
12. DNB Bank ASA
13. European Banking Federation
14. HSBC
15. ING
16. Intesa San Paolo
17. J P Morgan
18. Lewtan Technologies
19. Linklaters
20. Lloyds Banking Group
21. Nationwide
22. NIBC Bank
23. Obvion
24. Rabobank
25. Royal Bank of Scotland
26. Santander
27. Securitisation Services
28. Societe Generale

29. Twenty Four Asset Management

30. UBS

31. UniCredit

32. Weil, Gotshal & Manges

Additional Supporters of PCS (as of June 2012)

A number of other institutions and associations have contributed their time and expertise to assist in the development of PCS. These include:

1. AFME

2. Allianz SE

3. AXA Investment Management

4. EFAMA

5. EFR

6. EFRP

7. Holland Financial Centre

8. Insurance Europe

9. RBS Asset Management

10. Swiss Re

11. True Sale International

APPENDIX 2

SECURITISATION - SUMMARY OF PERFORMANCE INFORMATION FOR CERTAIN KEY ASSET CLASSES

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Asset credit quality performance

Despite the fact that the performance of European securitisation has been very good, it still has a bad reputation which is undeserved. Unlike certain products such as US subprime and CDOs squared, the vast majority of European securitisations have performed well through the crisis from three perspectives.

1. Credit performance

Credit performance has been excellent, for almost all product sectors. As Chart 6 below shows, only 0.07% of European RMBS outstanding before the crisis started in 2007 have defaulted (all tranches, including those below AAA).

Table 6 - European securitisation default performance, by asset class

Credit Performance, by asset class, Europe vs US Mid-2007 to end Q4 2011

By Asset Class	Original Issuance (EUR billion)	Default Rate (%)
Europe		
Total PCS eligible asset classes	**957.8**	**0.09**
Credit Cards	33.2	0.00
RMBS	753.0	0.07
Other Consumer ABS	68.7	0.13
SMEs	103.0	0.20
Only senior tranches to be PCS labelled, the default rate for which is zero, like Covered Bonds		
Total Non-PCS eligible asset classes/ structures	**736.8**	**3.41**
Leveraged loan CLO	71.3	0.10
Other ABS	71.0	0.16
Corporate Securitisations	67.7	0.22
Synthetic Corporate CDOs	255.1	1.99
CMBS	165.2	3.76
Other CDOs	77.8	6.09
CDOs of ABS	28.9	30.47
Total European securitisation issuances	**1,694.7**	**1.53**
Covered Bonds	**901.4**	**0.00**
Total European issuances	**2,596.1**	**1.00**
Select US asset classes		
Credit cards	295.4	0.00
Autos	198.2	0.04
Student loans	266.8	0.22
RMBS	3,255.0	12.65

Source: Standard & Poor's

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APPENDIX 3

COMPARISON OF STRUCTURED INVESTMENT VEHICLES AND COMMON SECURITISATION STRUCTURES

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SIVs AND ARBITRAGE CONDUITS	ABCP CONDUITS	TERM BOND ABS STRUCTURES
Business purpose was arbitrage.	Business purpose is customer financing in the form of individually negotiated customer transactions.	Business purpose is cost-effective financing for the lending business of the originator.
Held long term financial assets. Business purpose was arbitrage.	Fund a variety of assets including trade receivables, residential mortgages, auto and other vehicle loans, consumer loans, leases, credit card receivables, student loans and SME loans. Structures are self-liquidating and rely not just on asset cashflows to repay investors but also liquidity lines provided by regulated banks covering 100% of conduits' liabilities.	Fund a variety of assets including residential mortgages, auto and other vehicle loans, consumer loans, leases, credit card receivables, student loans and SME loans. With some exceptions (for example, CMBS and certain leasing transactions), structures are self-liquidating and rely on asset cashflows to repay investors.
Funding need (and liquidity risk) at or close to maximum utilization as most SIVs were fully "ramped up"; they were highly dependent on financial market conditions.	Funding need dependent on day-to-day financing needs of customers, namely whether business is good and a high volume of receivables is generated, or business is poor and a low volume of receivables is generated.	Usually fully funded at issue. Occasionally an element of pre-funding can be structured for a short initial period (say, 3 months) but the cost of negative carry limits any incentive to pre-fund for longer.
Contained market value triggers forcing liquidation exposing the investors to the market value risk of the assets.	Conduits do not contain mark-to-market or market value triggers requiring liquidation of financed transactions; they rely on asset cashflows to repay liabilities, supported by liquidity lines provided by regulated banks.	Did not and do not contain mark-to-market or market value triggers; rely on asset cashflows to repay liabilities.

