



afme / Restoring the brand: challenges for
today's securitisation market

**SCI 5th Annual Pricing, Trading and Risk
Management Seminar**

London, 29th November 2011

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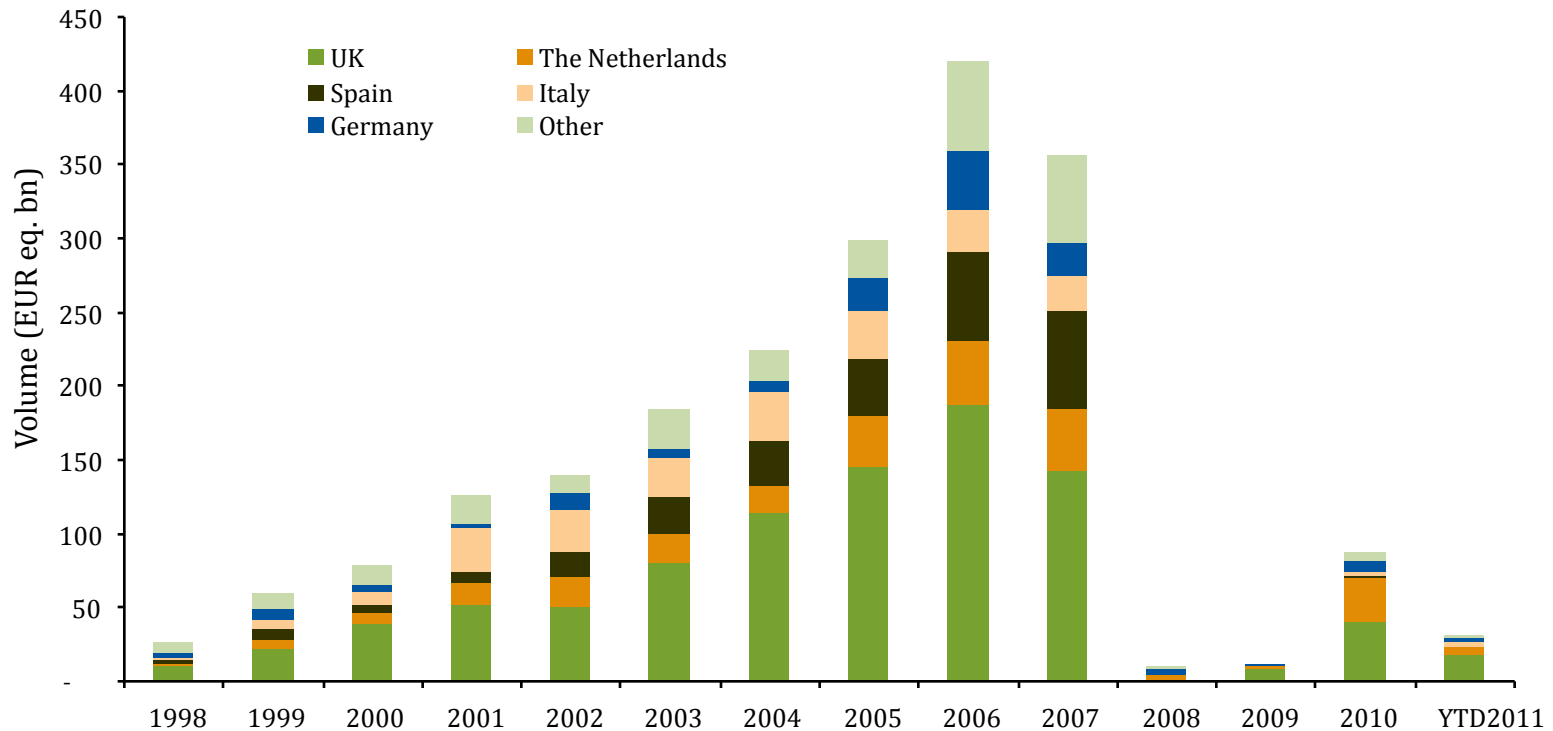
Managing Director, AFME

