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Joint Forum releases report on securitisation incentives

The Joint Forum today released its *Report on Asset Securitisation Incentives*. The Report is based on an extensive literature review, and interviews in Europe, the United States and Australia with originators, issuers, service providers and investors.

The Report analyses the incentives to engage in securitisation throughout the market before the financial crisis, the distortions created by misalignments and conflicts of interest which emerged, and the interplay of incentives in the aftermath of the crisis. It also examines some of the reasons why there has yet to be a meaningful recovery in securitisation activity. The Report outlines three recommendations to authorities on the tools and approaches they can employ to promote a sustainable and responsible securitisation framework.

Mr Tony D'Aloisio, Chairman of the Joint Forum, said "Re-establishing securitisation on a sound basis is a priority for the FSB and part of the G20's push to strengthen the international financial regulatory system. The Joint Forum recognises the important contribution it can make due to its cross-sectoral representation from the banking, insurance and securities sectors. Drawing on an extensive literature review and interviews with market participants in several key jurisdictions, this report provides an important perspective on the dynamics prevailing in securitisation markets and aims to inform the continuing regulatory efforts internationally to facilitate a sound and responsible framework for securitisation markets."

Key Findings:

- The Report confirms funding diversification, risk transfer, revenue generation and regulatory capital benefits as the key drivers for originators and issuers before the crisis. Investors saw securitisation as a source of high credit quality assets, portfolio diversification and attractive risk-adjusted yields. The Report also reflects the ways misaligned incentives and conflicts of interest - with parties focused on increasing volumes and short-term gains - contributed to the crisis and loss of investor confidence in securitisation;

- The key incentives which drove participation in securitisation markets before the crisis remain today. Originators continue to view securitisation as a source of funding while investors are still generally willing to invest given the right assets and pricing.
- The return of investor appetite is important for meaningful recovery, but according to market participants, it is being hampered by macroeconomic conditions, concerns regarding the credit quality of the securitised exposures and uncertainty about pending regulation.
- In any case, market participants interviewed generally expect securitisation markets to recover to levels significantly below those prior to the crisis. This is mainly driven by significantly reduced demand for investments due to the withdrawal of various arbitrage vehicles, such as certain ABCP conduits and SIVs, from the market.

Key Recommendations:

- The Report recognises regulators can play a role in establishing a framework for securitisation that ensures that it is conducted in a prudent manner, continues to be an alternative funding source for institutions, and contributes to the availability of credit to support the real economy. They can do this by building a regulatory and supervisory framework which addresses the misaligned incentives and conflicts of interest and which supports enhanced disclosure and transparency for investors.
- The Report encourages policy makers, regulators and supervisors to strive for internationally and cross-sectorally consistent supervisory frameworks, and to develop and implement regulations in a timely manner.
- The Report further sets out three recommendations (some of which build on earlier work of Parent Committees). These recommendations specify that:
    - Authorities should employ a broad suite of tools to address misaligned incentives, which may include measures to improve loan origination standards, and to align compensation arrangements with long-term performance and asset quality.
    - Authorities should encourage markets to improve transparency to ensure that investors, other market participants, and supervisors have access to relevant and reliable information.
    - Authorities should encourage greater document standardisation and less product complexity, which should assist in reducing information asymmetries and stimulating liquidity in secondary securitisation markets.