afme/
Finance for Europe

SIVs AND ARBITRAGE CONDUITS	ABCP CONDUITS	TERM BOND ABS STRUCTURES
Proved to be illiquid under stress due to sub-prime, CDO and monoline issues as well as MTM triggers. Short-term funding dried up, assets returned to banks' balance sheets or liquidity drawn, no market for sale of the underlying long term assets such as sub-prime RMBS.	Proved to be relatively liquid under stress: short term funding was less affected, some limited liquidity drawings, underlying assets were "real economy" and self-liquidating.	Decreases in liquidity varied by market sector, with some being affected worse than others. It should be noted that all markets suffer from decreases in liquidity when under stress. Examples of this can be found post-crisis in unsecured FI bonds, covered bonds and sovereigns, not just securitisation.
Liquidity backup was dependent on financial market conditions: if there was no market for the assets, then liquidity was drawn.	ABCP can be issued and liquidity put at risk of drawing only if good quality receivables are presented to the ABCP Conduit for funding. No receivables = No liquidity drawings or issuance of ABCP.	Much less reliance on liquidity due to longer term and self-liquidating nature of the assets; liquidity can be provided by third parties (such as regulated banks) or from internal asset cashflows.
Underlying assets performed poorly in credit and market terms: US sub-prime RMBS, US home equity loans, CDOs.	Underlying assets from the "real economy" have performed and continue to perform well and within tolerances.	Underlying assets from the "real economy" have mostly performed and continue to perform well and within tolerances.
Mis-used SSPE technology to exacerbate leverage and concentration of risk within the financial system.	Well-established traditional use of SSPE technology to complement bank funding and share risk with capital markets investors.	Well-established traditional use of SSPE technology to complement bank funding and share risk with capital markets investors.
No longer active in a manner which could pose systemic risk: no investor appetite and new regulations prevent re-emergence.	Struggling to cope with new liquidity rules: some conduits have been closed because of the new liquidity rules.	Issuance continues but far from a complete recovery due to significantly reduced investor base, cheap central bank funding across the global system and negative signaling around the product. Significant amounts of new issues are retained by the originator for repo with central banks.

APPENDIX 4

AFME DATA SUBMISSION REGARDING HISTORIC LIQUIDITY FUNDING FOR MULTI-SELLER ABCP CONDUITS (CONFIDENTIAL)

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APPENDIX 5

CLARIFICATION OF CERTAIN KEY POINTS ON SECURITISATION

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Appendix 5

Consultative Document – a Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities"

Clarification of certain key points on securitisation

Page	Reference	Text	AFME comment
Introduction and Summary			
1	Introduction	"As part of the process, WS3 met with industry representatives to exchange views and obtain additional information."	While our members are aware of constructive engagement by WS4, the dedicated workstream for securitisation, with representatives of the securitisation industry during 2012, our members are not aware that similar meetings have taken place under the auspices of WS3. Did WS3 undertake comprehensive co-ordination and liaison with WS4?
1	Introduction	"WS3 therefore developed an economic function based (i.e. activities-based) perspective for assessing shadow banking activity in non-bank entities."	Securitisation is a financing technique. We do not believe it is appropriate to characterize it as an economic function. See our response to the Consultative Document, *passim*.
1. High-level policy framework			
3	High-level policy framework	"The focus is on credit intermediation activities by non-bank financial entities that are close in nature to traditional banks (i.e. credit intermediation that involves maturity/liquidity transformation, leverage and/or credit risk transfer), while excluding non-bank financial entities which do not usually involve significant maturity/ liquidity transformation and are not typically part of a credit intermediation chain (e.g. pension funds).	We agree that securitisation generates benefits for the financial system and the real economy by helping banks to continue to lend in a deleveraging environment when new capital may be difficult to source and expensive. As part of an overall funding strategy including not just secured but also unsecured borrowing, and retail deposits, securitisation also provides incremental funding for "real economy" assets such as residential mortgages, auto, consumer and credit card loans and