- Represents some 170 global and European market participants
- Focus on wide range of wholesale markets, business and prudential issues, including topics previously covered by former European affiliates of the Securities Industry Financial Markets Association
- Main office in London with representation in Brussels
- An independent regional organisation with global integration through membership of the Global Financial Markets Association (GFMA), together with SIFMA in the US and ASIFMA in Hong Kong

afme / Increased Global Regulatory Burden on ABS Issuers and Investors

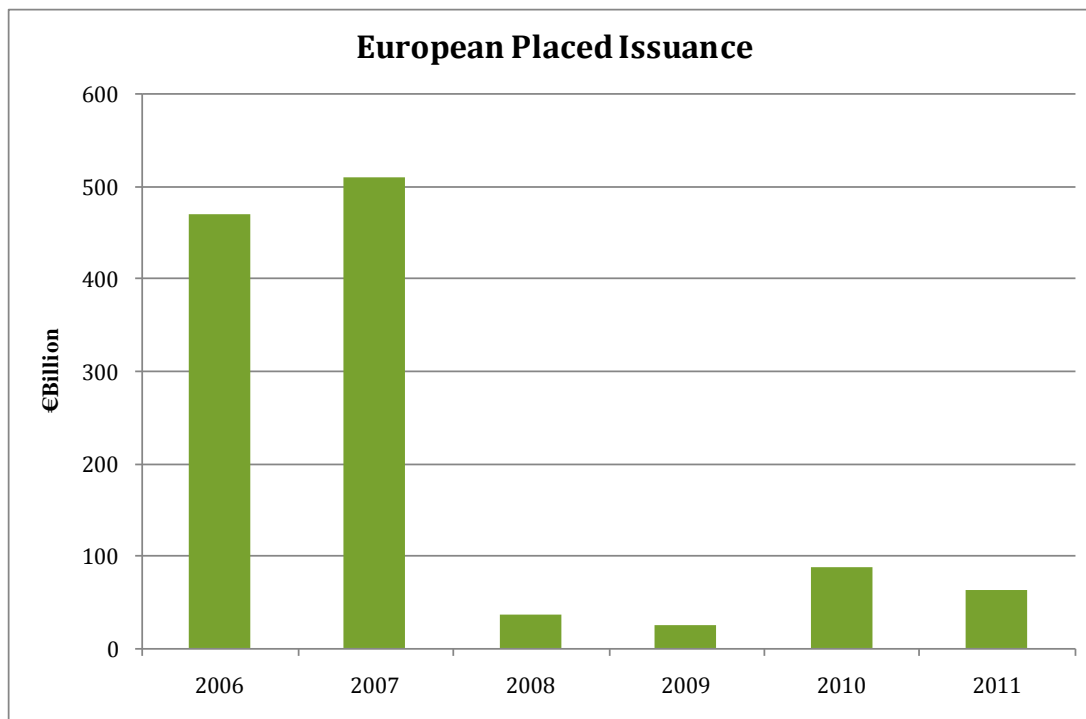
| Regulation | Effective Date | Advantages | Disadvantages |
|---|-----------------------------------|--|--|
| CRD Art 122a investor due diligence | Jan 2011 | Forces less investor reliance on CRAs | Increases investor compliance process |
| CRD Art 122a retention for originators | Jan 2011 | Forces 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 SF ratings identifiers | Sept 2010 | Highlights a SF rating | Raises compliance burden to investors |
| CRA Article 8(a)/SEC 17(g)5 | 8(a) – 2011? 17(g)5 – Dec 2010 | Encourages CRA competition through unsolicited ratings | Raises uncertainty for issuers and cost of compliance |
| 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 | 2018 | Increases liquid assets as a means of improving financial stability | ABS investment not eligible for liquidity book |
| ECB and Bank of England increased investor reporting, standardised definitions and prospectuses, cash flow models | 2011 | Improves investor confidence through improved data granularity and transparency | Increased IT and compliance costs for issuers |
| MiFID – post-trade price reporting changes | 2011/2012 | Potential changes to pre- and post-trade reporting | Potential changes to pre- and post-trade reporting |
| SEC Reg AB II | TBD | Improves information disclosure (asset level, models), standardises structures, realignment of interests | Increased issuer compliance costs |
| Dodd-Frank | July 2010 | Alignment of interest via retention, disclosure, R&W, reporting | Increased issuer compliance costs |
| Revisions to FDIC Safe Harbour | Jan 2011 | Revises legal isolation rules for banks, realignment of interest | Increased issuer compliance costs |

afme / Primary Market Issuance



- European issuance placed with third party investors (public and private) peaked at an estimated €420-450 billion in 2006
- Spreads have generally declined, but with different patterns depending on the jurisdiction
- Following a virtual market shut down from 2008 to September 2009, 2010 showed progress to recovery with an estimated €90 billion placed
- YTD 2011 (end Q3) issuance has lagged somewhat behind 2010 with an estimated €63 billion placed