Page	Reference	Text	AFME comment
		Such credit intermediation activities by non-bank financial entities often generate benefits for the financial system and real economy, for example by providing alternative financing/funding to the economy and by creating competition in financial markets that may lead to innovation, efficient credit allocation and cost reduction. However, unlike other non-bank financial activities, these activities create the potential for "runs" by their investors, creditors and/or counterparties, and can be procyclical, hence may be potential sources of systemic instability. These non-bank credit intermediation activities may also create regulatory arbitrage opportunities as they are not subject to the same prudential regulation as banks yet they potentially create some of the same externalities in the financial system."	SME loans. These assets form the sizeable majority of today's securitisation market. See, for more detail, AFME's paper entitled "The Economic Benefits of High Quality Securitisation to the EU Economy" linked here (scroll down to "Securitisation" http://www.afme.eu/Documents/Statistics-and-reports.aspx) Most term securitizations are less susceptible to "runs" than other types of funding, as the majority of structures only have to repay principal to investors when cash is received from the securitized assets. In other words, they are self-liquidating. The valuation and liquidity declines associated with sub-prime RMBS during the financial crisis in 2008 do not mean that that high quality securitisation in general is not a sound financing technique. Regulation should not seek to scapegoat securitisation. Policymakers must clearly differentiate different types of securitization structures, and not view them as a homogeneous market. To this we note that the vehicles with structural features, such as a need to roll over funding without the benefit of backup liquidity, which led to failure (e.g. SIVs) are no longer operational in a manner which could pose systemic risk. We do not agree that securitisation by banks necessarily creates "regulatory arbitrage opportunities". Indeed, regulatory arbitrage opportunities are created by regulation itself, and may be exploited by any number of mechanisms. We note that, post-crisis, high standards have already

Page	Reference	Text	AFME comment
			been set for any bank seeking regulatory capital release as part of a securitisation transaction, coupled with detailed scrutiny by national regulators. To the extent the standards are met, then prudential concerns should be satisfied. We note also that the motivation for most securitisation since (and in some cases before) the financial crisis has been funding, rather than regulatory capital release. This is particularly the case for RMBS where the regulatory capital requirements for mortgages held on balance sheet were lower than for other types of assets, so there was anyway less incentive to securitise for "capital" reasons. Additionally, regulatory capital and accounting requirements have changed since the crisis and it is more difficult for institutions to achieve off-balance sheet treatment for securitizations.
4	High-level policy framework	"The policy tool(s) adopted should be proportionate to the degree of risks posed by the non-bank financial entities, and should take into account the adequacy of the existing regulatory framework as well as the relative costs and benefits of applying the tool."	We agree, which is another reason why securitisation should not be an "economic function". The performance of most securitisation asset classes since the financial crisis, from both a credit and a pricing perspective, has been very good. See, for more detail, AFME's paper entitled "The Economic Benefits of High Quality Securitisation to the EU Economy" linked here (scroll down to "Securitisation" http://www.afme.eu/Documents/Statistics-and-reports.aspx).

Page	Reference	Text	AFME comment
4	High-level policy framework	"An important prerequisite for the implementation of the framework is the ability of authorities to collect relevant data and information. Improvement in transparency through enhancing data reporting and public disclosures is crucial in changing or reducing the incentives of market participants to arbitrage regulation at the boundaries of bank regulation."	Once again, AFME respectfully reminds the FSB that considerable data is, and for many years even before the financial crisis has been, available in the securitisation markets regarding the composition of asset pools and asset performance. Since the crisis several regulations and market initiatives of regulators and central banks (including the ECB, the Bank of England and the U.S. SEC) have gone even further. As described above, close scrutiny is undertaken by national regulators of any bank-originated securitisation transaction which seeks regulatory capital release.
2. Assessment based on the five economic functions			
7	2.2 Loan provision that is dependent on short-term funding	"Provision of loan/credit outside of the banking system, for both retail and corporate customers for any purpose (e.g. consumer finance, auto finance, retail mortgage, commercial property, equipment finance), on a secured or unsecured basis, may result in liquidity and maturity transformation. Entities that are engaged in these activities are likely to compete with banks or to offer services in niche markets where banks are not active players. They often concentrate lending in certain sectors due to expertise and other reasons. This may create significant risks if the sectors they focus on are cyclical in nature (e.g. real estate, construction, shipping, automobiles, and retail consumers). Such risk may be exacerbated if these entities are heavily dependent on short-term deposit-like funding or wholesale funding, or are dependent on parent companies for funding	We have assumed that it is not intended that this economic function and the corresponding full package of policy tools would apply in a securitisation context in general. It is our understanding that this economic function and corresponding toolkit would be relevant from a securitisation perspective only to the extent that a relevant finance company used securitisation as a funding tool. If this is not the intention, then we would have further comments as, for example, the application of capital and liquidity requirements in respect of securitisation SPVs would be highly problematic. We believe that the emphasis in the Consultative Document on the so-called maturity transformation effects of securitisation is misplaced. We are surprised by the claim that "[these entities] may also be used as vehicles for banks to circumvent regulations." We are not aware of any such

Page	Reference	Text	AFME comment
		and the parent companies are in sectors which are cyclical in nature. In some cases, they may also be used as vehicles for banks to circumvent regulations."	"circumvention" in a securitisation context by our members, and would be interested to discuss evidence of the same with the FSB. As we state *passim*, securitisation by banks is already highly regulated and subject to detailed scrutiny.
7	2.2 Loan provision that is dependent on short-term funding	"*Finance companies whose funding is heavily dependent on wholesale funding markets or short-term commitment lines from banks* – Finance companies may be prone to runs if their funding is heavily dependent on wholesale funding such as ABCPs, CPs, and repos or short-term bank commitment lines. Such run risk can be exacerbated if finance companies are leveraged or involved in complex financial transactions."	This is not always the case. There are examples of well-managed finance companies who are heavily dependent on wholesale funding – securitisation – which have negotiated the financial crisis successfully. Again, in a securitisation context the emphasis on maturity transformation is misplaced.
7	2.2 Loan provision that is dependent on short-term funding	"*Finance companies whose funding is heavily dependent on banks that use these companies as a means to bypass regulation/supervision* – Finance companies may be used by banks as vehicles in circumventing regulations or banks' internal risk management policies. For example, banks may lend to finance companies that in turn will lend to borrowers to whom banks may not be able to lend directly due to their internal risk management policies or prudential regulatory requirements."	Again, we are not aware of any examples of the type of conduct listed and would be interested to discuss further the evidence on which the FSB bases this remark.
9	2.5 Securitisation and funding of financial entities	"Provision of funding to related-banks and/or non-bank financial entities, with or without transfers of assets and risks from banks and/or non-bank financial entities, may be an integral part of credit intermediation chains (or often the regular banking system). In some cases, however, it may possibly aid in the creation of excessive maturity and liquidity transformation, leverage or regulatory arbitrage in the system.	Once again, we believe the emphasis on the so-called maturity transformation aspects of securitisation is misplaced for securitisation of traditional, real economy assets. SIVs may be a form of structured finance but are not securitizations, and in any case are no longer operational in a manner which could pose systemic risk. We request more clarity from the FSB regarding the