ABS Placed Primary Issuance



| | 2006 | 2007 | 2008 ² | 2009 | 2010 | 2011 ³ |
|---------------------------------|---------|---------|-------------------|---------|---------|-------------------|
| European placed issuance | 471.3 | 511.2 | 35.6 | 25.5 | 87.9 | 62.7 |
| European % retention | 0 | 15% | 95% | 94% | 77% | 73% |
| US issuance | 2,455.8 | 2,147.1 | 933.6 | 1,358.9 | 1,276.7 | 699.7 |

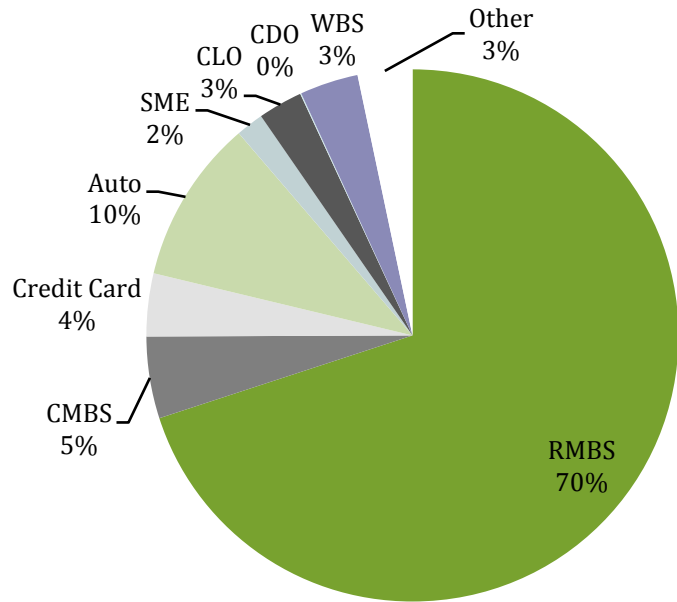
¹ Volumes include CDOs denominated in Euros

² Due to US originated and lack of information on certain CDO transactions, retained issuance may be in the range 89-95%. Retained volume assumes all Spanish issuance was retained

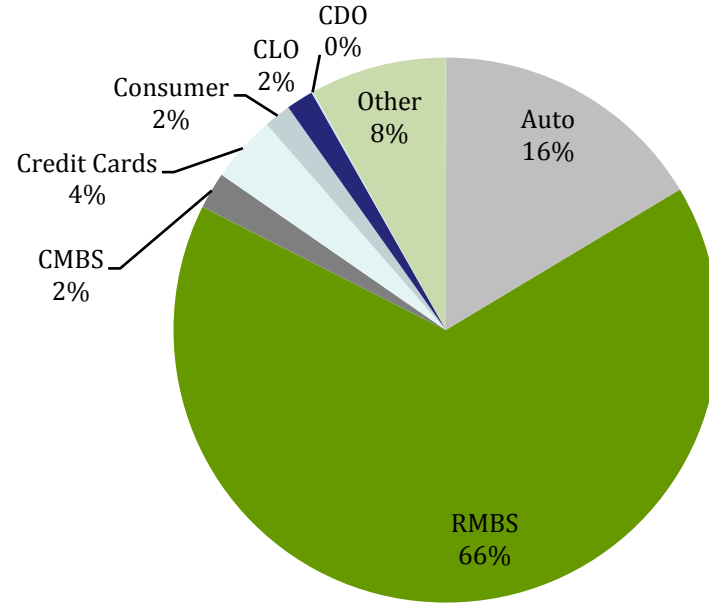
³ 2011 data includes the sum of Q1, Q2 and Q3 placed issuance