Page	Reference	Text	AFME comment
		Such activities may provide other functions but are also used by banks and/or non-bank financial entities for funding/warehousing as well as to avoid bank regulations. This was particularly the case leading up to the crisis, where this form of arbitrage was widespread. Consequently, many securitisation markets saw significant contractions in activity or were essentially "frozen". Since then, many securitisation markets, especially for the more opaque and more complex products, have been very slow to recover. However, regulators need to be alert to a potential resumption of large-scale activity, while facilitating the recovery of sound securitisation activities."	rationale for the statement that "[securitisation] activities ... are also used ... to avoid bank regulations" and "this form of arbitrage was widespread". We do not recognize the context described by the FSB, and strongly disagree with this statement. The price declines and decreases in liquidity associated with sub-prime RMBS during the financial crisis in 2008 do not mean that that high quality securitisation in general is not a sound financing technique. Regulation should not seek to scapegoat securitisation. Many sectors of the securitisation markets are far from "opaque"; some are complex, others less so. However, it is not justifiable to characterize the whole market with the poor performance of US sub-prime mortgages, CDOs and SIVs. The "one size fits all" approach that is implied is wholly inappropriate and not supported by the evidence. Securitisation markets have indeed been slow to recover. We note that their recovery has not been helped by negative signaling from some (but by no means all) policymakers, which unfortunately the tone of this section of the Consultative Document seems to perpetuate. We find the last paragraph particularly alarming, and would welcome instead far more emphasis in the Consultative Document on "facilitating the recovery of sound securitisation activities". Indeed, instead of being wary of resumption of activity in securitization markets,

Page	Reference	Text	AFME comment
			we believe that regulators should actively support and in fact promote the resumption of securitization broadly, so as to confer the economic benefits that increased credit provision would engender.
9-10	2.5 Securitisation and funding of financial entities	"*Securitisation entities that are used to fund long-term, illiquid assets by raising shorter term funds* – Securitisation entities may purchase or provide credit enhancements to a pool of loans provided by banks and/or non-bank financial entities, and issue ABCPs and other securities that are backed by such loan pool. Banks usually provide liquidity facilities to allow securitisation entities to reduce costs of funding. This, however, would create maturity/liquidity transformation and leverage in the system, as well as increasing interconnectedness between the banking system and non-bank financial entities. Under Basel I, securitisation entities were also used by banks to circumvent capital regulation as liquidity facilities are treated as 0% risk weights."	Once again, we respectfully remind the FSB that most securitizations are funded by term securities, not ABCP, and the majority of these are self-liquidating as cashflow received from the securitized assets is returned to investors. For ABCP conduit securitisation, liquidity lines provided by banks are already regulated as part of various bank regulatory capital and (soon) liquidity regimes. We do not understand the reference to Basel I. This can be only of historic interest as it ceased to apply many years ago.
10	2.5 Securitisation and funding of financial entities	"*Investment funds or other similar structures that are used by banks (or non-bank financial entities) to fund illiquid assets by raising funds from markets* – Synthetic ETFs, for instance, may be used by banks and/or non-bank financial entities to raise funding against an illiquid portfolio on their balance sheet that cannot otherwise be financed in the wholesale market through, for example, repos. The same may be said for physical ETFs, or other investment funds, where they provide a bank with a pool of	We do not understand this section in the context of securitisation and would appreciate further clarity from the FSB.

Page	Reference	Text	AFME comment
		lendable securities to be used for repo financing."	
3. The framework of policy toolkits			
10	The framework of policy toolkits	"*Effectiveness*: Regulatory measures should be designed and implemented in an effective manner, balancing the need for international consistency to address common risks and to avoid creating cross-border arbitrage opportunities against the need to take due account of differences between financial structures and systems across jurisdictions."	We agree. While outside the scope of the Consultative Document, one good example of international consistency which we seek is greater uniformity in the approach to risk retention for securitisation between the EU and the U.S. We have argued in various submissions for a mutual recognition regime to be established to facilitate and enhance cross-border flows of securitisation issuance and investment between these two large economies and liquidity pools.
3.1 Overarching principles			
11	Principle 1: Authorities should have the ability to define the regulatory perimeter.	"[...] the relevant authorities should have the ability to bring the relevant entity into their regulatory and supervisory oversight if necessary to ensure financial stability."	We agree, and for securitisation many of them have already done so.

Page	Reference	Text	AFME comment
12	Principle 3: Authorities should enhance disclosure by other shadow banking entities as necessary so as to help market participants understand the extent of shadow banking risks posed by such entities.	"Enhanced market disclosure and transparency (e.g. overall firm risk exposures, interconnectedness, funding concentration and aggregated maturity profiles of asset and liabilities) will help market participants to better monitor the entities, absorb any news/ developments in a timely manner, and make informed decisions, hence avoiding sudden loss of confidence that may lead to runs."	Significant enhancements to disclosure of securitization asset performance have already been implemented in some major jurisdictions and are expected to be shortly implemented in others. On the prudential side, we note that the Basel Committee is currently proposing significant revisions to the regulatory capital framework that applies to securitizations. These developments, when finalized, should work together toward the goals the FSB seeks.
12	Principle 4: Authorities should assess their non-bank financial entities based on the economic functions and take necessary actions drawing on tools from the policy toolkit.	"Authorities should put in place the high-level policy framework for other shadow banking Entities"	Many authorities already have detailed rules in place to regulate securitisation by banks.
3.2.2 Loan provision that is dependent on short-term funding			
15	Tool 2: Capital requirements	"An appropriate level of capital is crucial for entities that provide loans so that they can absorb the losses that may reasonably be expected to result from these activities."	We assume this is not directed at securitisation SPVs given that these SPVs do not generally originate loans. For the avoidance of doubt, this would not be appropriate because securitisation SPVs are and must be thinly-capitalised, bankruptcy-remote entities in order to achieve the highest ratings. We also note that loss absorption is generally accounted for in the structure of the transaction.
15	Tool 3: Liquidity buffers	"To counteract potential stress and run risks from short-term liabilities, and to address the risks arising from *maturity/liquidity transformation*, authorities may impose liquidity regulation based on requiring liquidity buffers of a certain size and composition."	We assume this is not directed at securitisation SPVs. For the avoidance of doubt, this would not be appropriate because the liabilities issued by most securitisation SPVs are self-liquidating and therefore the vehicles are not subject to stress from liquidity risk, or rollover risk is otherwise managed through liquidity lines from banks and similar features within the ambit of

Page	Reference	Text	AFME comment
			existing regulation.
16	Tool 4: Leverage limits	"To mitigate the potential risks arising from the entities' use of leverage, especially where the entities' leverage is at a level where it may pose a threat to financial stability, authorities should impose leverage limits on the entities as appropriate."	We assume this is not directed at securitisation SPVs. For the avoidance of doubt, this would not be appropriate because securitisation SPVs are and must be thinly-capitalised, bankruptcy-remote entities in order to achieve the highest ratings.
16	Tool 5: Limits on asset concentration	"The risks arising from maturity/liquidity transformation as well as leverage can be exacerbated when an entity is exposed to significant risks to asset quality, such as when there are significant concentrations in the asset composition."	We assume this is not directed at securitisation SPVs. By definition, securitisation SPVs hold pools of assets which are concentrated - for example, all mortgages, or all auto loans. Indeed, homogeneity of assets promotes liquidity and maximizes economic benefits (see, e.g., the U.S. agency MBS markets) It is very rare to see securitised pools of mixed assets. This is not the function of securitisation, and not what investors want.
16	Tool 6: Restrictions on types of liabilities	"A direct restriction on the types of liabilities will eliminate or reduce the risks such as run risks associated with particular liability types such as ABCPs. Such restrictions may be prohibiting certain use of funding instruments like ABCPs in cases where entities do not have appropriate securitisation and risk management processes in place. Also it may involve concentration limits on the particular lender/sector/instrument. They will help mitigate the risks arising from maturity/liquidity transformation."	This is a very alarming proposal, entirely misconceived and wholly unnecessary as bank liquidity lines to ABCP conduits are already and will be further regulated under existing prudential regimes.