Placed Issuance by Collateral

2010 Issuance by Collateral



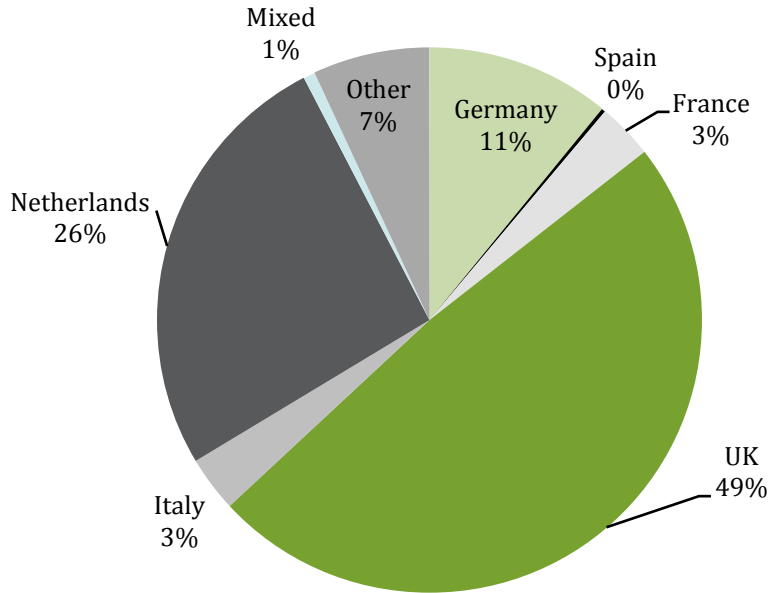
2011¹ Issuance by Collateral



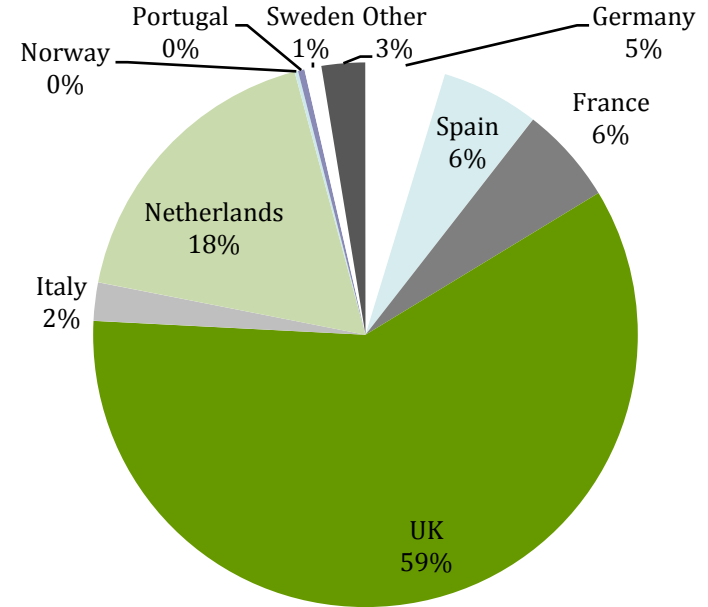
¹ 2011 data includes the sum of Q1 and Q2 placed issuance

Placed Issuance by Country

2010 Issuance by Country



2011¹ Issuance by Country



¹ 2011 data includes the sum of Q1 and Q2 placed issuance

- Existing regulation and the industry response
- Remaining regulatory challenges
- Perceptions of regulators and policymakers



afme / Existing regulation and the industry
response

What is it?

- Issuers to retain 5% of issuance
- Legal requirement on investors to undertake “due diligence”

Status

- Article 122a came into effect on 1st January 2011
- CEBS Guidelines and EBA Q&A available as guidance

Key issues

- “Classic” originate-then-distribute structures such as RMBS and ABS have largely adjusted to Article 122a
- There have been significant tensions in CLOs, some CMBS deals and “whole-business” securitisations
- These have now lessened following further guidance from the EBA, seen as helpful

afme / Collateral Transparency Frameworks

What are they?

- ECB and the BoE transparency frameworks for repo or use of the Discount Window Facility (DWF)
- Bank of England: RMBS and Covered Bonds
 - Loan-level data plus legal documentation, investor reporting and cashflow models
 - Disclosure on originator website
- ECB: RMBS, CMBS and SME loans
 - Loan-level data only
 - European DataWarehouse being built to house the data

Status

- Implementation is underway: by November 2011 for the BoE and June 2012 for the ECB
- Significant systems work required from originators
- Technical workshops held in November 2011, “completion guide” published
- Similar initiatives underway for remaining asset classes



afme / Remaining regulatory challenges

Status

- Text published 20th July
- AFME preparing comments on the directive generally and securitisation aspects in particular
- Appears that European regulators are open to considering final composition for liquidity assets, including securitisation

Key Issues

- Inclusion of some securitisations in the LCR and NSFR
- Definitional issues
- Credit risk mitigation
- Use of SFM
- ABCP conduits
- Use of ECAIs / CRAs

Key Issues

- Capital charge for insurance companies investing in securitisation
- Commission has now proposed in its draft Level 2 text
 - A framework differentiating: securitisations and re-securitisations; assets by credit rating
 - A 7% capital charge per year of duration on market value for a AAA securitisation

AFME advocacy

- Submitted letter to EIOPA and EC on the 31 March with QIS5 concerns
- Submitted a proposal to EIOPA and the EC on 19 May
- Met with EIOPA on 26 May and the Commission on 10 June
- On 20 July, submitted a report with a calibration on the basis of empirical evidence
- Met with Commission on 4 July to discuss our report and calibration
- Submitted an updated report on 1 September

Status

- Advocacy continues, contacting Member States and MEPs

AFME calibration

| Values of Fup | AAA | AA | A | BBB | BB | B | Unrated |
|--|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Qualifying Securitisation | 1.1% | 2.5% | 4.5% | 7% | 10% | 50% | 100% |
| Qualifying Resecuritisation (=Fup for duration 3 equivalent to "Other Equity") | 16% | 32% | 32% | 32% | 100% | 100% | 100% |
| <i>QIS 5 Corporate for comparison</i> | <i>0.9%</i> | <i>1.1%</i> | <i>1.4%</i> | <i>2.5%</i> | <i>4.5%</i> | <i>7.5%</i> | <i>3.0%</i> |
| Qualifying <u>Securitisation</u> Duration Caps | 30 | 20 | 11 | 7 | 5 | 2 | 1 |
| <i>implied Max Charge</i> | <i>33%</i> | <i>49%</i> | <i>49%</i> | <i>49%</i> | <i>49%</i> | <i>100%</i> | <i>100%</i> |
| Qualifying Resecuritisation Duration Caps | 3 | 3 | 3 | 3 | 1 | 1 | 1 |
| <i>implied Max Charge</i> | <i>49%</i> | <i>100%</i> | <i>100%</i> | <i>100%</i> | <i>100%</i> | <i>100%</i> | <i>100%</i> |

Commission's calibration

| Credit Quality Step | 0 | 1 | 2 | 3 | 4 | 5 | 6 |
|-----------------------------|----|-----|-----|-----|-----|------|------|
| Charge per year of duration | 7% | 16% | 19% | 20% | 82% | 100% | 100% |

- On 13th July 2011 ESMA published draft technical advice including on Implementing Measures on Investment in Securitisation Positions
- Stated need to ensure cross-sectoral consistency, i.e. with CRD 2 Article 122a and Solvency 2
- However, unfortunately many aspects of ESMA's proposal are unclear and inconsistent
 - Date of calculation of the retained interest
 - Disclosure of the retained interest
 - Incomplete incorporation of the CEBS Guidelines
- Investors should not suffer a disproportionately onerous compliance burden
- Entities should not be subject to more than one retention regime within the EU
- Scope of application should be certain; definitional issues
- Need for a consistent approach to managed CLOs

Key Issues

- Six US regulatory agencies consulting on proposals
- Controversial issue in the US

Update

- AFME filed its response in July
- Need to align requirements better with existing European regime
- Requesting broad recognition of European regime
- As a fallback, requesting that if 33% or less of a European deal is placed in the US, there should be no need to comply with US risk retention
- Need for clarity on recognition of European features, for example Seller Interest in UK master trusts
- AFME is in ongoing dialogue with the SEC

afme / Credit Rating Agencies – amendments to Regulation 1060 / 2009 (“CRA 3”)

Seeks to address

- Overreliance on ratings
- Problems in sovereign debt ratings
- The CRA “oligopoly”
- Civil legal liability
- Endorsement to ensure consistent application of EU standards from outside the EU

Status

- Provisional text for new legislation published November 2011
- Mandatory rotation
- ESMA to approve CRA methodology
- SF transactions to be posted to ESMA website for public display

“Endorsement” and US CRA regulation

- ESMA and endorsement: seeking visibility on progress generally, emerging markets and approval of registration of three major CRAs.
- US SEC consultation on “Franken” amendment and possible alternatives
- Need to ensure consistency between Europe and the US

What it is

- April 2011 - Financial Stability Board's (FSB's) initial recommendations on the Shadow Banking System:
 - Definition of the shadow bank system
 - Monitoring of the shadow banking system
 - Possible regulation of the shadow banking system
- 27 October 2011 – FSB published further recommendations

Update

- GFMA submitted letter on 16 May 2011
- IOSCO meeting in November

Next Steps

- GFMA regulatory mapping exercise

afme / Perceptions of regulators and policymakers

- Securitisation seen as at the heart of the financial crisis
- Revival is essential - but must not undermine stability
- Market-led initiatives are encouraged, but will they make a difference to investor behaviour?
- Transparency
- Risk retention
- Overshoot in order to regain confidence
- Global co-ordination seen as important

afme / Where do we go from here?

Key problems

- Funding the “real” economy
- Consistency and clarity
- Time for reflection
- Global co-ordination
- Market incentives

Ways forward

- Positive engagement by the industry must continue
- Cut through “headline” risk and stress the facts
- Encourage non-bank investors to return
- Seek positive regulatory signalling
- Insist on a level playing field
- Incentivise, do not discourage, issuance and investment in securitisation