Page	Reference	Text	AFME comment
16	Tool 7: Monitoring of the extent of maturity mismatch between assets and liabilities	"By relying on short-term funding and investing in long term assets, entities can be faced with significant liquidity pressures in the event of runs, especially if a significant portion of their funding is obtained from instruments such as demand deposits. The extent of maturity/liquidity transformation needs to be properly monitored by the entities and relevant authorities, so that timely action can be taken to mitigate the associated risks."	We repeat our previous remarks, *passim*, regarding the misplaced emphasis on maturity transformation and securitisation.
3.2.5 Securitisation and funding of financial entities			
20	Tool 1: Restrictions on maturity/liquidity transformation	"To the extent that securitisation vehicles are used as funding channels via the issuance of short-term liabilities (e.g. in the case of ABCP issuance), restrictions on differences in maturity between the securities issued and the underlying asset pool are a direct method to limit the risks arising from the maturity/liquidity transformation through securitisation. Appropriate liquidity rules on securitisation vehicles will also enhance their resilience and help mitigate the risks arising from the liquidity transformation. Such restrictions will reduce the roll-over risk of the asset-backed securities (ABS) issued and excessive reliance on support from sponsors (e.g. banks). However, authorities may face difficulties in assessing the appropriate maturity mismatch beyond which restrictions should be imposed. Also, such restrictions would have to be tailored to different securitisation structures, taking into account their respective strategies."	This is a very alarming proposal, entirely misconceived and wholly unnecessary as bank liquidity lines to ABCP conduits are already and will be further regulated under existing prudential regimes. Again we note that structures such as SIVs which failed in the crisis are no longer operational in a manner which could pose systemic risk, and other structures such as multi-seller ABCP conduits did not experience similar "runs" or failures. See Appendix 4. We repeat our previous remarks, *passim*, regarding the misplaced emphasis on maturity transformation and securitisation. We do not believe any such restrictions are necessary, as the vast majority of securitisation structures do not create the maturity / liquidity transformation risks highlighted.

Page	Reference	Text	AFME comment
20	Tool 2: Restrictions on eligible collateral	"Certain non-bank financial entities may be used by banks and/or other financial entities to fund an illiquid portfolio on their balance sheet that cannot otherwise be financed in the wholesale market (e.g. through repos)."	To the extent that banks undertake activity of this kind, it is already well within the remit of existing prudential regimes to prevent it occurring if so desired by banking regulators. It is entirely disproportionate to contemplate the invention of a new regulatory tool to control what types of assets a bank may originate, or may decide to securitise, when existing regulation already provides for such authority.
21	Tool 3: Restrictions on exposures to, or funding from, banks/other financial entities	"Banks or other financial entities may take advantage of alternative sources of funding such as securitisation which may be cheaper or more readily available than, for example, deposits or inter-bank funding."	As stated above, securitisation has an important part to play in banks' overall funding strategy along with other types of secured funding, unsecured funding and retail deposits. Sometimes securitisation will be cheaper, sometimes not. We do not think policymaking should be driven by relative pricing of different types of financing. Policymakers and regulators should instead be concerned that banks have access to an appropriate range of funding options to ensure their safe and sound operation.
Annex: Suggested information items for assessing the extent of shadow banking risks inherent in the activities of non-bank financial institutions			
22		"In assessing the extent of shadow banking risks inherent in the activities of a non-bank financial institution that are associated with one of the five economic functions, authorities should conduct analyses based on qualitative and quantitative information obtained through regulatory/supervisory reporting, market intelligence and/or public disclosures."	We wholeheartedly agree and would be delighted to provide the FSB with further evidence of the strong performance of many traditional, real economy securitisation market sectors. See, for more detail, AFME's paper entitled "The Economic Benefits of High Quality Securitisation to the EU Economy" linked here (scroll down to "Securitisation" http://www.afme.eu/Documents/Statistics-and-reports.aspx).